

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the financial statements of the Polokwane Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2013, the statements of financial performance, changes in net assets and cash flows for the year then ended, and the notes, comprising a summary of the 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 of South Africa (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 the financial statements based on conducting the 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. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis of a disclaimer

Property, plant and equipment

4. The Standard of Generally Recognised Accounting Practice, GRAP 17, *Property, plant and equipment, impairment of non-cash-generating assets and impairment of cash-generating assets* and GRAP 21 and 26 require that a municipality assess at each reporting date whether there is any indication that an asset may be impaired and, if any such indication exists, the entity shall estimate the recoverable amount of the asset. Furthermore, an asset is impaired when its carrying amount exceeds its recoverable amount. I have identified material errors in the information provided by management in the calculation of the recoverable amount and, as a result property, plant and equipment are misstated by an unquantifiable amount. Consequently, I was unable to determine the correct net carrying amount of property, plant and equipment of R5 666 973 194 (2012: R5 599 936 285) as disclosed in note 8 to the financial statements as it was impracticable to do so.

5. The accounting records of the municipality did not in all instances contain adequate information to enable me to perform a physical verification of infrastructure assets. As a result I was unable to physically verify infrastructure assets stated at R3 056 222 854 (2012: R2 952 923 947) in note 8 to the financial statements.
6. In terms of the relevant legislation, the district municipalities in Limpopo have powers and functions with regards to municipal roads which form an integral part of a road transport system for the area of the district municipality as a whole. The municipality accounted for municipal roads that form an integral part of a road transport system in its accounting records. There was no evidence that the responsibilities for roads forming an integral part of a road transport system had been transferred to the municipality. This was identified during a transversal review on the completeness of the recording of roads in the province. I was unable to determine the amount by which these municipal roads are overstated in the financial statements and, consequently, I was unable to determine the correct net carrying amount of road infrastructure included in property, plant and equipment stated at R3 056 222 854 (2012: R2 952 923) in note 8 to the financial statements as it was impracticable to do so.
7. Standard of Generally Recognised Accounting Practice, GRAP 3, *Accounting policies, change in accounting estimates and errors*, requires material prior period errors to be corrected retrospectively by restating the opening balances of assets, liabilities and net assets for the earliest prior period presented. I have noted that the comparative amounts for the prior period in which the error occurred as disclosed in note 30 to the financial statements were not presented for three years retrospectively as part of the opening balances of assets, liabilities and net assets. Consequently, I was unable to satisfy myself as to the correctness of the prior period errors amounting to R128 439 317 as disclosed in the statement of changes in net assets and note 30 to the financial statements
8. I was unable to obtain sufficient appropriate audit evidence for the restatement of the corresponding figure for property, plant and equipment due to the inaccessibility of the old system to retrieve source documentation pertaining to the adjustments. As described in note 30 to the financial statements, the restatement was made in order to rectify a prior year misstatement. I was unable to confirm the restatement of R86 610 836 by alternative means. Consequently, I was unable to determine whether any adjustment to the property, plant and equipment corresponding figure in the financial statements was necessary.

Revenue

9. Meter readings provided by the service provider were regularly restated for various reasons during the billing process. Evidence to support differences between the meter readings provided by the meter readers and those on the billing system could not be provided and reasons were not always documented. Consequently, I was unable to determine the extent of the misstatement on service charges for water of R164 175 447 (2012: R137 850 018) disclosed in note 18 to the financial statements as it was impracticable to do so.

Trade and other receivables from exchange transactions

10. During 2011-12 I was unable to obtain sufficient appropriate audit evidence about the valuation of trade and other receivables from exchange transactions stated as R26 246 588. The municipality made corrections to the account balance in order to clear the prior year misstatements; however, I was unable to determine the reasonableness

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of corrections of prior year estimates due to insufficient information. There were no satisfactory alternative procedures that I could perform to obtain reasonable assurance on the trade and other receivables from exchange transactions disclosed in the financial statements. My audit opinion on the financial statements for the period ended 30 June 2012 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

11. The municipality calculated the provision for bad debts based on a percentage of the total debtor age analysis and did not account for the provision for bad debts as the difference between the receivables carrying amount and the present value of estimated future cash flows discounted at the effective interest rate in terms of GRAP104, *Financial instruments*. Furthermore, the municipality did not disclose the age analysis per category of debtors as required in terms of the above accounting standard. Consequently, I was unable to determine the correctness of provision for bad debts amounting to R221 833 013 (2012: R168 346 946) as disclosed in note 12 to the financial statements as it was impracticable to do so.
12. I was unable to confirm the existence of trade and other receivables from exchange transactions amounting to R13 793 419 due to insufficient details included in the debtors records. Furthermore, no supporting documentation could be provided to validate debtors amounting R12 827 970. Management did not perform regular debtor reconciliations during the year. Consequently, I was unable to determine the amount by which trade and other receivables from exchange transactions receivables of R26 621 389 had been misstated. There were no satisfactory alternative procedures that I could perform to obtain reasonable assurance on the correctness of the balance.

Trade and other payables from exchange transaction

13. I was unable to obtain sufficient appropriate audit evidence to verify amounts received in advance stated at R32 079 138 (2012: R28 555 906) in note 6 to the financial statements. The municipality did not maintain adequate records of amounts received in advance. There were no satisfactory alternative procedures that I could perform to obtain reasonable assurance on the correctness of the balance.

Contingent liability

14. The municipality has not implemented the wage curve agreement entered into by SALGA on behalf of the municipal employees. The municipality has not disclosed a contingent liability in respect of the uncertainties arising from the pending litigation regarding the implementation of these agreements. Consequently, I was unable to determine whether any adjustment to the contingent liabilities of R10 636 726 (2012: R24 630 520) as disclosed in note 33.2 to the financial statements was necessary, as it was impracticable to do so.

Aggregation of immaterial uncorrected misstatements

15. The financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements for which I was unable to obtain sufficient and appropriate audit evidence due to the inaccessibility of the old system to retrieve source documentation and I was therefore unable to confirm by alternative means the following elements making up the statement of financial position:

- Investment property reflected as R234 602 329 is understated by R42 615 542
- Property, plant and equipment reflected as 6 418 537 102 (at cost) are overstated by R49 966 937.
- Intangible assets reflected as R34 282 878 (at cost) are overstated by R21 395 420.

Irregular expenditure

16. During 2012 I was unable to obtain sufficient appropriate audit evidence regarding irregular expenditure. I was unable to confirm the irregular expenditure by alternative means. Consequently, I was unable to determine whether any adjustments to irregular expenditure stated at R222 718 967 was necessary. My audit opinion on the financial statements for the period ended 30 June 2012 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Disclaimer of opinion

17. 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

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

Restatement of corresponding figures

19. As disclosed in note 30 to the financial statements, the corresponding figures for 30 June 2012 have been restated as a result of errors discovered during 30 June 2013 in the financial statements of the Polokwane municipality at, and for the year ended, 30 June 2012

Material losses

20. As disclosed in note 40 to the financial statements, material losses to the amount of R60 242 857 were incurred as a result of water and electricity losses.

Unauthorised expenditure

21. As disclosed in note 34.1 to the financial statements, the municipality incurred R119 889 970 in unauthorised expenditure as expenditure was incurred in excess of the limits of the amounts provided for the approved budget

Material underspending of votes

22. As disclosed in note 34.1 to the financial statements, the municipality underspent an amount of R120 262 110 as expenditure incurred per vote was less than amounts provided for in the approved budget

Irregular expenditure

23. As disclosed in note 34.3 to the financial statements, the municipality incurred irregular expenditure of R246 383 053 in contravention of the supply chain management (SCM) regulations.

Land and buildings

24. As disclosed in note 8 there are approximately 13 121 properties registered in the name of the municipality which are in the process of being transferred to various beneficiaries. This is a legacy issue which originates from the former self-governing territory of Lebowa and must still be resolved. The properties have therefore not been included in the accounting records and financial statements of the municipality.

Additional matters

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

Unaudited supplementary schedules

26. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

27. 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

28. I performed procedures to obtain evidence about the usefulness and reliability of the information in the performance report as set out on pages ... to ... of the annual report.
29. 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 key performance areas. 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*.

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

30. The material findings on the usefulness and reliability of the information are as follows:

Usefulness of information

Presentation

31. Section 46 of the Municipal Systems Act 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 27% of the 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

32. The Municipal Systems Act, section 41(c) requires that the service delivery agreement should form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 23% of the reported targets are not consistent with the planned targets as per the approved service delivery agreement. This is due to the lack of proper review and monitoring of the reported performance.

Reliability of information

33. The National Treasury *Framework for managing programme performance information* 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.

The information presented with respect to basic services and local economic development was not reliable when compared to the source information and/or evidence provided.

This was due to the lack of standard operating procedures for the accurate recording of actual achievements; monitoring of the completeness of source documentation in support of actual achievements and frequent review of validity and accuracy of reported achievements against source documentation

Additional matters

34. I draw attention to the following matters below. These matters do not have an impact on the predetermined objectives audit findings reported above.

Material adjustments to the annual performance report

35. Material adjustments in the annual performance report were identified during the audit, some of which were corrected by management, while those that were not corrected have been reported on accordingly.

Compliance with laws and regulations

36. I performed procedures to obtain evidence that the entity had 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

37. The municipality did not have and maintain effective, efficient and transparent systems of financial and risk management and internal controls as required by section 62(1)(c)(i) of the MFMA as misstatements were identified by the auditors in the annual

performance report indicating that information was not adequately reviewed before submission. Indicators in the integrated development plan (IDP) were also initially omitted from the annual performance plan but were, however, subsequently corrected. The municipality did not set measurable performance targets for the financial year with regard to each of the development priorities and objectives and key performance indicators set out in the IDP, as required by section 41(1)(b) of the Municipal Systems Act and the Municipal planning and performance management regulation 12(1) and 12(2)(e) as there was no approved policy for the measurement of construction projects.

Budgets

38. The municipality incurred expenditure in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

Annual financial statements, performance and annual reports

39. 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, liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a disclaimer of opinion.
40. The council's oversight report on the 2011-12 annual report was not made public within seven days of its adoption, as required by section 129(3) of the MFMA.

Asset management and liability management

41. An adequate management, accounting and information system which accounts for assets and liabilities was not in place, as required by section 63(2)(a) of the MFMA.
42. An effective system of internal control for assets and liabilities, as required by section 63(2)(c) of the MFMA, was not in place.
43. Capital assets were permanently disposed of without the approval of the council, as required by section 14(2)(a) of the MFMA and Municipal asset transfer regulation 5.

Expenditure management

44. The accounting officer did not take reasonable steps to prevent unauthorised expenditure and irregular expenditure, as required by section 62(1)(d) of the MFMA.

Revenue management

45. An effective system of internal control for debtors and revenue, as required by section 64(2)(f) of the MFMA, was not in place.
46. Sufficient audit evidence could not be obtained that interest had been charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

Consequence management

47. Prior year irregular and unauthorised expenditure incurred by the municipality was not investigated to determine whether any person is liable for the expenditure, as required by section 32(2) of the MFMA.

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48. Investigations were not instituted into all allegations of financial misconduct against officials of the municipality, as required by section 171(4)(a) of the MFMA.

Procurement and contract management

49. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, as required by SCM regulation 17(a) and (c).
50. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding were advertised for a required minimum period of days, as required by SCM regulation 22(1) and 22(2).
51. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).
52. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
53. Contracts were extended without tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.
54. Contracts were extended without the approval of a properly delegated official, as required by SCM regulation 5
55. Awards were made to providers who are in the service of other state institutions or whose directors/ principal shareholders are in the service of other state institutions, in contravention of MFMA 112(j) and SCM regulation 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).

Internal control

56. 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 disclaimer of opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

57. The municipality has substantially filled key critical vacancies; however, there is still a need to capacitate certain functions, especially in the area of asset management, and to ensure that finance staff have adequate GRAP knowledge.
58. Although the accounting officer reviewed the financial statements and the annual performance report with the assistance of the National Treasury and internal audit prior to submission for audit, a number of material misstatements were identified and remain uncorrected.

Financial and performance management

59. The municipality did not compile and maintain an approved record classification system

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for paper-based and electronic records in order to safeguard these records and facilitate their timely retrieval. As a result, significant delays were experienced in management providing the required information.

60. The municipality did not have an adequate system of record management that provides for the maintenance of information that supports the reported performance contained in the annual performance report. This includes information that relates to the collection, collation, verification, storage and reporting of actual performance information.
61. In order to address the prior year findings on assets, consultants were used to assist the municipality but the consultants were not adequately monitored and supervised and as a result the prior findings were not resolved.

Governance

62. The municipality developed a plan to address internal and external audit findings; however, not all issues were fully resolved.
63. The audit committee made recommendations to management and the council but not all recommendations were timeously implemented by the municipality.

T-Auditor - General.

Auditor-General

Polokwane

7 March 2014



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence