

# **AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND COUNCIL ON MOTHEO DISTRICT MUNICIPALITY**

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Introduction**

1. I have audited the accompanying financial statements of the Motheo District 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, and 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) and the Division of Revenue Act of South Africa, 2009 (Act No. 12 of 2009) (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; 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 my 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.

### **Opinion**

7. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Motheo District Municipality as at 30 June 2010 and its financial performance and its cash flows for the year then ended, in accordance with the SA Standards of GRAP and in the manner required by the MFMA and DoRA.

### **Emphasis of matters**

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

### **Restatement of corresponding figures**

9. As disclosed in note 37 to the financial statements, the corresponding figures for 30 June 2009 have been significantly restated as a result of the conversion from the entity-specific accounting basis (IMFO) to SA Standards of GRAP during the 2009-10 financial year in the financial statements of the Motheo District Municipality at, and for the year ended, 30 June 2009.

### **Irregular expenditure**

10. As disclosed in note 32 to the financial statements, irregular expenditure to the amount of R49 808 600 was incurred, as proper procurement processes had not been followed.

### **Fruitless and wasteful expenditure**

11. As disclosed in note 33 to the financial statements, fruitless and wasteful expenditure to the amount of R7 636 540 was incurred.

### **Going concern**

12. The accounting officer's report on page XX to the financial statements indicates that a material uncertainty exists regarding the continuance of the Motheo District Municipality as a going concern due to the possible disestablishment of the district municipality and establishment of the Metropolitan Municipality.

### **Additional matters**

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

### **Unaudited supplementary schedules**

14. 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**

15. 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, DoRA, 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**

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

#### **Inadequate content of integrated development plan (IDP)**

16. Through inspection of the IDP it was noted that information on the assessment of the existing level of development and identification of communities that do not have access to basic municipal services was not included, in terms of section 26(b) of the MSA.
17. The IDP does not include the financial plan, which covers three years of budget projections, in terms of section 26(h) of the MSA.

#### **Lack of reporting on all predetermined objectives in the annual report**

18. Through inspection it was noted that the municipality does not have procedures or mechanisms in place for monitoring and reviewing of the performance management system, in terms of section 40 of the MSA.

#### **Reported information not consistent with planned objectives, indicators and targets**

19. The annual performance report did not meet all the criteria as set out in section 46(1) of the MSA, in respect of actual achievements against predetermined targets, consistency of the reported measurable objectives with the IDP or service delivery agreements, comparisons between performance in the current year with targets set for the current and previous financial years and measures taken to improve on performance.

#### **Usefulness of reported performance information**

20. 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 IDP, 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 and reported performance targets not specific, measurable or time bound**

21. For the selected two programmes, 45% of the planned and reported targets were not:
- specific in clearly identifying the nature and the required level of performance
  - measurable in identifying the required performance
  - time bound in specifying the time period or deadline for delivery.

### **Planned and reported indicators/measures not well defined**

22. For the selected two programmes, 47% of the planned and reported indicators/measures were not clear, with an unambiguous definition to allow for data to be collected consistently.

### **Planned and reported indicators/measures not verifiable**

23. For the selected two programmes, 40% of the planned and reported indicators/measures were not verifiable, as it was not possible to validate/adequately validate the processes and systems that produce the indicator.

## **Compliance with laws and regulations**

### **Municipal Finance Management Act**

#### **The audit committee was not properly established or not functioning properly**

24. Contrary to the requirements of section 166(1) of the MFMA, the Motheo District Municipality did not have an audit committee for the entire financial year as the audit committee was only established in March 2010.
25. Section 166(4)(b) of the MFMA requires the audit committee to meet at least four times a year, while the audit committee met only once during the current financial year.
26. The audit committee did not advise the municipal council, the political office-bearers, the accounting officer and management staff on matters relating to internal financial control and has also not tabled any reports and assessments to the council for their consideration in the current financial year, in terms of section 166(2)(a) of the MFMA.
27. From the available documentation it could not be determined whether two audit committee members had the appropriate experience as required by section 166(4)(a) of the MFMA.

#### **The internal audit unit was not properly established or not functioning properly**

28. Evidence could not be submitted that the internal audit unit advised the accounting officer and reported to the audit committee on the implementation of the internal audit plan and matters specified in section 165(2)(b) of the MFMA.

### **Transfer of funds and subsidies were not made in compliance with applicable legislation**

29. Contrary to section 67(3) of the MFMA the accounting officer did not ensure that, through contractual and other appropriate mechanisms, compliance was enforced with the requirements as set out in section 67(1) of the MFMA, when transfer payments were made to individuals or entities outside the sphere of government.
30. In instance where section 67(1) of the MFMA did not apply, no evidence was found to confirm that the accounting officer, in terms of section 67(4) of the MFMA has taken reasonable steps to ensure that the benefit as a result of the transfer of funds was received by the targeted beneficiaries and to certify to the Auditor-General that compliance is uneconomical or unreasonable.

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

31. The performance of contractors was not monitored on a monthly basis, in terms of section 116(2)(b) of the MFMA.
32. No action in terms of section 116(1)(b) of the MFMA was taken against service providers who failed to perform to the standard terms and conditions of the contract or agreement with the Motheo District Municipality.
33. Evidence to substantiate any deviation from the supply chain management requirements was not submitted in terms of paragraph 36 of the supply chain management policy of the district municipality.

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

34. Expenditure was made in vain and could have been avoided based on the fact that reasonability had been exercised, as set out in section 1 the definition of "fruitless and wasteful expenditure" of the MFMA.

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

35. Expenditure was not incurred in accordance with the requirements of the MFMA as set out in section 1 the definition of "irregular expenditure" paragraph (a) of the MFMA.

## **INTERNAL CONTROL**

36. 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, MSA, DoRA and the Municipal Planning and Performance Management Regulations, 2001, but not for the purpose of expressing an opinion on the effectiveness of internal control.
37. The matters reported below are limited to the significant deficiencies regarding the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

## **Leadership**

38. The accounting officer did not prioritise and take appropriate action to address the lack of discipline in the human resource, finance and supply chain management directorates, resulting in non-compliance with applicable legislation and inadequate budgetary control measures. This, in turn, resulted in irregular and fruitless and wasteful expenditure and furthermore the non-achievement of objectives as determined in the IDP.
39. The accounting officer does not exercise continuous oversight responsibility over reporting and compliance with laws and regulations and internal control in respect of transfer payments to individuals, resulting in fruitless and wasteful expenditure due to non-compliance by service providers.
40. The accounting officer does not evaluate on a continuous basis and in all instances whether senior management has implemented effective internal controls by gaining an understanding of how senior management has met its responsibilities.

## **Financial and performance management**

41. The financial statements were subjected to material corrections resulting from the audit process, which are attributable to weaknesses in the design and implementation of internal control in respect of financial management and financial reporting and weaknesses in the information systems of the municipality.
42. Other information to be included in the annual report is not reviewed for completeness and accuracy and was not submitted for audit purposes.
43. Requested information was not available and supplied without any significant delay.

## **Governance**

44. As no formal risk assessment was performed and approved for the 2009-10 financial year, management could not respond to assessed risks through determining a risk strategy and action plan to manage identified risks. Consequently, internal controls were not selected and developed to prevent, detect and correct material misstatements in financial reporting and reporting on predetermined objectives.

45. A fraud prevention plan was not finalised and used as per the requirements of applicable legislation. In this regard, internal audit did not fulfil its responsibilities as set out in legislation and in accordance with accepted best practice and standards.
46. The late establishment of the audit committee resulted in the committee not fulfilling its responsibilities, as set out in legislation and in accordance with accepted best practice.

Bloemfontein

30 November 2010



AUDITOR - GENERAL  
SOUTH AFRICA

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