

**REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE PROVINCIAL
LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND
PERFORMANCE INFORMATION OF THE NALA LOCAL MUNICIPALITY FOR THE YEAR
ENDED 30 JUNE 2009**

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Nala Local Municipality which comprise the statement of financial position as at 30 June 2009, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages xx to xx.

The accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the Standards of Generally Recognised Accounting Practice (Standards of GRAP) and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Financial records

4. The municipality made corrections to prior period balances amounting to R4 675 361 as per note 26 to the financial statements. The municipality's financial records were, however, not updated with these corrections.

Financial system and accounting framework conversion for the year ended 30 June 2008

5. The municipality converted to a new financial system at the end of the current financial year and at the same time the municipality also converted to a new accounting framework (from IMFO to GAMAP/GRAP).
6. During the conversion process, the prior year closing balances were restated to account for the change in accounting policy as well as for prior period errors that were identified. These restatements were disclosed in note 33 to the financial statements. However, the conversion process was not attended by the Auditor-General and insufficient supporting documentation was maintained regarding the conversion process to allow for the retrospective audit of the conversion process.

7. During the conversion process, the IT consultants had unrestricted access to modify the data inputted into the new system. The IT consultants were also able to post correcting and reallocation journals for which no supporting documentation was maintained. These journals were also not formally reviewed and approved by the management of the municipality.
8. I could consequently not obtain adequate audit evidence as to whether the restated opening balances as disclosed in note 33 to the financial statements were accurately and completely reflected in the financial statements and whether the amendments made to the original 2006-07 closing balances were in fact valid, approved and supported by sufficient supporting documentation. I could also not obtain adequate audit evidence as to the completeness, accuracy and occurrence of the underlying financial data for the current financial year. I was unable to perform alternative audit procedures.
9. As disclosed in note 36 to the financial statements, the data conversion from the accounting systems had not been completed at year-end and the results of the conversion of the remaining modules might have an effect on the financial statements of the municipality. As at the date of my report, the municipality had not completed its conversion process. I could consequently not obtain adequate audit assurance as to the completeness, accuracy and validity of the underlying financial data.

Property, plant and equipment

10. As a result of the audit matters detailed below, I was unable to obtain sufficient appropriate audit evidence as to the completeness, existence, valuation and presentation and disclosure of, and the municipality's rights to, property, plant and equipment with a carrying value of R58 456 560 (2008: R39 819 201), as disclosed in note 1 to the financial statements for the current and prior financial years:
 - For assets with a carrying value of R58 456 560 (2008: R30 923 712), the descriptions, serial numbers, location and condition of the items as indicated in the fixed asset register were inadequate for identification purposes. Furthermore, the municipality did not conduct asset verifications or updated the fixed asset register during the year under review. Consequently, a difference of R4 218 844 existed between the asset register and the annual financial statements. The municipality's records did not permit the performance of alternative audit procedures and I was consequently unable to perform all the procedures I considered necessary to obtain adequate audit evidence as to the existence, valuation, completeness and presentation and disclosure of, and the municipality's rights to, property, plant and equipment amounting to R58 456 560.
 - Supporting documentation could not be obtained for fixed asset additions amounting to R2 444 379 (2008: R7 069 736) for the year. Alternative audit procedures could not be performed to obtain adequate audit evidence as to the existence and valuation of, and rights to, these assets.
 - Supporting documentation could not be obtained for fixed asset journals amounting to R14 213 635 for the year. Alternative audit procedures could not be performed to obtain adequate audit evidence as to the existence and valuation of, and rights to, these asset transactions.
 - Insufficient information was included in the municipality's erven listing to enable me to obtain adequate audit evidence as to the municipality's rights with regard to erven to the value of R4 274 009 (2008: R4 274 009). The municipality's records did not permit the performance of alternative audit procedures regarding its rights to the erven.
 - Erven to the value of R669 350 (2008: R1 625 350) included in the asset register and note 1 to the financial statements were not registered in the name of the municipality. Consequently, property, plant and equipment were overstated by this amount.

- The depreciation on property, plant and equipment as disclosed in the statement of financial performance amounted to R2 992 779 (2008: R1 575 649). However, due to the matters listed in the preceding paragraphs, I was unable to confirm the completeness, accuracy and occurrence of the depreciation charge for the year. The municipality's records did not permit the performance of alternative audit procedures regarding the depreciation charge.

