

REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND THE COUNCIL ON THE XHARIEP DISTRICT MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Xhariep District Municipality set out on pages 77 to 127, which comprise the statement of financial position as at 30 June 2012, 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 of South Africa, 2011 (Act No. 6 of 2011) (DoRA), and for such internal control as the accounting officer determines 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 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 audit opinion.

Opinion

6. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Xhariep District Municipality as at 30 June 2012, and its financial performance and cash flows for the year then ended in accordance with the SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

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

Irregular expenditure

8. As disclosed in note 38 to the financial statements, the municipality incurred irregular expenditure of R10 465 869 (2011: R11 918 523) as proper procurement processes had not been followed as required by the supply chain management (SCM) regulations. The full extent of the irregular

expenditure of R10 465 869, as disclosed in note 38 to the financial statements, is still in the process of being investigated.

Unauthorised expenditure

9. As disclosed in note 36 to the financial statements, the municipality incurred unauthorised expenditure of R1 524 583 (2011: R3 604 257) due to inadequate budgetary control measures.

Restatement of corresponding figures

10. As disclosed in note 34 and note 35 to the financial statements, the corresponding figures for 30 June 2011 have been restated as a result of errors discovered and due to a change in accounting policy during 30 June 2012 in the financial statements of the municipality at, and for the year ended, 30 June 2011.

Financial sustainability

11. As disclosed in note 43 to the financial statements, the municipality might experience difficulties as a formal guarantee could not be provided to confirm that the municipality will be receiving grants from the Free State Department of Cooperative Governance and Traditional Affairs to maintain their operations. The municipality also did not settle its debt within 30 days as required by the MFMA and is significantly dependent on the national and provincial governments for its continued sustainability. These conditions, along with other matters, point to the existence of a material uncertainty that may cast significant doubt on the municipality's ability to continue as a going concern. The municipality may, therefore, be unable to realise its assets and discharge its liabilities in the normal course of business.

Material underspending of the budget and conditional grants

12. As disclosed in note 41 and 42 to the financial statements, the municipality has materially under spent its budget on all votes to the amount of R14 777 735. The underspending occurred because the approved grant from the Free State Department of Cooperative Governance and Traditional Affairs was not paid over to the district municipality during the financial year and was thus not available to them. The underspending did not adversely affect the achievement of the district municipalities reported performance.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

13. 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

14. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages 23 to 53 of the annual report.
15. 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 annual reporting principles and whether the reported performance is consistent with the planned development objectives. 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 development objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

16. There were no material findings on the annual performance report concerning the usefulness and reliability of the information.

Compliance with laws and regulations

17. 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:

Budgets

18. Quarterly reports were not submitted to the council on the implementation of the budget and financial state of affairs of the municipality within 30 days after the end of each quarter, as required by section 52(d) of the MFMA.
19. Expenditure was incurred 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

20. 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 asset, liabilities, expenditure and disclosure items identified by the auditors were subsequently corrected resulting in the financial statements receiving an unqualified audit opinion.

Expenditure management

21. The accounting officer did not take reasonable steps to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
22. Unauthorised, irregular and fruitless and wasteful expenditure was not investigated and as a result it was not recovered from the liable person, as required by section 32(2) of the MFMA.

Procurement and contract management

23. 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) & (c).
24. Contracts and quotations were awarded to providers whose tax matters had not been declared by the South African Revenue Services to be in order, as required by SCM regulation 43.
25. The performance of contractors or providers was not monitored on a monthly basis as required by section 116(2)(b) of the MFMA.
26. The contract performance measures and methods whereby they are monitored were insufficient to ensure effective contract management as per the requirements of section 116(2)(c) of the MFMA.

Internal control

27. 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 findings on compliance with laws and regulations included in this report.

Leadership

28. The leadership of Xhariep district municipality neglected to evaluate whether management had implemented effective internal controls. They did not gain a comprehensive understanding of how senior management members had met their responsibilities in terms of ensuring proper record management for preparing the financial statements and monitoring compliance to laws and regulations.
29. The leadership neglected to take appropriate action to address the lack of discipline in the finance and SCM directorates, this resulted in non-compliance to procurement legislation which in turn gave rise to the high level of irregular expenditure incurred in the financial statements.
30. The leadership of the municipality neglected to develop, implement and monitor internal control procedures to ensure that quarterly financial statements are prepared and subjected to review. This oversight resulted in the challenge faced to submit financial statements to audit that are fully

compliant to the SA Standards of GRAP and necessitated the amendment of financial statements provided for audit purposes.

Financial and performance management

31. Due to oversight on the part of the senior management group of the district municipality the regular review and monitoring of compliance to laws and regulation were not sufficiently prioritised. As a result, material non-compliance issues were noted that could have been prevented.
32. The municipality did not have the human resource capacity throughout the financial year to adequately address prior year issues and weaknesses identified in the financial and control systems of the district municipality. This necessitated the municipality to make use of consultants to supplement such constraints. Consultants assisted with the preparation of an asset register, the preparation of the financial statements and with the establishment and improvement of certain business processes.
33. Due to time pressure brought about by the fact that the process of preparing the financial statements were only started late in the financial year, sufficient time was not available to the chief financial officer to properly review such statements for completeness and accuracy prior to submission thereof for auditing. This resulted in many findings relating to incorrect disclosure which were subsequently corrected.
34. Staff within the finance directorate of the district municipality had an insufficient understanding of the accounting framework. This contributed towards the errors that were subsequently corrected in the financial statements of the municipality.

Bloemfontein

30 November 2012



A U D I T O R - G E N E R A L
S O U T H A F R I C A

Auditing to build public confidence