

**REPORT OF THE AUDITOR-GENERAL TO THE LIMPOPO PROVINCIAL LEGISLATURE
AND COUNCIL ON MAKHADO MUNICIPALITY**

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Makhado Municipality set out on pages ... to ..., which comprise, the statement of financial position as at 30 June 2013, the statement of financial performance, statement of changes in net assets and the cash flow statement for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

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 South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2012 (Act No.5 of 2012) (DoRA) 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.

Auditor-General's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the *General Notice* issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Inventory

6. The municipality did not recognise inventory where it is probable that future economic benefits or service potential will flow to the municipality in accordance with SA Standards of GRAP 12, *Inventories*. The municipality did not establish internal controls over recognition of inventory in the accounting records. I identified land and buildings and investment properties included in land inventory. Consequently, I was unable to determine whether any adjustments to land inventory stated at R309 115 200 (2012: R310 673 200), land and

buildings stated at R313 350 047 (2012: R315 348 024) and investment property stated at R52 491 463 (2012: R52 491 463) in the financial statements were necessary.

7. SA Standards of GRAP 12, *Inventories* states that inventory shall initially be measured at cost and where inventory is acquired through a non-exchange transaction the cost shall be measured at the fair value, as at the date of acquisition. I was unable to obtain sufficient appropriate audit evidence for the measurement of land inventory in the accounting records. I was unable to confirm the value of land inventory by alternative means. Consequently, I was unable to determine whether any adjustments to the land inventory stated at R309 115 200 (2012: R310 673 200) were necessary.

Trade receivables

8. I was unable to obtain sufficient appropriate audit evidence that management has assessed objective evidence of impairment for individually significant financial assets, as required by SA Standards of GRAP 104, *Financial Instruments*. The municipality assessed trade receivables collectively that are not individually significant. I was unable to confirm by alternative means whether objective evidence of impairment exists for individually significant trade receivables. Consequently, I was unable to determine whether any adjustments to trade receivable stated at R62 656 504 (2012:R53 919 649) in the financial statements were necessary. Additionally, there is a consequential impact on the surplus for the period and accumulated surplus.

Contingent liability

9. The municipality has not disclosed a contingent liability in respect of the uncertainties arising from the dispute declared by the unions and the pending litigation regarding the wage curve agreement. I was unable to confirm the contingent liabilities by alternative means. Consequently, I am unable to determine whether any adjustments to contingent liability stated at R29 584 613 (2012: R9 774 418) in the financial statements was necessary.

Related party

10. The municipality did not disclose related party transactions in the financial statements, as required by International Public Sector Accounting Standard, IPSAS 20: *Related Party Disclosures*. I was unable to determine the full extent of the non-disclosure of related party transactions as it was impracticable to do so.

Qualified opinion

11. In my opinion, except for the possible effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Makhado Municipality as at 30 June 2013 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

12. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Material impairments

13. As disclosed in note 5 and 7 to the financial statements, the municipality made material impairments to the amount of R170 412 064 for receivables due to the municipality's inadequate collection practices.

Irregular expenditure

14. As disclosed in note 47 to the financial statements, the municipality incurred irregular expenditure amounting to R47 389 556 due to contravention of the supply chain procurement policy.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

15. In accordance with the PAA and the *General Notice* issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

16. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages ... to ... of the annual report.
17. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned development priorities. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury *Framework for managing programme performance information (FMPPI)*.

The reliability of the information in respect of the selected development priority is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

18. The material findings are as follows:

Usefulness of information

Presentation

Measures taken to improve performance not disclosed

19. Section 46 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved. Measures to improve performance for a total of 86% of the planned targets not achieved were not reflected in the annual performance report. This was due to the lack of proper budgeting and monitoring of performance management and reporting on progress made during the financial year.

Measures taken to improve performance not supported by sufficient appropriate evidence

20. Section 46 of the MSA requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved. Adequate and reliable corroborating evidence could not be provided for 90% of measures taken to improve performance as disclosed in the annual performance report. The municipality's records did not permit the application of alternative audit procedures.

Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the reliability of the measures taken to improve performance.

Consistency

Reported objectives, indicators and targets not consistent with planned objectives, indicators and targets

21. Section 41(c) of the MSA requires that the integrated development plan should form the basis for the annual report, therefore requiring consistency of objectives between planning and reporting documents. A total of 60% of the reported objectives are not consistent with the objectives as per the approved integrated development plan. This is due to the lack of proper review and procedures for monitoring of the planning and reporting of performance information.
22. Section 41(c) of the MSA requires that the integrated development plan should form the basis for the annual report, therefore requiring consistency of indicators between planning and reporting documents. A total of 30% of the reported indicators are not consistent with the indicators as per the approved integrated development plan. This is due to the lack of proper review and procedures for monitoring of the planning and reporting of performance information.
23. Section 41(c) of the MSA requires that the integrated development plan should form the basis for the annual report, therefore requiring consistency of targets between planning and reporting documents. A total of 48% of the reported targets are not consistent with the targets as per the approved integrated development plan. This is due to the lack of proper review and procedures for monitoring of the planning and reporting of performance information.

Measurability

Performance targets not specific

24. The National Treasury *FMPPi* requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 43% of the targets were not specific in clearly identifying the nature and the required level of performance. This was due to the fact that management was aware of the requirements of the *FMPPi* but did not receive the necessary training to enable application of the principle.

Performance targets not measurable

25. The National Treasury *FMPPi* requires that performance targets be measurable. The required performance could not be measured for a total of 35% of the targets. This was due to the fact that management was aware of the requirements of the *FMPPi* but did not receive the necessary training to enable application of the principle.

Performance targets not time bound

26. The National Treasury *FMPPi* requires that the time period or deadline for delivery be specified. A total of 69% of the targets were not time bound in specifying a time period or deadline for delivery. This was due to the fact that management was aware of the requirements of the *FMPPi* but did not receive the necessary training to enable application of the principle.

Performance indicators not well defined

27. The National Treasury *FMPPi* requires that indicators should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 34% of the indicators were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was due to the fact that management was aware of the requirements of the *FMPPi* but did not receive the

necessary training to enable application of the principles

Reliability of information

Reported performance not reliable

28. The National Treasury *FMPPI* requires that institutions should have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets.

Significantly important targets with respect to development priority: basic services and infrastructure development are materially misstated.

This was due to the lack of frequent review of the accuracy and validity of reported achievements against source documentation.

Additional matter

29. I draw attention to the following matter below. This matter does not have an impact on the predetermined objectives audit findings reported above.

Achievements of planned targets

30. Of the total number of 244 targets planned for the year, 185 targets were not achieved during the year under review. This represents 76% of total planned targets that were not achieved during the year under review.

This was mainly due to the indicators and targets which were not suitably developed during the strategic planning process.

Compliance with laws and regulations

31. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the *General Notice* issued in terms of the PAA are as follows:

Strategic planning and performance management

32. The municipality did not have and maintain effective, efficient and transparent systems of financial and risk management and internal control as required by section 62(1)(c)(i) of the MFMA.

33. The annual performance report for the year under review does not include measures taken to improve performance, as required by section 46(1)(c) of the MSA.

Annual financial statements, performance and annual reports

34. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA.

Material misstatements of non-current assets, current assets, current liabilities and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Asset management

35. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

Procurement and contract management

36. Invitations for competitive bidding were not always advertised for a required minimum period of days, as required by Supply Chain Management (SCM) regulation 22(1) and 22(2)

37. Bids were not always evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services and at least one supply chain management practitioner of the municipality as required by SCM regulation 28(2).

38. Contracts were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding in contravention of SCM Regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations.

39. Awards were made to bidders other than those recommended by the bid evaluation committee without ratification by the accounting officer, as required by SCM regulation 29(5)(b).

40. Contracts were awarded to bidders based on preference points that were not calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000) (PPPFA) and its regulations

41. Contracts were extended or modified without the approval of a properly delegated official, as required by SCM Regulation 5.

Consequences management

42. Unauthorised, irregular, fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.

Internal control

43. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

- The accounting officer and management did not exercise adequate oversight responsibility over the enforcement of the municipality's SCM policy.
- Management did not have sufficient monitoring controls to ensure the proper implementation of the action plan and reports from internal audit. The municipality did not properly plan and provide training on performance information planning, management and reporting.
- The municipality did not have key controls to address the systems of collection, collation, verification and storage of performance information.

Financial and performance management

- The municipality did not have a proper system of record management that provides for the maintenance of information that supports the financial statements and reported performance information.
- The financial statements contained numerous misstatements that were corrected. This was mainly due to staff members not fully understanding the requirements of the financial reporting framework and inadequate review over the preparation of the financial statements.
- The municipality's preventive internal controls over procurement of goods and services did not identify contraventions to the municipality's SCM policy.
- The municipality does not have internal control systems to recognise land inventory.

Governance

- The accounting officer and audit committee did not yet find a solution that would ensure that the recommendations of internal audit are addressed and implemented timely.
- The council, accounting officer and audit committee did not yet find a solution that would ensure that the recommendations of audit committee are addressed and implemented timely.

OTHER REPORTS

Investigation

44. An investigation was concluded during 2012 based on discrepancies relating to money received and deposited by a testing station and allegations relating to missing deposit books. The investigation resulted in criminal proceedings and a summons being instituted against an employee and a service provider.

Auditor-General
Polokwane

30 November 2013



AUDITOR-GENERAL
SOUTH AFRICA

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