Investments

11. Sufficient supporting documentation could not be obtained for journals amounting to R39 406 873 processed to investments as per note 2 to the financial statements. Alternative audit procedures could not be performed to obtain adequate audit evidence as to the existence, valuation and completeness of, and rights and obligations relating to, these journals.
12. For the year ended 30 June 2008, the municipality did not classify an investment amounting to R1 207 110 as per note 2 to the financial statements, in accordance with paragraph 67 of the Standards of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements*. This investment matured within 30 days after year-end and should have been classified as cash and cash equivalents. Consequently, cash and cash equivalents were understated and investments overstated by R1 207 110.
13. For the year ended 30 June 2008, the municipality did not classify the short-term call investments amounting to R4 519 739 as per note 2 to the financial statements, in accordance with paragraph 67 of the Standards of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements*. These call investments matured within 90 days and should have been classified as cash and cash equivalents. Consequently, cash and cash equivalents were understated and investments overstated by R4 519 739.

Inventory

14. Sufficient supporting documents could not be obtained for inventory journals amounting to R1 563 997. The municipality's records did not permit the application of alternative audit procedures and I could consequently not obtain adequate audit evidence as to the existence and valuation of this inventory.
15. Sufficient supporting documents for inventory write-offs of R1 546 106 as included in note 4 to the financial statement could not be obtained. I was unable to perform alternative audit procedures. Consequently, the valuation and existence of inventory write-offs could not be confirmed.
16. I was not invited to attend the inventory count for the year ended 30 June 2008 of inventory amounting to R850 617 as disclosed in the financial statements under note 4. Furthermore, there was no inventory system and the inventory count documentation compiled by the municipality was destroyed after the inventory count. The municipality's records did not permit the application of alternative audit procedures and I could consequently not obtain adequate audit evidence as to the existence and valuation of the inventory disclosed for the year ended 30 June 2008.

Consumer and other receivables

17. As a result of the audit matters detailed below, I was unable to obtain sufficient appropriate audit evidence as to the completeness, existence, valuation and presentation and disclosure of, and the municipality's rights to, consumer receivables with a carrying value of R95 469 347 (2008: R7 135 279), as disclosed in the statement of financial position for the current and prior financial years:

- Paragraph 58 of the South African Statement on Generally Accepted Accounting Practice, IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 39) requires the municipality to assess at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets is impaired. However, the municipality made a general provision for doubtful bad debts for consumer and other debtors amounting to R115 687 514 (2008: R112 225 886) and R50 707 133 (2008: R50 169 329), respectively, as disclosed in notes 5 and 6 to the financial statements, which was not in accordance with the impairment requirements of IAS 39. As the relevant information was not available, I was not able to calculate what the impairment charge against consumer and other debtors and the bad debts expense should have been if IAS 39 had been applied correctly.
- Sufficient supporting documents could not be obtained for consumer deposits amounting to R1 080 577 as per note 11 to the financial statements. The municipality's records did not permit the application of alternative audit procedures and I could consequently not obtain adequate audit evidence as to the existence and valuation of consumer deposits.
- Sufficient supporting documentation could not be obtained for accounts receivable transactions amounting to R856 328 for the year. Alternative audit procedures could not be performed to obtain adequate audit evidence as to the existence and valuation of, and rights to, these assets.
- Sufficient supporting documentation could not be obtained for journals processed between the provision for bad debts in the statement of financial performance and the provision for bad debts in the statement of financial position amounting to R6 062 242 (2008: R42 595 359). Alternative audit procedures could not be performed to obtain adequate audit evidence as to the existence and valuation of these journals.
- Sufficient supporting documentation could not be obtained for uncleared suspense accounts included in note 6 to the financial statements amounting to R15 423 099. Alternative audit procedures could not be performed to obtain adequate audit evidence as to the existence, valuation and completeness of, and rights and obligations relating to, these suspense accounts included in receivables.
- Supporting documentation could not be obtained for accounts receivable journals amounting to R6 062 242 for the year. Alternative audit procedures could not be performed to obtain adequate audit evidence as to the existence and valuation of, and rights relating to, these transactions.
- I was unable to obtain adequate audit evidence as to the valuation and existence of debtors amounting to R41 051 819 (2008: R70 730 362), as supporting documents for payments made after year-end could not be obtained for audit purposes. Alternative audit procedures could not be performed to obtain adequate audit evidence as to the valuation and existence of these debtors.

Cash and cash equivalents

18. As a result of the audit matters detailed below, I was unable to obtain sufficient appropriate audit evidence as to the completeness, existence, valuation and presentation and disclosure of, and the municipality's rights to, cash and cash equivalents with a carrying value (bank overdraft) of R19 450 252 (2008: R6 197 776), as disclosed in the statement of financial position for the current and prior financial years:

- Sufficient supporting documentation could not be obtained for journals amounting to R7 165 402 (2008: R187 121 613) that were posted to the cash general ledger during the financial year. Alternative audit procedures could not be performed to obtain adequate audit evidence as to the existence, classification and valuation of these journals.
- Sufficient supporting documentation could not be obtained for reconciling items amounting to R12 398 814 (2008: R9 907 269) that were included in the year-end bank reconciliation. Consequently, I could not obtain adequate audit evidence as to the completeness, valuation and existence of the cash and cash equivalents balance disclosed in the financial statements.
- A difference of R3 445 499 (2008: R4 369 571) was identified between the negative cash book balance disclosed in the bank reconciliation of R16 025 869, and the amount as per note 8 to the financial statements of R19 471 368 (bank overdraft). I could not be provided with sufficient supporting documentation relating to the existence and valuation of this difference. The municipality's financial systems did not permit the performance of alternative audit procedures. Consequently, cash and cash equivalents and expenditure were misstated by R3 445 499.
- I was unable to obtain adequate audit evidence as to the accuracy and classification of direct deposits amounting to R5 086 946 as per the bank statements, as these amounts could not be followed through to the general ledger. Consequently, the accuracy and classification of direct deposits amounting to R5 086 946 could not be confirmed.

Reserves

19. Differences were identified relating to offsetting depreciation between the government grant reserve and the accumulated deficit in the statement of changes in net assets amounting to R1 269 213 (2008: R1 201 878), for which no supporting documentation could be obtained. The latter resulted in depreciation being understated by R1 269 213 and the accumulated surplus/deficit being overstated by the said amount.
20. The government grant reserve amounting to R28 132 150 as disclosed in the statement of changes in net assets was not unbundled as required by GRAP 1 *Presentation of Financial Statements*. The government grant reserve was thus overstated by R28 132 150 and the accumulated surplus understated by R28 132 150.
21. For the year ended 30 June 2008, sufficient supporting documentation could not be obtained for transactions processed in the government grant reserve and the accumulated deficit amounting to R12 443 048. I was unable to perform alternative audit procedures to obtain adequate audit evidence as to the existence and valuation of these transactions and balances.

Accumulated surplus

22. Sufficient supporting documentation could not be obtained for transactions processed in the government grant reserve and the accumulated deficit amounting to R518 134 (2008: R12 443 048). I was unable to perform alternative audit procedures to obtain adequate audit evidence as to the existence and valuation of these transactions and balances.

Long-term borrowings

23. Differences were identified between the present value of long-term borrowings disclosed as per note 10 to the financial statements. Based on my calculations, long-term borrowings were understated by R2 624 213.

Non-current provisions

24. The municipality did not provide for the rehabilitation of landfill sites as required by section 28(1) of the National Environmental Management Act, 1998 (Act No. 107 of 1998) and in accordance with the Standard of Generally Accepted Municipal Accounting Practice, GAMAP 19 *Provisions, Contingent Liabilities and Contingent Assets*. The municipality's records also did not permit the performance of alternative audit procedures regarding the provision for the rehabilitation of these landfill sites.
25. Consequently, I did not obtain sufficient appropriate audit evidence as to the completeness and valuation of, and rights and obligations relating to, non-current provisions and property, plant and equipment in accordance with paragraph 28(e) of GAMAP 17 *Property, Plant and Equipment*, which requires the capitalisation of future rehabilitation costs of an asset to the extent that these costs have been provided for in terms of GAMAP 19.
26. For the year ended 30 June 2008, accruals for leave and bonuses amounting to R927 040 as disclosed in note 12 to the financial statements were incorrectly accounted for in terms of paragraph 10 of the South African Statement of Generally Accepted Accounting Practice, IAS 19 (AC 116) *Employee Benefits*. The accruals were inaccurately classified as current provisions instead of accruals. Consequently, accruals as per note 13 were understated and provisions overstated by this amount.

Payables

27. As a result of the audit matters detailed below, I was unable to obtain adequate audit evidence as to the existence, valuation, completeness and cut-off of, and rights and obligations relating to, payables amounting to R55 224 755, as disclosed in the statement of financial performance for the current and previous years:
- I was unable to obtain adequate audit evidence as to the completeness, cut-off and existence of creditors included in note 13 to the financial statements, as supporting documentation relating to creditor balances amounting to R46 643 574 (2008: R10 735 346) could not be provided. The municipality's records did not permit me to perform alternative audit procedures.
 - I was unable to obtain adequate audit evidence as to the completeness and valuation of accruals included in note 13, as supporting documentation could not be obtained relating to payments amounting to R2 294 380 (2008: R6 484 059) made to creditors after year-end.
 - Sufficient supporting documentation could not be obtained for journals processed regarding creditors amounting to R918 816 (2008: R42 595 359). Alternative audit procedures could not be performed to obtain adequate audit evidence as to the existence and valuation of these journals.

