

# 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 ... to ..., which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as 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 the 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, 2013 (Act No. 2 of 2013) (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 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 have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

### Basis for qualified opinion

#### Property, plant and equipment

6. I was unable to obtain sufficient appropriate audit evidence regarding property, plant and equipment. Management could not provide supporting documentation to confirm the adjustments made to the fixed asset register. In addition, I was unable to physically verify the existence of the property, plant and equipment due to a lack of unique numbers as well as inadequate descriptions of assets and locations recorded in the fixed asset register. I was unable to confirm property, plant and equipment by alternative means. Consequently, I was unable to determine whether any adjustment was necessary in

respect of property, plant and equipment stated at R20 095 302 (2013: R22 261 494) in note 6 to the financial statements.

#### **Unspent conditional grants and receipts**

7. I was unable to obtain sufficient appropriate audit evidence that management had properly accounted for unspent conditional grants and receipts due to management not providing sufficient supporting information. I was unable to confirm unspent conditional grants and receipts by alternative means. Consequently, I was unable to determine whether any adjustment was necessary relating to unspent conditional grants and receipts stated at R1 699 499 in note 9 to the financial statements.

#### **Commitments**

8. I was unable to obtain sufficient appropriate audit evidence that management had properly accounted for all commitments due inadequate contract management systems. I was unable to confirm commitments by alternative means. Consequently, I was unable to determine whether any adjustment was necessary in respect of commitments stated at R2 962 787 (2013: R1 328 470) in note 25 to the financial statements.

#### **Prior period errors**

9. I was unable to obtain sufficient appropriate audit evidence regarding the disclosure of the prior period errors. Management could not provide documentation to support the adjustments made to the prior period error note as well as the accumulated surplus. I was unable to confirm the prior period errors by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to the prior period errors as disclosed in note 36 to the financial statements.

#### **Aggregation of immaterial uncorrected misstatements**

10. The financial statements were materially misstated due to the cumulative effect of individually immaterial uncorrected misstatements in the following items making up the statement of financial position and the statement of financial performance:

- Trade and other receivables reflected as R1 737 141 was overstated by R158 432
- Employee related costs reflected as R34 017 652 was overstated by R139 585

In addition, I was unable to obtain sufficient appropriate audit evidence and to confirm the following items by alternative means:

- Payables from exchange transactions of R138 457 as included in the disclosed balance of R5 542 848
- Employee related costs of R197 795 as included in the disclosed balance of R34 017 652

As a result, I was unable to determine whether any adjustment to these items was necessary.

#### **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 Xhariep District Municipality as at 30 June 2014 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.

### **Restatement of corresponding figures**

13. As disclosed in note 36 to the financial statements, the corresponding figures for the 30 June 2013 have been restated as a result of errors discovered during 2014 in the financial statements of the municipality at, and for the year ended, 30 June 2013.

### **Irregular expenditure**

14. As disclosed in note 23.3 to the financial statements, the municipality incurred irregular expenditure of R8 364 073 (2013: R4 957 023) during the year under review due to non-compliance with supply chain management (SCM) regulations.

### **Unauthorised expenditure**

15. As disclosed in note 23.1 to the financial statements, the municipality incurred unauthorised expenditure of R2 377 362 (2013: R5 667 656) during the year under review, due to overspending of the municipal budget.

### **Going concern**

16. As disclosed in note 34 to the financial statements, the municipality incurred a deficit of R3 700 003 during the year ended 30 June 2014 and, as of that date the municipality's unspent conditional grants and receipts of R1 699 499 exceed the cash balance held by the municipality of R769 595. The net cash outflow from operating activities is R853 082 and the current liabilities of R7 502 347 exceed the current assets of R3 461 970. These conditions, along with other matters indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

### **Additional matter**

17. I draw attention to the matters below. My opinion is not modified in respect of this matter.

### **Unaudited disclosure notes**

18. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

19. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected development objectives presented in the annual performance report, non-compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

### **Predetermined objectives**

20. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development objectives presented in the annual performance report of the municipality for the year ended 30 June 2014:

- Development objective: Corporate services on pages x to x

- Development objective: Planning and social development on pages x to x
21. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
  22. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development objectives. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
  23. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
  24. I did not raise any material findings on the usefulness and reliability of the reported performance information for the selected development objectives.

#### **Additional matter**

25. Although I raised no material findings on the usefulness and reliability of the reported performance information for the selected development objectives, I draw attention to the following matter:

#### **Achievement of planned targets**

26. Refer to the annual performance report on pages x to x and x to x for information on the achievement of the planned targets for the year.

#### **Compliance with legislation**

27. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

#### **Budgets**

28. Expenditure was incurred in excess of the limits of amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

#### **Annual financial statements, performance and annual report**

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

#### **Audit committee**

30. The audit committee was not constituted in the manner required by section 166(4)(a) of the MFMA. One member of the audit committee resigned during the year and another member's contract was not renewed. This resulted in the audit committee not having the required minimum of three members. The latest audit committee member position became vacant in March 2014.
31. The audit committee did not review the annual financial statements to provide the council with an authoritative and credible view of the financial position of the entity, its efficiency

and effectiveness and its overall level of compliance with legislation, as required by section 166(2)(b) of the MFMA.

32. The audit committee did not review the fourth quarter internal audit reports on performance measurement, as required by municipal planning and performance management regulation 14(4)(a)(i).
33. The audit committee did not advise the council on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.
34. The audit committee did not advise the council on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA.

#### **Asset management**

35. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.
36. Assets disposed by the municipality were not approved by the council as required by section 14(2)(a) of MFMA.

#### **Procurement and contract management**

37. Sufficient appropriate audit evidence could not be obtained to confirm that contracts were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive due to inadequate record keeping.
38. 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).
39. Bid specifications were not always drafted by bid specification committees which were composed of one or more officials of the municipality as required by SCM regulation 27(3).
40. Invitations for competitive bidding were not always advertised for a required minimum period of days, as required by SCM regulation 22(1) and 22(2).
41. The preference point system was not applied in all procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act of South Africa, 2000 (Act No. 5 of 2000) (PPPFA) and SCM regulation 28(1)(a).
42. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
43. Contracts and quotations were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.

#### **Expenditure management**

44. Reasonable steps were not taken to prevent unauthorised, irregular as well as fruitless and wasteful expenditure as required by section 62(1)(d) of the MFMA.

### **Consequence management**

45. Unauthorised, irregular as well as 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.
46. Council certified irregular, fruitless and wasteful expenditure as irrecoverable without conducting an investigation by council committee to determine recoverability of the expenditure, as required by section 32(2) of the MFMA.

### **Internal control**

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

### **Leadership**

48. The leadership did not respond to the matters reported by the external auditors in the previous financial year in order to ensure an improvement in the audit outcome. They did not take timely and adequate action to address weaknesses in the finance and supply chain management directorate, which resulted in non-compliance with applicable legislation and an increase in irregular expenditure. There were no consequences for officials that did not perform or performed their job functions poorly.

### **Financial and performance management**

49. Inadequate filing procedures and a lack of proper record keeping resulted in the municipality obtaining a qualified opinion once again. As a result, significant difficulties and delays were experienced in respect of the availability of information. The financial statements were not properly reviewed by the chief financial officer for completeness and accuracy prior to submission for auditing, which resulted in material audit adjustments being made.
50. The municipality did not establish effective monitoring and evaluation processes within its finance and strategic planning directorates to regularly review and monitor compliance with laws, regulations and internally designed policies and procedures due to capacity problems. As a result, significant non-compliance issues were identified that could have been prevented.

### **Governance**

51. The governance structures of the municipality were not sufficiently capacitated and as a result did not deliver on its mandate. Internal control deficiencies and risks affecting the municipal environment were not identified, communicated and corrected in a timely manner. The implementation of external and internal audit recommendations were not prioritised and monitored which resulted in some of the qualification matters recurring.

## OTHER REPORTS

### Investigation

52. The municipality is in the process of conducting an internal review in respect of possible fraudulent transactions identified during the audit. It is alleged that management could be colluding with service providers to procure services in contravention of the SCM regulations. The accounting officer has indicated that this will be investigated and officials involved will be criminally charged and monies will be recovered. At the time of this report, the composition, terms and reference of the investigation was not yet finalised.

*Auditor-General*

Bloemfontein

30 November 2014



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

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