

AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND THE COUNCIL ON THE DIHLABENG LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Dihlabeng Local Municipality, which comprise the statement of financial position as at 30 June 2010, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory information, as set out on pages XX to XX.

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 in the manner required by the Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA). 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; and making accounting estimates that are reasonable in the circumstances.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of South Africa, 1996 (Act No. 108 of 1996), section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on the audit.
4. I conducted my audit in accordance with International Standards on Auditing and *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*. 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.
5. 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.
6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis for qualified opinion

Property, plant and equipment

7. I was unable to verify the existence and rights and obligations of property, plant and equipment of R4 872 474 (2009: R11 946 214) included in the balance for property, plant and equipment at 30 June 2010 in the statement of financial position and note 4 to the financial statements, as the descriptions in the asset register were not detailed and specific enough to facilitate verification and identification of these assets. The entity's records did not permit the application of alternative audit procedures regarding the existence of these assets.
8. Furthermore, moveable assets with an unknown value used by the municipality were found on the premises but were not recorded in the asset register. Due to a lack of documentation, I was not able to confirm whether these items were considered to be assets of the municipality. I was not able to apply alternative procedures regarding the rights and completeness of these assets.

Unspent conditional grants and receipts

9. Unspent conditional grants of R9 716 000, as disclosed in note 15 to the financial statements, were overstated while property, plant and equipment were understated by R4 977 301, due to additions to fixed assets not being accounted for in the current financial year.

Trade and other payables

10. Trade and other payables of R59 653 850, as disclosed in note 17 to the financial statements, were overstated by R3 916 863 (2009: R2 696 636) and the accumulated surplus was understated due to prior period errors not corrected.

Trade and other receivables

11. The provision for impairment of trade and other receivables as required by paragraphs 63 and 64 of the South African Statement of Generally Accepted Accounting Practice, IAS 39 (AC 133) *Financial Instruments: Recognition and Measurement* and as disclosed in note 9 to the financial statements amounting to R115 477 790 was regarded as insufficient. Based on the age analysis and payment history of consumer debtors, the provision should be R148 565 303. The provision for impairment of trade and other receivables and expenditure were therefore understated by R33 087 513.

Government grants and subsidies

12. Equitable share grants received of R83 824 526, as disclosed in note 21 to the financial statements, were overstated by R2 006 410. Accounts receivable were also overstated by the same amount due to receipts incorrectly allocated to the equitable share account.

Cash flow statement

13. The cash flow statement was re-compiled on the direct method. Furthermore, various corrections to prior year figures were made as reflected in note 40 to the financial statements which also influence the cash flow statement. Sufficient appropriate evidence for the re-compilation due to prior year errors was not submitted. I was therefore not able to confirm the accuracy of the comparative figures and could not perform alternative procedures in this regard. The effect of the re-compilation of the cash flow figures was also

not disclosed as prescribed by paragraph 28 of the SA Standard of GRAP, GRAP 3 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Qualified opinion

14. 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 Dihlabeng Local Municipality as at 30 June 2010 and its financial performance and its cash flows for the year then ended, in accordance with SA Standards of GRAP and in the manner required by the MFMA.

Emphasis of matters

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

Restatement of corresponding figures

16. As disclosed in note 40 to the financial statements, the corresponding figures for 30 June 2009 have been restated as a result of errors discovered during the 2009-10 financial year in the financial statements of the Dihlabeng Local Municipality at, and for the year ended, 30 June 2009.

Fruitless and wasteful expenditure

17. As disclosed in note 42 to the financial statements, fruitless and wasteful expenditure of R2 021 273 was incurred on interest and penalties, due to the late payment of outstanding accounts.

Irregular expenditure

18. As disclosed in note 43 to the financial statements, irregular expenditure of R26 210 087 was incurred, as a proper tender process and supply chain management policy were not followed.

Additional matter

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

Unaudited supplementary schedules

20. 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

21. As required by the PAA and in terms of *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*, I include below my findings on the report on predetermined objectives, compliance with the MFMA, Local Government: Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA), Local Government: Municipal Planning and Performance Management Regulations of South Africa, 2001 (GNR.796 of 24 August 2001) and financial management (internal control).

Predetermined objectives

22. Material findings on the report on predetermined objectives, as set out on pages XX to XX, are reported below:

Non-compliance with regulatory and reporting requirements

The integrated development plan did not inform the annual budget

23. Contrary to the requirements of regulation 6 of the Municipal Planning and Performance Management Regulations, 2001, no logical link existed between the integrated development plan and the annual budget.

No performance contracts for the year under review signed by municipal manager and other section 57 managers

24. Contrary to the requirements of section 57 of the MSA, the municipal managers and some managers directly accountable to the municipal manager did not sign performance contracts for the year under review.

Performance of employees not monitored in terms of performance contracts

25. Employees did not have performance contracts to monitor their performance against set targets, as required by section 38 of the MSA.

Lack of adoption of a performance management system

26. The municipality did not adopt a framework that described and represented how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement would be conducted, organised and managed, including determining the roles of the different role players, as required in terms of sections 36, 38 and 41(2) of the MSA and regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

Performance of service providers not measured

27. Contrary to the requirements of section 46(a) of the MSA, the municipality did not prepare a performance report for each external service provider.

Measure to improve performance not included in the performance report

28. Contrary to the requirements of section 46(c) of the MSA, the municipality did not prepare a performance report reflecting measures taken to improve performance.

Inadequate content of integrated development plan

29. The key performance indicators did not include all the general key performance indicators applicable to the municipality, as required by section 43(1) of the MSA.

Internal auditing of performance measurements

30. The internal auditors of the municipality did not audit the performance measurements as required by regulation 14(1)(c) of the Local Government Municipal Planning and Performance Management Regulations, 2001.

Usefulness of information

31. The following criteria were used to assess the usefulness of the planned and reported performance:

- Consistency: Has the municipality reported on its performance with regard to its objectives, indicators and targets in its approved integrated development plan, i.e. are the objectives, indicators and targets consistent between planning and reporting documents?
- Relevance: Is there a clear and logical link between the objectives, outcomes, outputs, indicators and performance targets?
- Measurability: Are objectives made measurable by means of indicators and targets? Are indicators well defined and verifiable, and are targets specific, measurable and time bound?

The following audit findings relate to the above criteria:

Planned performance targets not specific and measurable

32. One hundred per cent of the selected indicators were not measurable or specific to indicate, for example, numbers, percentages and time to be completed.

Reported information not consistent with planned objectives, indicators and targets

33. Performance reports did not always indicate key performance indicators, clearly linked to the performance targets set in the integrated development plan.

Reliability of information

34. The following criteria were used to assess the reliability of the planned and reported performance:

- Validity: Has the actual reported performance occurred and does it pertain to the entity, i.e. can the reported performance information be traced back to the source data or documentation?
- Accuracy: Have amounts, numbers and other data relating to reported actual performance been recorded and reported appropriately?
- Completeness: Have all actual results and events that should have been recorded been included in the reported performance information?

The following audit finding relates to the above criteria:

Reported indicators not reliable as no supporting source information was provided

35. For the selected objectives the validity, accuracy and completeness of 100% of the reported indicators could not be established as the relevant source documentation could not be provided for audit purposes.

Compliance with laws and regulations

Municipal Finance Management Act

The mayor did not adhere to his legislative responsibilities

36. Contrary to the requirements of section 53(3)(a) of the MFMA, the mayor did not ensure that the report on the revenue and expenditure projections for each month and the service delivery targets and performance indicators for each quarter, as set out in the service delivery and budget implementation plan, was made public no later than 14 days after the approval of the service delivery and budget implementation plan.

37. Contrary to the requirements of section 54(1)(f) of the MFMA, the section 72 mid-year report was only submitted to the council on 2 March 2010, after the cut-off date of 31 January.

Expenditure was not paid within the parameters set by the applicable legislation

38. Contrary to the requirements of section 65(2)(e) of the MFMA, payments were not in all instances made within 30 days from the receipt of invoices.

Municipal officials did not adhere to their statutory responsibilities

39. Contrary to the requirements of section 62(1)(c)(i) of the MFMA, no fraud prevention plan existed.

40. Contrary to the requirements of section 70(1) and (2) of the MFMA, the accounting officer did not report in writing to the council any impending shortfalls in budgeted revenue or overspending of the municipality's budget and steps to rectify the matters.

41. Contrary to the requirements of section 71 of the MFMA, not all the required budget statements were included in the monthly reports.

42. Contrary to the requirements of section 72 of the MFMA, the mid-year budget was completed after 25 January. The report was also not sent to the National Treasury.

The internal audit unit was not functioning properly

43. The internal audit unit did not function properly during the year under review as required by section 165 of MFMA, due to various shortcomings identified.

The audit committee was not properly established and not functioning properly

44. Contrary to the requirements of section 166(1) of the MFMA, the municipality did not have a properly functioning audit committee in operation throughout the financial year.

Expenditure was incurred in contravention of or not in accordance with applicable legislation resulting in irregular expenditure

45. Expenditure was incurred which was not in accordance with the municipality's supply chain management policy resulting in irregular expenditure as defined in section 1 of the MFMA.

Expenditure incurred was made in vain or could have been avoided resulting in fruitless and wasteful expenditure

46. Expenditure was incurred which could have been avoided had reasonable care been exercised resulting in fruitless and wasteful expenditure, as defined in section 1 of the MFMA.

Municipal Systems Act

Interests not disclosed by councillors and municipal officials

47. Contrary to the requirements of the MSA (schedule 1, paragraph 5 and schedule 2, paragraph 5), not all councillors and municipal staff members disclosed their interests.

Supply chain management regulations

Supply chain management legislative requirements were not implemented or not adhered to

48. Contrary to the requirements of regulation 3(1)(a) of the SCM Regulations, an annual review was not conducted on the implementation of the SCM policy.

INTERNAL CONTROL

49. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the MFMA and MSA but not for the purpose of expressing an opinion on the effectiveness of internal control.

50. The matters reported below are limited to the significant deficiencies regarding the Basis for qualified opinion paragraphs, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

Leadership

51. Management did not properly perform all oversight and review functions, as various posts (including some senior and management positions) were vacant during the year under review.

52. Performance was not measured and the environment was not conducive to accountability and service delivery through positive attitude, competence and ethical behaviour.

Financial and performance management

53. Proper financial and performance management were not achieved during the year, as evidenced by the significant number of findings on the original financial statements submitted for auditing and all the adjustments that were needed on that set of financial statements. All the required documents were not submitted in the audit file with the financial statements.

Governance

54. Appropriate measures to achieve good governance were not always in place, as various policies and procedures had not been approved by the council and the internal audit unit did not function effectively during the year under review. The audit committee also did not properly perform their functions.

OTHER REPORTS

Investigations

55. An investigation was conducted by an independent consulting firm on request of the previous municipal manager. The investigation was initiated based on the allegation of possible fraudulent transactions by employees with regard to supply chain management, handling of inventory, disposal of assets and revenue collection. Action is being taken by management with regard to the findings detailed in that report.

Bloemfontein

30 November 2010



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