- Long-term borrowing instalments due amounting to R11 226 437 were not paid during the year under review. Consequently, payables were understated and long-term borrowings overstated by this amount.
- For the year ended 30 June 2008, I was unable to obtain adequate audit evidence as to the completeness and valuation of creditors, as supporting documents relating to payments made after year-end amounting to R6 484 059 could not be obtained.
- For the year ended 30 June 2008, creditors with debit balances amounting to R568 976 were not reclassified as other debtors in the financial statements. Debtors with credit balances amounting to R293 776 were not reclassified as creditors in the financial statements. Consequently, creditors and other debtors were understated by R862 752.
- For the year ended 30 June 2008, invoices amounting to R1 070 360 that relate to the current financial year were only processed on the financial system after year-end. Consequently, creditors and expenditure were understated by R1 070 360.

Revenue

28. As a result of the audit matters detailed below, I was unable to obtain sufficient appropriate audit evidence as to the completeness, occurrence, accuracy, classification and disclosure of revenue with a carrying value of R177 789 043 (2008: R226 262 639), as disclosed in the statement of financial performance for the current and prior financial years:

- An unreconciled difference of R3 549 893 (2008: R12 121 115) was identified between the municipality's valuation roll and the total property valuation as disclosed in note 16 to the financial statements. I could not be provided with sufficient supporting documentation for this difference. Alternative audit procedures could not be performed to obtain adequate audit evidence as to the valuation of property on which assessment rates amounting to R9 626 424 had been levied. Consequently, I could not obtain adequate audit evidence as to the accuracy, classification, occurrence and completeness of assessment rates levied amounting to R10 028 757.
- Sufficient supporting documentation could not be obtained for journals amounting to R12 139 086 (2008: R83 087 000) that were posted to the revenue general ledger accounts. The municipality's records did not permit alternative audit procedures and consequently I could not confirm the occurrence, classification and accuracy of these journals.
- Grants received amounting to R4 822 000 as per the municipality's bank statements could not be followed through to the general ledger. Consequently, grants received as per note 21 to the financial statements were understated by this amount.
- Sufficient supporting documentation could not be obtained regarding the number of sewerage points and refuse bins allocated to consumer debtors upon which refuse removal and sewerage and sanitation charges were levied. The client system did not allow the performance of alternative audit procedures. I could consequently not obtain adequate audit evidence as to the completeness, accuracy and occurrence of revenue from refuse removal services and sewerage and sanitation services amounting to R12 652 297 (2008: R16 330 960) and R17 793 043 (2008: R11 572 939), respectively.
- Differences were identified with regard to meter readings and tariffs used to levy service charges during the year. Based on my calculations, service charges and consumer debtors were both understated by R2 641 838 (2008: R5 959 083).
- Sufficient supporting documentation could not be obtained for service charges amounting to R23 697 759 as per note 17 to the financial statements. I was unable to perform alternative procedures in order to confirm the completeness and accuracy of these service charges.

- For the year ended 30 June 2008, sufficient supporting documentation could not be obtained for the sale of erven amounting to R3 088 672 as disclosed in note 19 to the financial statements. Consequently, I was unable to obtain adequate audit evidence as to the occurrence, completeness and accuracy of erven sold during the previous financial year.

Expenditure

29. As a result of the audit matters detailed below, I was unable to obtain sufficient appropriate audit evidence as to the completeness, occurrence, accuracy and presentation and disclosure of the municipality's expenditure with a carrying value of R74 763 604 (2008: R164 749 537), as disclosed in the statement of financial performance for the current and prior financial years:

- Sufficient supporting documentation could not be obtained for expenditure amounting to R60 220 809 (2008: R90 084 967) and credit expenditure transactions amounting to R3 390 030 (2008: R4 042 585). Alternative audit procedures could not be performed to obtain adequate audit evidence as to the occurrence, classification and accuracy of expenditure.
- Sufficient supporting documentation could not be obtained for expenditure journals amounting to R12 019 505. Alternative audit procedures could not be performed to obtain adequate audit evidence as to the classification, accuracy and occurrence of these expenditure transactions.
- Expenditure amounting to R2 640 232 could not be followed through to the municipality's records. Alternative audit procedures could not be performed to obtain adequate audit evidence as to the completeness of these expenditure transactions.
- For the year ended 30 June 2008, value-added tax (VAT) amounting to R4 777 390 was claimed on expenditure invoices that did not comply with the requirements of a valid VAT invoice as required by the Value-Added Tax Act, 1991 (Act No. 68 of 1991). Consequently, expenditure and the VAT liability were both understated by R4 777 390.
- For the year ended 30 June 2008, excess payments were made regarding retention monies and sureties to be withheld. Consequently, accounts receivable were understated and general expenses overstated by R1 674 430.
- For the year ended 30 June 2008, departmental expenditure and revenue amounting to R1 309 696 were not offset against each other, as required by paragraph 42 of GRAP 1. Revenue and expenses were consequently overstated by R1 309 696.
- Sufficient supporting documentation could not be obtained for payments made to service organisations amounting to R1 952 060. Alternative audit procedures could not be performed to obtain adequate audit evidence as to the occurrence, classification and accuracy of these expenditure transactions.

Employee-related cost

30. As a result of the audit matters detailed below, I was unable to obtain sufficient appropriate audit evidence as to the completeness, accuracy, classification and presentation and disclosure of the municipality's employee-related cost with a carrying value of R49 664 101 (2008: R37 379 086), as disclosed in the statement of financial performance for the current and prior financial years:

- Sufficient supporting documentation relating to journals amounting to R3 403 490 (2008: R1 232 203) could not be obtained. The municipality's records did not permit the performance of alternative audit procedures. Consequently, the occurrence, accuracy and classification of these journals could not be confirmed.

- Payments amounting to R19 257 343 (R18 902 984 + R354 359) (2008: R10 604 875) made to third parties as per the municipality's bank statements could not be followed through to the general ledger. Consequently, third party payments as per note 22 to the financial statements were understated by this amount.
- Employment contracts of staff and council members could not be provided for audit purposes. Consequently, I could not perform the necessary procedures in order to verify the occurrence, accuracy and completeness of employee-related cost amounting to R2 256 793.
- For the year ended 30 June 2008, an allocation error amounting to R805 638 was identified between the employee-related cost and the remuneration of councillors. Consequently, employee-related cost was understated and remuneration to councillors overstated by R805 638.
- Sufficient supporting documentation relating to overtime payments amounting to R2 864 069 could not be obtained. Alternative audit procedures could not be performed to obtain adequate audit evidence as to the occurrence, classification and accuracy of these overtime payments.

Value-added tax

31. The VAT payable as disclosed in note 15 to the financial statements amounted to R7 223 514 (2008: R2 732 827). However, due to the matters listed in the preceding paragraphs, I was unable to confirm the completeness, accuracy and occurrence of the VAT liability for the year. The municipality's records did not permit the performance of alternative audit procedures regarding these transactions.

Cash flow statement

32. I was unable to obtain adequate audit evidence as to whether the cash flow statement and the related notes for the current and prior financial years were fairly stated, due to the material effect of scope limitations and identified misstatements reported in this report.

Contingent liabilities

33. For the year ended 30 June 2009, contingent liabilities as per note 31 to the financial statements were understated by R3 872 005. Litigation against the municipality as per third party confirmations was not disclosed in the financial statements.

Unauthorised expenditure

34. The municipality overspent its adjustment budget for the current year by R23 363 251 (2008: R94 633 072). This expenditure is regarded as unauthorised expenditure in terms of section 1 of the MFMA. The disclosure requirements of section 125(2)(d) of the MFMA relating to unauthorised expenditure were not complied with.

Irregular expenditure

35. In terms of the municipality's supply chain management policy and section 112(1) of the MFMA, a municipality shall award contracts for goods and services in accordance with a system that is fair, equitable, transparent, competitive and cost-effective. The following irregular expenditure was identified because the above was not complied with. Furthermore, this expenditure was not included in note 36 to the financial statements as irregular expenditure, as required by section 125(2) of the MFMA.
 - Agreements for the purchase of office equipment amounting to R4 505 222 were entered into during the period under review. Sufficient supporting documents in terms of the supply chain management policy could not be obtained for audit purposes. Expenditure incurred in terms of these contracts amounting to R1 206 221 was consequently regarded as irregular expenditure.

- Quotations were not obtained for payments amounting to R236 703.
- According to the Construction Industry Development Board (CIDB) Act, 2000 (Act No. 38 of 2000), municipalities must advertise for tenders on the CIDB website. For contracts awarded amounting to R32 281 728, no proof could be obtained that the municipality had advertised for tenders as required.
- For the year ended 30 June 2008, irregular expenditure amounting to R67 263 043 was not disclosed in the financial statements. Irregular expenditure for the year ended 30 June 2008 was thus understated by this amount.

Consequently irregular expenditure as disclosed in note 36 to the financial statements was understated by R33 724 652 for the year under review.

Going concern

36. The municipality incurred a cash flow shortfall of R25 648 028 for the year ended 30 June 2008 as per the cash flow statement. The municipality also had a bank overdraft of R19 471 368 as at 30 June 2009. The municipality had not obtained financing to address this matter. This situation indicates the existence of a material uncertainty that may cast significant doubt on the entity's ability to continue as a going concern. The entity may therefore be unable to realise its assets and discharge its liabilities in the normal course of business. The financial statements did not disclose this fact.

Management representation

37. A signed management representation letter could not be obtained from the municipality's management in order to confirm the municipality's responsibility to express an opinion as to whether the financial statements were prepared in accordance with the Standards of Generally Recognised Accounting Practice and that these financial statements fairly present the financial position, the results of operations and cash flows of the Nala Local Municipality.

Disclaimer of opinion

38. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matters

I draw attention to the following matters on which I do not express a disclaimer of opinion:

Fruitless and wasteful expenditure

39. As disclosed in note 36, fruitless and wasteful expenditure to the amount of R1 607 212 (2008: R3 091 520) was incurred during the current financial year, due to interest incurred on external loans owing to the non-payment of loan premiums.

Restatement of corresponding figures

40. As disclosed in note 26 to the financial statements, the corresponding figures for the financial year ended 30 June 2009 have been restated as a result of errors discovered during the year under review in the financial statements of the Nala Local Municipality at, and for the year ended, 30 June 2008.

Other matters

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Material inconsistencies in information included in the annual report/other information

41. Material inconsistencies were identified between the budgeted figures disclosed in appendix C to the financial statements and the approved adjustment budget.
42. I have not obtained the other information included in the annual report and have not been able to identify any material inconsistencies with the financial statements.

Unaudited supplementary schedules

43. The municipality provided supplementary information in the financial statements on whether resources were obtained and used in accordance with the legally adopted budget, in accordance with GRAP 1. The supplementary budget information set out in appendix C does not form part of the financial statements and is presented as additional information. Accordingly I do not express an opinion thereon.

Non-compliance with applicable legislation**Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA)**

44. Various issues from the prior period audit report reoccurred in the current period, as the mayor did not ensure compliance by the municipality in terms of section 131(1) of the MFMA.
45. Contrary to section 75 of the MFMA, none of the required information was made available on the municipal website.
46. Contrary to section 127(2), 133 or 132(1) and (2) of the MFMA, it could not be determined that the prior period annual report had been tabled before the council or whether any reasons had been tabled to indicate why not.
47. No disclosure of non-compliance with the MFMA was made in the notes to the financial statements, as required by section 125(2)(e) of the MFMA
48. Neither the annual report nor the oversight reports (on the annual report) of the municipality were submitted to the legislature as required by section 132(1) and (2) of the MFMA.
49. Contrary to section 52 of the MFMA, the mayor did not submit a report to council, within 30 days after the end of each quarter, on the implementation of the budget and the financial state of affairs of the municipality.
50. The accounting officer did not, within 30 days after each quarter, table in the municipal council a consolidated report of all withdrawals made in terms of section 11(4) of the MFMA.
51. Contrary to section 11(4) of the MFMA, the municipality did not compile a consolidated report of withdrawals made in terms of subsection (1)(b) to (j) and submitted it to the provincial treasury and the Auditor-General.
52. Although the municipality faces serious financial and cash flow problems, I could not determine whether the mayor had responded promptly and initiated remedial or corrective steps proposed by the accounting officer to deal with such problems, as required by section 54 of the MFMA.
53. The accounting officer did not keep full and proper records of the financial affairs of the municipality as required by section 62(1)(b) of the MFMA.
54. The accounting municipality did not manage, maintain and safeguard municipal assets as required by section 63 of the MFMA,

55. Contrary to section 65(2)(e) of the MFMA, the municipality did not pay certain creditor accounts within 30 days of receiving the relevant invoice.
56. Contrary to section 66 of the MFMA, the accounting officer did not table reports to the municipal council detailing all expenditure incurred by the municipality on staff salaries, wages, allowances and benefits.
57. It could not be confirmed if the performance of the municipality had been evaluated or that any reports as prescribed by section 72 of the MFMA had been submitted to the council.
58. No reports could be identified to have been submitted detailing fruitless and wasteful, irregular or unauthorised expenditure as disclosed in the 2008-09 financial statements, nor could any indication be obtained that any person was held liable for such expenditure incurred, as required by section 32 of the MFMA.
59. Contrary to section 111 of the MFMA, the municipality did not have a supply chain management policy that had been approved by the council.
60. Section 125(2) of the MFMA states that the notes to the financial statements of a municipality must include particulars of non-compliance with the MFMA. Although various instances of non-compliance with the MFMA were identified, it was not disclosed in terms of this requirement.

Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA)

61. No evidence could be obtained that the community members' inputs had been considered in the compilation of the budget and municipal by-laws for the period under review, as required by section 5 of the MSA.
62. No indication could be obtained that the approved municipal budget, proposed integrated development plan, proposed municipal service delivery and budget implementation plan or any other strategic document had been made public to the community, as required by section 21(a) of the MSA.
63. Contrary to section 57 of the MSA, the municipality did not have performance contracts for the section 57 managers and the municipal manager.
64. The municipality did not have implemented policies and procedures to promote the effectiveness of its human resource management or capacity retention and capacity building, as required by section 68 of the MSA.
65. The municipality did not have an approved municipal code of conduct as required by section 70 of the MSA.
66. Contrary to section 95 of the MSA, the municipality did not have an approved and implemented customer care policy or procedures.

Supply Chain Management Regulations (GNR 868, 30 May 2005)

67. Contrary to regulation 7(1) of the Supply Chain Management Regulations, the municipality did not establish an operating supply chain management unit nor a supply chain management policy.
68. The municipality did not establish and maintain a register of accredited prospective service providers as required by regulation 3(1) of the Supply Chain Management Regulations.

69. No declaration of interest register was maintained by the municipality as required by regulation 46(2)(e) of the Supply Chain Management Regulations.

Governance framework

70. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below:

Internal control deficiencies

71. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the deficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances, deficiencies exist in more than one internal control component.

Par. no.	Basis for disclaimer of opinion	CE	RA	CA	IC	M
4	Financial records	7,5		1,6	1,2,3	1,2,3
5 – 9	Financial system and accounting framework for the year ended 30 June 2008	7,5		1,6	1,2,3	1,2,3
10	Property, plant and equipment	7,5		1,6	1,2,3	1,2,3
11 – 13	Investments	7,5		1,6	1,2,3	1,2,3
14 – 16	Inventory	7,5		1,6	1,2,3	1,2,3
17	Consumer and other receivables	7,5		1,6	1,2,3	1,2,3
18	Cash and cash equivalents	7,5		1,6	1,2,3	1,2,3
19 – 21	Reserves	7,5		1,6	1,2,3	1,2,3
22	Accumulated surplus	7,5		1,6	1,2,3	1,2,3
23	Long-term borrowings	7,5		1,6	1,2,3	1,2,3
24 – 26	Non-current provisions	7,5		1,6	1,2,3	1,2,3
27	Payables	7,5		1,6	1,2,3	1,2,3
28	Revenue	7,5		1,6	1,2,3	1,2,3
29	Expenditure	7,5		1,6	1,2,3	1,2,3
30	Employee-related cost	7,5		1,6	1,2,3	1,2,3
31	Value-added tax	7,5		1,6	1,2,3	1,2,3
32	Cash flow statement	7,5		1,6	1,2,3	1,2,3
33	Contingent liabilities	7,4,5		1,6	1,2,3	1,2,3
34	Unauthorised expenditure	7,4,5		1,6	1,2,3	1,2,3
35	Irregular expenditure	7,4,5		1,6	1,2,3	1,2,3
36	Going concern	7,5		1,6	1,2,3	1,2,3
37	Management representation letter	4	5			

Overall reflections on the governance framework based on internal control deficiencies

72. The municipality lacked a filing system, which would have ensured both the safeguarding of supporting documentation as well as accurate financial reporting. The municipality furthermore did not have individuals competent in financial reporting and related matters.
73. The chief financial officer did not sufficiently monitor the recording and reconciliation of the financial records. Sufficient control measures were furthermore not developed to address the qualifications reported in prior years.

Legend	
CE = Control environment	
The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.	1
Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.	2
Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.	3
Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting.	4
The accounting officer/accounting authority does not exercise oversight responsibility over financial reporting and internal control.	5
Management's philosophy and operating style do not promote effective control over financial reporting.	6
The entity does not have individuals competent in financial reporting and related matters.	7
RA = Risk assessment	
Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting.	1
The entity does not identify risks to the achievement of financial reporting objectives.	2
The entity does not analyse the likelihood and impact of the risks identified.	3
The entity does not determine a risk strategy/action plan to manage identified risks.	4
The potential for material misstatement due to fraud is not considered.	5
CA = Control activities	
There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.	1
General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.	2
Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.	3
Actions are not taken to address risks to the achievement of financial reporting objectives.	4
Control activities are not selected and developed to mitigate risks over financial reporting.	5
Policies and procedures related to financial reporting are not established and communicated.	6
Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system.	7
IC = Information and communication	
Pertinent information is not identified and captured in a form and time frame to support financial reporting.	1
Information required to implement internal control is not available to personnel to enable internal control responsibilities.	2
Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel.	3
M = Monitoring	
Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting.	1
Neither reviews by internal audit or the audit committee nor self-assessments are evident.	2
Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken.	3

Key governance responsibilities

74. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of key governance responsibilities, which I have assessed as follows:

No.	Matter	Y	N
Clear trail of supporting documentation that is easily available and provided in a timely manner			
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.		X
Quality of financial statements and related management information			
2.	The financial statements were not subject to any material amendments resulting from the audit.		X
3.	The annual report was submitted for consideration prior to the tabling of the auditor's report.		X
Timeliness of financial statements and management information			
4.	The annual financial statements were submitted for auditing as per the legislated deadline (section 126 of the MFMA).	X	
Availability of key officials during audit			
5.	Key officials were available throughout the audit process.		X
Development of and compliance with risk management, effective internal control and governance practices			
6.	Audit committee		
	• The municipality had an audit committee in operation throughout the financial year.		X
	• The audit committee operates in accordance with approved, written terms of reference.		X
	• The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA and Treasury Regulation 27.1.8.		X
7.	Internal audit		
	• The municipality had an internal audit function in operation throughout the financial year.		X
	• The internal audit function operates in terms of an approved internal audit plan.		X
	• The internal audit function substantially fulfilled its responsibilities for the year, as set out in Treasury Regulation 27.2 and section 165(2) of the MFMA.		X
8.	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.		X
9.	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.		X
10.	The information systems were appropriate to facilitate the preparation of the financial statements.		X
11.	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in Treasury Regulation 27.2 and section 62(1)(c)(i) of the MFMA.		X
12.	Delegations of responsibility are in place, as set out in section 79 of the MFMA.	X	
Follow-up of audit findings			
13.	The prior year audit findings have been substantially addressed.		X
14.	SCOPA resolutions have been substantially implemented.		X
Issues relating to the reporting of performance information			
15.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.		X
16.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.		X
17.	A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the municipality against its mandate, predetermined objectives, outputs, indicators and targets as required by section 68 of the MFMA.		X
18.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.		X

Overall reflections on the governance framework based on other key governance requirements

75. Significant difficulties were experienced due to the unavailability of requested supporting documentation and the lack of availability of key officials during the audit. The late responses from management on communications of audit findings issued during the audit further complicated the audit.
76. The financial statements were subject to material corrections resulting from the audit process, which are attributable to the weaknesses in the design and implementation of internal control in respect of financial management, inadequate responses to identified risks and weaknesses in information systems.
77. The final draft of the annual report was not finalised and submitted to my office during the time of my audit.
78. The municipality did not have a functioning audit committee and internal audit department during the current and prior financial years.
79. Policies and procedures related to financial reporting, risk management and compliance with laws and regulations were not established and communicated within the municipality.
80. Inadequate senior management monitoring during the financial system conversion process resulted in the financial systems and underlying financial data not being appropriate for the preparation of the financial statements.
81. A formal risk assessment had not been conducted during the current and prior financial years and no risk strategies, including a fraud prevention plan, were in place to address the financial and operational risks faced by the municipality.
82. The municipality had not substantially addressed all prior year audit findings, resulting in a recurrence of audit report qualifications and management report findings.
83. According to the responses received in respect of the SCOPA resolutions, most resolutions had not been implemented.
84. The internal controls regarding performance management were not effective, efficient and transparent to ensure that strategic objectives and targets were aligned to the priorities and that actual performance was accurately measured and reported on. Policies and procedures with regard to reporting performance against predetermined objectives had not been established.
85. The integrated development plan was only approved and implemented at the end of the current financial year. No performance management system was implemented during the current financial year.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

86. I was engaged to review the performance information.

Responsibility of the accounting officer for the performance information

87. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the MSA.

The Auditor-General's responsibility

88. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.

89. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate audit evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

90. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the findings reported below.

Findings on performance information

Non-compliance with regulatory requirements

Reporting of performance information

91. After numerous requests to correct inconsistencies in the annual report, an updated annual report of the municipality could not be obtained for audit purposes. This was mainly due to a lack of skilled staff at the municipality. Consequently, I could not assess whether the municipality had reported the performance information as required by section 46 of the MSA and section 121(3)(c) of the MFMA.

Integrated development plan

92. An approved integrated development plan could not be obtained for audit purposes. This was mainly due to a lack of skilled staff at the municipality. Consequently, I could not verify compliance with the relevant MSA requirements.

Existence and functioning of a performance audit committee

93. The municipality did not appoint and budget for a performance audit committee, nor was another audit committee utilised as the performance audit committee, as required by regulation 14(2) of the Municipal Planning and Performance Management Regulations, 2001. This was mainly due to a lack of funds and the availability of knowledgeable people in this regard.

Internal auditing of performance measurements

94. The municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal audit processes, as required in terms of section 45 of the MSA. This was mainly due to a lack of skills regarding internal auditing and the audit of performance measures.

Lack of adoption and implementation of a performance management system

95. The municipality did not adopt a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players, as required in terms of regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001. This was mainly due to the lack of skilled staff members in this regard.

No mid-year budget and performance assessments

96. The accounting officer of the municipality did not by 25 January assess the performance of the municipality during the first half of the financial year, taking into account the municipality's service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan, as required by section 72 of the MFMA. This was mainly due to a shortage of staff at the municipality.

APPRECIATION

97. The assistance rendered by the staff of the Nala Local Municipality during the audit is sincerely appreciated.

Auditor-General
Bloemfontein

30 September 2010



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence