

**REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF XHARIEP DISTRICT MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2008**

**REPORT ON THE FINANCIAL STATEMENTS**

**Introduction**

1. I was engaged to audit the accompanying financial statements of the Xhariep District Municipality which comprise the balance sheet as at 30 June 2008, income statement 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].

**Responsibility of the accounting officer for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the entity-specific basis of accounting, as set out in accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA)] and the Division of Revenue Act, 2007 (Act No. 1 of 2007 (DoRA)]. This responsibility includes:
  - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
  - selecting and applying appropriate accounting policies
  - making accounting estimates that are reasonable in the circumstances.

**Responsibility of the Auditor-General**

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)], my responsibility is to express an opinion on these 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 discussed 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 of accounting**

4. The municipality's policy is to prepare financial statements on the entity-specific basis of accounting, as set out in accounting policy note 1.

## **Basis for disclaimer of opinion**

### **Fixed assets**

5. The existence, valuation, completeness and rights and obligations of fixed assets as disclosed in note 3 to the annual financial statements, amounting to R17 901 884 in the current year and R17 891 358 in the prior year, could not be confirmed as a detailed asset register containing information on the valuation, financing, physical condition and location of each asset as required by section 63(2)(c) of the MFMA was not adequately kept. A difference of R1 563 214 occurred between the register and the financial statements in the current year. In contravention of section 116(2) of the MFMA, a contract register could not be obtained.

Consequently, I was not able to verify all assets as disclosed in the financial statements. The municipality's system did not permit me to do any alternative procedures.

### **Cash on hand**

6. The existence, valuation and completeness of cash on hand as disclosed on the balance sheet and note 7 to the annual financial statements, amounting to R1 773 760 in the current year and R466 415 in the prior year, could not be confirmed as the cash book amount of R1 010 055 in the current year as per the bank reconciliation did not agree to the general ledger and annual financial statements. The difference of R763 705 could not be explained. This impacts the financial statements as a whole. The bank also did not reconcile in the 2007 financial year. The municipality's system did not permit me to do alternative procedures.

### **Creditors**

7. The completeness, valuation and allocation of creditors, as disclosed in the balance sheet and note 9 to the annual financial statements, of R1 915 860 and R8 630 242 in the current and prior years respectively, could not be confirmed due to the following:

- (a) An amount of R471 472 relating to retention fees was written off during the year under review. No supporting documentation could be obtained for this write-off.
- (b) Sufficient appropriate audit evidence could not be obtained for suspense accounts written off amounting to R7 037 243 and R7 040 865 in the 2008 and 2007 financial years respectively. These suspense accounts were written off against debtors and the appropriation account in the current year.

Alternative procedures could not be performed as the general ledger accounts contained no detail as to what these balances are made up of. These balances have been carried forward for a couple of financial years.

8. Included in the balance of creditors was an amount of R3 381 984 in respect of VAT. A reconciliation between the general ledger and the VAT201s indicated a difference of R3 430 439 which was written off against the appropriation account.

Sufficient appropriate audit evidence could not be obtained for this difference, nor could alternative procedures be performed.

### **Debtors**

9. The completeness, valuation and allocation of debtors as disclosed in the balance sheet and note 6 to the annual financial statements, of R1 004 589 in the current year and R3 061 694 in the prior year could not be verified as no supporting documentation could be obtained for the write-off of debtors to the sum of R6 397 084. In the prior year, supporting documentation to the amount of R6 412 538 could not be obtained. These suspense accounts were written off against creditors and the appropriation account.

Debtors of the prior year were understated by R3 455 439. Credit balances relating to VAT amounting to R3 400 153 were included as debtors, while the VAT receivable at the prior financial year-end was R55 286.

Alternative procedures could not be performed as there was no detail in the general ledger accounts as to what these balances are made up of. These balances have been carried forward for a couple of financial years.

### **Accumulated surplus / deficit**

10. The existence, valuation and completeness of the accumulated surplus of R3 040 064 as presented on the face of the balance sheet could not be verified. Included in the accumulated surplus are appropriations, as disclosed in note 10 to the annual financial statements, amounting to R6 451 028. Sufficient appropriate audit evidence could not be obtained to substantiate the existence, valuation and allocation of these corrections. Alternative procedures could also not be performed due to weaknesses in controls and therefore no assurance could be obtained that these prior period errors were accurately and completely adjusted and presented in the financial statements.

### **Provisions**

11. A provision for leave amounting to R134 132 in the current year and R222 461 in the prior year, as disclosed in the balance sheet and note 8 to the financial statements, could not be confirmed. No supporting documentation for the leave calculation could be obtained. The entity's records did not permit the application of alternative procedures. Consequently, I did not obtain all the information and explanations I considered necessary to assure the existence, completeness, valuation and allocation of provisions.

### **Expenditure**

12. The occurrence and accuracy of expenditure, as per the income statement, to the sum of R18 047 144 in the current year and R17 587 635 in the prior year could not be confirmed due to the following:
- a) Supporting documentation relating to general expenses amounting to R745 678 in the current year and R460 682 in the prior year could not be obtained.
  - b) Supporting documentation for the amount of R46 644 included under salaries, wages and allowances could not be obtained.

I was furthermore not able to perform alternative procedures due to control weaknesses.

### **Income**

13. The completeness, occurrence and accuracy of operating income could not be confirmed due to the following:
- a) Rental income amounting to R255 214 as per appendix C of the annual financial statements could not be confirmed. The municipality was unable to submit a register for direct income received. It was not possible to confirm whether direct income registers are reconciled to the relevant income vote on a monthly basis nor that rentals according to the registers are balanced to the relevant general ledger rental revenue accounts on a monthly basis.
  - b) Interest and other income amounting to R1 257 890 as per appendix C of the annual financial statements could not be confirmed. Included in the amount are various deposits as per the bank statements amounting to R96 950. No supporting documentation could be obtained to substantiate this amount.
  - c) Receipts amounting to R40 706 could not be traced to a deposit slip or the bank statements.
  - d) Paragraph 100 of the *Framework for the preparation and presentation of financial statements by Local Government (GA100)* states that income is recognised in the income statement when an increase in future economic benefit related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably. This means in effect that the recognition of income occurs simultaneously with the recognition of increases in assets or decreases in liabilities. Outstanding levy income amounting to R551 381 in the prior year which should have been recorded against the appropriation account as a debtor was not created to estimate the levy income to be received when the levies were abolished on 30 June 2006. Income is therefore overstated and the appropriation account understated.

I was furthermore not able to perform alternative procedures due to a lack of source documents.

### **Long-term debtors**

14. Paragraph 68 of *Framework for the preparation and presentation of financial statements by Local Government* defines an asset as a resource controlled by the local authority arising from past events, and from which future economic benefits are expected to flow to the local authority. The recoverability of prior period long-term debtors of R568 130 as per note 5 to the annual financial statements could not be confirmed, as long-term debtors with an outstanding balance of R387 667 had not serviced their debt in the prior year. The prior year net profit and accumulated deficit are therefore overstated and the provision for bad debts and expenditure are understated.

## Opinion

15. 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 on the financial statements of the Xhariep District Municipality. Accordingly, I do not express an opinion on the financial statements.

## Emphasis of matters

16. I draw attention to the following matters:

## Going concern

17. Note 24 to the financial statements indicates that Xhariep District Municipality incurred a net loss of R3 077 117 for the year ended 30 June 2008.

## Unauthorised expenditure

18. As disclosed in note 23.2 to the financial statements, unauthorised expenditure to the amount of R3 024 018.

## Irregular expenditure

19. As disclosed in note 23.1 to the financial statements is irregular expenditure to the amount of R1 793 843 was incurred due to proper procurement procedures which were not followed in terms of the Supply Chain Management policy.

## OTHER MATTERS

20. I draw attention to the following matter(s) that relate to my responsibilities in the audit of the financial statements:

## Internal controls

21. 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 inefficiencies 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.

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Fixed assets	X				
Cash on hand			X		
Creditors			X		
Debtors			X		
Accumulated surplus			X		

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
/deficit					
Provisions			X		
Expenditure			X		
Income		X			

Control environment: establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.

Risk assessment: involves the identification and analysis by management of relevant financial reporting risks to achieve predetermined financial reporting objectives.

Control activities: policies, procedures and practices that ensure that management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.

Information and communication: supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allow people to carry out their financial reporting duties.

Monitoring: covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within a process.

## Non-compliance with applicable legislation

### Municipal Finance Management Act

22. An appropriate and effective cash management and investment policy has not yet been approved by council as required by section 13(2) of the MFMA.
23. The annual budget was not tabled at a council meeting at least 90 days before the start of the budget year as required by section 16(2) of the MFMA.
24. The municipal council did not consider approval of the budget at least 30 days before the start of the budget year as required by section 24(1) of the MFMA.
25. Section 22 of the MFMA requires the accounting officer, immediately after an annual budget is tabled in a municipal council, to make public the annual budget and the documents referred to in section 17(3) and invite the local community to submit representations in connection with the budget; to submit the annual budget in both printed and electronic format to the National Treasury and the relevant provincial treasury and in either format to any prescribed national or provincial organs of state and to other municipalities affected by the budget. No evidence could be obtained that this was done by the municipality.
26. An annual budget must be approved together with any municipal tariffs set for the budget year. Any changes to the municipality's integrated development plan and any changes to the municipality's budget-related policies must be approved. This could not be verified as required by section 24(2)(c) of the MFMA.
27. The 2007-08 budget was approved by council with a deficit of R7 229 399. The municipality had budgeted for a deficit notwithstanding sections 54(2), 54(3), (70)(1)(a) and 70(1)(b) of the MFMA.

28. The mayor did not submit a report to the council on the implementation of the budget and the financial state of affairs of the municipality within 30 days of the end of each quarter as required by section 52(d) of the MFMA.
29. The mid-year budget report was not submitted to the council by 31 January 2008 as required by section 54(1) of the MFMA.
30. It was noted that payments amounting to R518 435 were not made within 30 days after receipt of the supplier's invoice, which is in contravention of section 65(2)(e) of the MFMA.

#### **Municipal Systems Act**

31. The performance agreement between the accounting officer and the executive authority could not be provided, as required by section 57(1)(b) of the MSA, and not all written employment contracts could be obtained in terms of section 57(1)(a) of the MFMA.
32. The entire delegation of powers policy has not been approved as required by section 59(4).
33. No updated tariff policy could be obtained for the rental of the municipality's buildings as required by section 74 of the MSA.

#### **Municipal Structures Act**

34. The municipal council did not meet quarterly as required by section 18(2) of the Municipal Structures Act.

#### **Matters of governance**

35. 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 certain key governance responsibilities, which I have assessed as follows:

<b>Matter of governance</b>	<b>Yes</b>	<b>No</b>
<b>Audit committee</b>		
• 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.		X
<b>Internal audit</b>		X
• 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 section 165(2) of the MFMA.		X
<b>Other matters of governance</b>		
• The annual financial statements were submitted for audit as per the		X

<b>Matter of governance</b>	<b>Yes</b>	<b>No</b>
legislated deadlines in section 126 of the MFMA.		
<ul style="list-style-type: none"> <li>The annual report was submitted to the auditor for consideration prior to the date of the auditor's report.</li> </ul>		X
<ul style="list-style-type: none"> <li>The financial statements submitted for audit were not subject to any material amendments resulting from the audit.</li> </ul>		X
<ul style="list-style-type: none"> <li>No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.</li> </ul>		X
<ul style="list-style-type: none"> <li>The prior year's external audit recommendations have been substantially implemented.</li> </ul>		X
<ul style="list-style-type: none"> <li>The Provincial PROPAC resolutions have been substantially implemented.</li> </ul>		X
<b>Implementation of Standards of Generally Recognised Accounting Practice (GRAP)</b>		
<ul style="list-style-type: none"> <li>The municipality submitted an implementation plan, detailing progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 30 October 2007.</li> </ul>		X
<ul style="list-style-type: none"> <li>The municipality substantially complied with the implementation plan it submitted to the National Treasury and the relevant provincial treasury before 30 October 2007, detailing its progress towards full compliance with GRAP.</li> </ul>		X
<ul style="list-style-type: none"> <li>The municipality submitted an implementation plan, detailing further progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 31 March 2008.</li> </ul>		X

### **Unaudited supplementary schedules**

36. The supplementary information set out on pages 20 to 24 does not form part of the financial statements and is presented as additional information. I have not audited these appendices and accordingly I do not express an opinion thereon.

### **OTHER REPORTING RESPONSIBILITIES**

#### **Report on performance information**

37. I was engaged to review the performance information.

#### **Responsibility of the accounting officer for the performance information**

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

#### **Responsibility of the Auditor-General**

39. 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.



40. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
41. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

### **Audit findings**

#### **Non-compliance with regulatory requirements**

##### **No reporting on performance information**

42. The annual performance report of the municipality prepared in terms of section 46 of the MSA, as required by section 121(3)(c) of the MFMA, was not submitted for audit purposes.

##### **Lack of sufficient appropriate audit evidence**

43. The integrated development plan was in draft format, contrary to the requirements of section 41 of the MSA.

### **OTHER REPORTS**

#### **Investigations**

44. An investigation is being conducted with regard to the 2003-04 audit report of the Auditor-General. The investigation was still ongoing at the reporting date.

### **APPRECIATION**

45. The assistance rendered by the staff of the Xhariep District Municipality during the audit is sincerely appreciated.

*Auditor-General*

Bloemfontein

30 January 2009



A U D I T O R - G E N E R A L