

**REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF THE DIHLABENG LOCAL 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 Dihlabeng Local Municipality (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 basic 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 my 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. Audit assurance could not be obtained as to the municipality's rights to, and the existence and valuation of, gross fixed assets to the amount of R590,3 million as disclosed in note 5 to the financial statements. This was due to the fact that the asset register was not detailed enough to make the physical verification of assets possible in all instances and the location of fixed assets amounting to R22,3 million was not indicated in the asset register. The municipality also did not perform an asset count to confirm the existence, condition and utilisation of the municipality's assets. The audit revealed that the condition of assets to the value of R3,3 million had deteriorated significantly due to a lack of proper maintenance.

6. Supporting tender documentation could not be provided for project payments totalling R18 million made during the year, which placed a serious limitation on the scope of the audit. The financial systems did not make provision for alternative procedures to gain assurance regarding these amounts.
7. All expenditure relating to the eradication of the bucket system was capitalised to fixed assets but could not be regarded as an asset of the municipality, as the assets are mainly located on private properties. Assets were therefore overstated by approximately R15,6 million in respect of the 2005-06 and 2006-07 financial years and R18 million in respect of the 2007-08 financial year.

#### **Creditors**

8. Due to a lack of supporting evidence and the fact that proper reconciliations were not done, audit assurance could not be obtained as to the existence and valuation of, and the municipality's obligation towards, other creditors included in note 11 to the amount of R39 995 413. Included in this amount were balances without movement for the year under review amounting to R3 228 820. The financial systems did not allow for the performance of alternative audit procedures.
9. Trade creditors at year-end as disclosed in note 11 to the financial statements to the value of R2 428 783 did not reconcile with the sub-ledgers of R6 039 601. The difference of R3 610 818 could not be explained. The financial statements, which agree with the control account, did therefore not agree with the creditors list. Furthermore, supporting documentation for trade creditors to the value of R1 764 599 could not be submitted. The financial systems did not make provision for alternative audit procedures to verify these amounts. Therefore audit assurance as to the rights and obligations and valuation of trade creditors could not be obtained.
10. Payments after year-end to the amount of R3 887 512 related to services and goods rendered or delivered before year-end, resulted in trade creditors and expenditure disclosed in note 11 being understated by this amount.
11. Supporting documentation for journals totalling R7,8 million could not be submitted and the completeness and valuation of value-added tax (VAT) creditors included in note 11 to the financial statements could not be confirmed. The financial systems did not make provision for alternative procedures to confirm this amount.
12. A recalculation of VAT revealed various errors due to VAT not being declared or incorrectly claimed, resulting in an understatement of VAT creditors and overstatement of retained income by at least R3,5 million.

#### **Debtors**

13. Supporting documentation for various debtors with credit balances totalling R5,2 million could not be provided. The accuracy and valuation of these amounts could therefore not be confirmed.
14. The provision for bad debts as disclosed in note 9 to the financial statements amounting to R104,4 million was regarded as insufficient. Based on the payment history of consumer debtors, the provision should be approximately R124,1 million (2007: R106,6 million). The provision for bad debts and expenditure were therefore understated by approximately R19,7 million (2007: R19,8 million).
15. Sufficient appropriate audit evidence could not be obtained as to the existence of debtor accounts totalling R4 664 559, while the financial systems did not make provision for the performance of alternative audit procedures.
16. The accuracy and completeness of indigent subsidies totalling R6,4 million paid for the year under review could not be confirmed in all instances, owing to the lack of indigent application files. The financial systems did not make provision for alternative procedures to verify the accuracy of indigent applications.
17. Expenditure was understated and debtors were overstated by R2,9 million, as this amount related to indigent subsidies from the previous accounting system.
18. The completeness of debtors disclosed in note 9 to the financial statements could not be confirmed as a result of property improvements not timely levied and pre-paid electricity

erroneously not recognised in the year under review. Debtors and revenue were therefore understated by R684 351.

#### **Retained income**

19. No supporting documentation could be provided for debit journals totalling R3 712 327 and credit journals of R1 640 407 accounted for against the appropriation account. The financial systems did not make provision for the performance of alternative procedures and therefore audit assurance could not be obtained as to the accuracy of adjustments of R2 071 920 included in the retained income account as disclosed in note 17.

#### **Cash and bank**

20. Supporting documentation for journals totalling R4,3 million could not be submitted and the financial systems did not make provision for the performance of alternative procedures to verify this amount. Therefore audit assurance as to the existence and valuation of the bank balance of R20 843 168 as disclosed in note 30 could not be obtained.

#### **Capital commitments**

21. Audit assurance could not be obtained as to the completeness of capital commitments to the amount of R38 331 000 as disclosed in note 25 to the financial statements, as supporting documentation for these commitments as at 30 June 2008 could not be submitted. The financial systems did not make provision for the performance of alternative audit procedures.

#### **Funds and reserves**

22. Council approval for the transfer of funds and reserves amounting to R74 million to the provision for bad debts, due to the lack of investments, was contradictory to paragraph 5 of the accounting policy as well as sections 83(2) and 85(2) of Local Government Ordinance No. 8 of 1962. Funds and reserves were therefore understated and the provision for bad debts was overstated by the said amount. This matter was also reported in paragraph 7 of the previous audit report.

#### **Inventory**

23. Audit assurance could not be obtained as to the completeness of game stock amounting to R1 686 117 included in inventory in note 8 to the financial statements, due to the lack of a game stock counting certificate and an unbalanced game stock register. The financial systems did not make provision for the performance of alternative procedures and the effect on game stock as included in inventory could not be determined.

#### **Provisions**

24. The valuation of provisions for free basic services amounting to R931 394 is doubtful, as there was no movement during the year under review. This matter was also reported in paragraph 13 of the previous audit report.

25. The leave provision as disclosed in note 10 did not agree with the leave records, due to a calculation error by management, and was therefore overstated by an amount of R1 321 614. The retained income was understated by the same amount.

26. A current obligation for the payment of audit fees did not exist whilst a provision for audit fees amounting to R1 668 607 was included in the financial statements, resulting in the overstatement of provisions and the understatement of retained income by this amount.

#### **Income**

27. Building plans to determine the number of sewerage points per erf could not be submitted in all instances and audit assurance could therefore not be obtained as to the completeness and accuracy of sewerage income amounting to R32,5 million for the year under review. The financial system did not make provision for alternative audit procedures to confirm the accuracy and

completeness of these income transactions. This matter was also reported in paragraph 5(e) of the previous audit report.

28. Income as reflected in the income statement was overstated by an amount of R1 750 000 and retained income understated, as a result of an order incorrectly written back in the current financial year.
29. A total of 9 778 consumer debtors owed the municipality R46,4 million at 30 June 2008, but no interest was charged on these accounts. Interest and debtors are as a result understated by an unknown amount. The financial systems did not make provision for alternative procedures to quantify the amount, as the capital portion of the outstanding debt is not available to calculate the loss in income.

#### **Employee cost**

30. Due to the lack of time sheets or attendance registers, the accuracy of wage payments amounting to R2 037 644 as disclosed in note 31 to the financial statements could not be confirmed. The financial systems did not make provision for alternative procedures to gain accurate audit assurance of this amount.
31. Councillor allowances amounting to R4 608 361 were incorrectly included in note 31 to the financial statements on employee-related costs for the 2007-08 financial year.

#### **Expenditure**

32. Lease contracts could not be provided and the completeness of payments of debit orders totalling R1 164 804 as well as compliance with contract stipulations could not be verified. The financial systems did not make provision for alternative procedures to verify this amount.

#### **Fruitless and wasteful expenditure**

33. Unit managers were appointed from August 2005 to January 2008 but it could not be confirmed that they had rendered any services. The salaries of R1 993 358 paid in this regard are considered to be fruitless and wasteful expenditure, as defined in section 1 of the MFMA. This fruitless expenditure was, however, not disclosed as such in note 27 to the financial statements, as required by section 125(2)(d)(i) of the MFMA. This matter was also reported in paragraph 10 of the previous audit report and cognisance is taken of the fact that these allowances were stopped during January 2008 and are currently under investigation at a high level.
34. Penalty interest amounting to R69 769 was paid, mainly due to the late payment of electricity purchases, resulting in fruitless and wasteful expenditure, as defined in section 65(2)(e) of the MFMA. However, this fruitless and wasteful expenditure was not disclosed as such, as required by section 125(2)(d)(i) of the MFMA.

#### **Irregular expenditure**

35. Procurement policies or supply chain management regulations were not adhered to in all instances, resulting in payments totalling R1 753 881 where the required number of quotations and/or tenders was not obtained for purchases made. This is regarded as irregular expenditure in terms of the definition of irregular expenditure in section 1 of the MFMA, but was not disclosed as such, as required by section 125(2)(d)(i) of the MFMA.

#### **Cash flow statement**

36. Cash generated by operations to the amount of R82 103 156 in the cash flow statement could not be accepted as correct, as unexplained differences were noted on the appropriations debited against income and the, grants received from the state, while there was also a lack of appropriate detailed working papers.

### Contingent liabilities

37. A contingent liability ("Bonus personnel") as disclosed in note 26 to the financial statements amounting to R1 929 137 should, due to its nature, have been recognised as a provision. Contingent liabilities were therefore overstated and provisions understated by R1 929 137. The corresponding figure of R1,8 million for 2006-07 was similarly misstated.
38. A schedule for the provision for bonus payments submitted by management did not add up correctly and the bonus provision was therefore understated and retained income overstated by R2 159 511.

### Inter-governmental grants

39. The inter-governmental grants as disclosed in note 35 to the financial statements did not include municipal infrastructure grants to the value of R32 191 113 for the 2007-08 financial year.

### Retirement benefits

40. As disclosed in note 24 to the financial statements, an actuarial valuation could not be obtained from three of the pension funds. I could therefore not confirm whether any obligations by the municipality existed in this regard.

### Disclaimer of opinion

41. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have been unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of the Dihlabeng Local Municipality. Accordingly, I do not express an opinion on the financial statements.

### Emphasis of matter

I draw attention to the following matter that relates to my responsibilities in the audit of the financial statements:

### Going concern

42. The Treasurer's report on page 18 to the financial statements indicates that the Dihlabeng local municipality might experience challenges over the next twelve months in relation to meet some of its obligations. These conditions, along with other matters, point to existence of a material uncertainty that may cast significant doubt on the municipality's ability to continue as a going concern.

## OTHER MATTERS

### Internal controls

43. 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				
Creditors	X				

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Debtors	X				
Retained income			X		
Cash and bank			X		
Capital commitments		X			
Funds and reserves			X		
Inventory			X		
Provisions	X				
Income	X				
Employee cost	X				
Expenditure	X				
Fruitless and wasteful expenditure	X				
Irregular expenditure	X				
Cash flow statement		X			
Contingent liabilities					X
Inter-governmental grants		X			
Retirement benefits		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 allows 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

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
checklists, by employees within a process.					

## Non-compliance with applicable legislation

### Municipal Finance Management Act

44. Various instances of non-compliance with the MFMA were observed, which included the following:

Section	Detail
62(1)(c)(i)	Policies were only submitted to council for adoption on 29 May 2008.
63	The accounting officer did not implement controls to ensure a complete, sufficient asset register.
65(2)(e)	Payments were not always made within 30 days of receipt of invoices. Examples of R10 million were revealed during the audit.
75(1)	The accounting officer of a municipality must place on the website certain documents of the municipality, which was not done in all instances.
73 & 111	The municipality did not approve the budget and supply chain management policies in terms of section 111 and did not inform the provincial treasury of such a failure or non-compliance in terms of section 73.
127 & 130	The annual report for the 2006-07 financial year was not submitted and tabled.

### Matters of governance

45. 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:

Matter of governance	Yes	No
<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>		
• 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>Matter of governance</b>	<b>Yes</b>	<b>No</b>
<b>Other matters of governance</b>		
• The annual financial statements were submitted for audit as per the legislated deadlines in section 126 of the MFMA.	X	
• The annual report was submitted to the auditor for consideration prior to the date of the auditor's report.		X
• The financial statements submitted for audit were not subject to any material amendments resulting from the audit.	X	
• No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.		X
• The prior year's external audit recommendations have been substantially implemented.		X
• The provincial SCOPA resolutions have been substantially implemented.	X	
• There are documented policies and procedures and control systems to ensure the reliability of financial reporting.		X
• There are documented policies and procedures and control systems to ensure compliance with applicable laws and regulations.		X
• The information systems were appropriate to facilitate the preparation of financial statements that are free from material misstatement.	X	
• Delegations of responsibilities are in place.	X	
• Supply chain management policies and procedures were appropriately applied.		X
• There is a functioning performance management system.		X
• Based on the available information, performance bonuses are only paid after proper assessment and approval by those charged with governance.		X
<b>Implementation of Standards of Generally Recognised Accounting Practice (GRAP)</b>		
• 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.	X	
• 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.		X
• 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.		X

#### **Unaudited supplementary schedules**

46. The supplementary information set out on pages X to X 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.



## OTHER REPORTING RESPONSIBILITIES

### Reporting on performance information

47. I was engaged to review the performance information.

### Responsibility of the accounting officer

48. 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

49. 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.

50. 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.

51. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

### Audit findings (performance information)

#### Measurable objectives are materially inconsistent between annual report and budget

52. The objectives reported in the report of performance information submitted by the municipality were materially inconsistent when compared with the predetermined objectives as per the budget, as the budget did not include any objectives. The following table reflects examples of the material differences:

Development priorities and objectives per budget	Development priorities and objectives per annual performance report
Infrastructure	
No objective	To utilise the allocated funds for municipal infrastructure efficiently by maintaining the essential infrastructure and to upgrade and extend the services cost effectively.
Sanitation	
No objective	To utilise the allocated funds for municipal infrastructure efficiently by maintaining the essential infrastructure and to upgrade and extend the services cost effectively.
Safety and security	
No objective	To provide prompt fire fighting and rescue services to the residents.
No objective	To ensure the safety of the community, protection of property and humanitarian services.

**Measurable objectives are materially inconsistent between annual report and integrated development plan**

53. The measurable objectives reported in the annual report of the municipality were materially inconsistent when compared with the predetermined objectives as per the integrated development plan. The following table reflects examples of the material differences:

Objective per integrated development plan	Development priorities and objectives per annual performance report
Infrastructure	
BULK & INTERNAL WATER SUPPLY Upgrade and extend to the existing water infrastructure to all under-service areas within Dihlabeng.	To utilise the allocated funds for municipal infrastructure efficiently by maintaining the essential infrastructure and to upgrade and extend the services cost effectively.
Sanitation	
Improve sanitation services to all communities in Dihlabeng and eradicate the bucket system by 2007.	To utilise the allocated funds for municipal infrastructure efficiently by maintaining the essential infrastructure and to upgrade and extend the services cost effectively.
Safety and security	
Provide prompt emergency services and to ensure safe usage of all municipal roads.	To provide prompt fire fighting and rescue services to the residents.
Reduce the level of crime within Dihlabeng.	To ensure the safety of the community, protection of property and humanitarian services.

**Lack of systems generating performance information**

54. I was unable to obtain sufficient appropriate audit evidence in relation to the performance information of the municipality. A performance management information system was not in place for generating the information.

**APPRECIATION**

55. The assistance rendered by the staff of the municipality during the audit is sincerely appreciated.

*Auditor-General*  
Bloemfontein

30 November 2008

