

# **REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE FEZILE DABI DISTRICT MUNICIPALITY REPORT ON THE FINANCIAL STATEMENTS**

## **Introduction**

1. We have audited the financial statements of the Fezile Dabi District Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets and cash flow statement 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. Our responsibility is to express an opinion on the financial statements based on our audit. We 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 we 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 qualified audit opinion.

## **Basis for qualified opinion**

### **Unspent conditional grants**

6. I was unable to obtain sufficient appropriate audit evidence regarding unspent conditional grants as the municipality did not provide me with supporting documentation for the material adjustments made to the unspent conditional grant balance. I was unable to confirm the unspent conditional grants through alternative means. Consequently, I was unable to determine whether adjustments to the amount of the unspent conditional grants amounting to R8 570 457 (2013: R7 360 048) as disclosed in note 10 were

necessary. In addition, the municipality incorrectly claimed value added tax (VAT) input on grant expenditure incurred in contravention of section 54(2) of the VAT Act, 1991 (Act No. 89 of 1991), resulting in VAT receivable being overstated and unspent grants being overstated. I was unable to determine the full extent of the misstatement as it was impracticable to do so.

### **Trade and other payables**

7. I was unable to obtain sufficient appropriate audit evidence regarding retention creditors included in trade and other payables as the municipality did not provide me with supporting documentation to confirm the validity of the obligation created by retention creditors. I was unable to confirm the retention creditors by alternative means. Consequently, I was unable to determine whether any adjustments to the retention creditors amounting to R3 250 255 as disclosed in the note 9 of the financial statements were necessary. In addition, the municipality incorrectly accrued for invoices which had already been paid and or did not relate to the financial period under review. Consequently trade and other payables and expenditure is understated by R3 467 000, respectively. This has a resultant impact on the surplus for the period as well as the accumulated surplus.

### **Expenditure**

8. The municipality did not correctly classify expenditure as required by GRAP1 Presentation of Financial statements. Expenditure transactions were incorrectly recorded in the financial system of the municipality due to inadequate monitoring and reviewing controls over processing of expenditure transactions. Consequently, various line items included in note 25 to the financial statements are misstated in the current financial year. I was not able to determine the full extent of the misstatements within general expenses as it was impracticable to do so.

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

9. The financial statements were materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements making up the statement of financial performance and statement of change in net assets as the revaluation reserve amounting to R15 652 321 was overstated by R1 252 997. This has a resultant impact on the surplus for the period as well as the accumulated surplus.

### **Qualified opinion**

10. In my opinion, except for the possible effects of the matter described in the basis for qualified opinion paragraph, the financial statements present fairly, in all material respects, the financial position of the Fezile Dabi District Municipality as at 30 June 2014 and their 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**

11. We draw attention to the matters below. Our opinion is not modified in respect of this matters.

### **Restatement of corresponding figures**

12. As disclosed in note 29 to the financial statements, the corresponding figures for the 30 June 2013 have been restated as a result of reversing the retention creditors on completed project and correcting the depreciation on building which was incorrectly

processed.

### **Irregular expenditure**

13. As disclosed in note 35 to the financial statements, the department incurred irregular expenditure of R 4 432 849 during the year under review due to non-compliance with SCM regulations. In addition, the full extent of the irregular expenditure is still in the process of being determined.

### **Additional matters**

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

### **Unaudited disclosure notes**

15. 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**

16. 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 programmes 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**

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

- KPA2 Service delivery and infrastructural development on pages x to x
- KPA3 Local Economic Development (LED) on pages x to x
- KPA 4 Municipal Financial and Viability and Management on pages x to x

18. I evaluated the reported performance information against the overall criteria of usefulness and reliability.

19. 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 priorities. 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).

20. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

21. The material findings in respect of the selected development priorities are as follows:

## **KPA2 – Service delivery and infrastructural development**

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

22. The FMPPI requires that the performance targets must be specific in clearly identifying the nature and required level of performance. A total of 45% of the targets were not specific as the targets were not measurable. This was because management did not adhere to the requirements of the FMPPI and a lack of proper systems and processes and technical indicator descriptions.

## **KPA 4 – Municipal Financial and Viability and Management**

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

23. The FMPPI requires that the performance targets must be specific in clearly identifying the nature and required level of performance. A total of 27% of the targets were not specific as the deadline for delivery is not specified. This was because management did not adhere to the requirements of the FMPPI and a lack of proper systems and processes and technical indicator descriptions.

### **Additional matter**

24. I draw attention to the following matter:

### **Achievement of planned targets**

25. Refer to the annual performance report on page(s) x to x and x to x for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness of the reported performance information for the selected programmes reported in paragraphs 23 to 25 of this report.

### **Compliance with laws and regulations**

26. 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:

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

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

### **Procurement and contract management**

28. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).

### **Liability management**

29. An effective system of internal control for liabilities was not in place, as required by section 63(2)(c) of the MFMA.

### **Internal control**

30. I considered internal control relevant to my audit of the financial statements, the 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 basis for the qualified opinion, the findings on the performance report and the findings on compliance with laws and regulations included in this report.

### **Leadership**

31. The leadership did not always take timely and adequate action to address weaknesses in the finance directorate as material adjustments were again made to the financial statements, which resulted in non-compliance with applicable legislation. Management failed to properly analyse the control weaknesses and implement appropriate follow-up actions that adequately addressed the root causes previously reported.

### **Financial and performance management**

32. Management did not fully implement controls in respect of the daily financial activities and ensure that all transactions are correctly recorded in the records of the municipality. Management also did not ensure that adequate controls were in place to detect and correct all errors in the financial records. Proper record keeping was not implemented in a timely manner to ensure that complete, relevant and accurate information is accessible and available to support financial reporting.
33. Effective performance systems, processes and procedures as well as the management thereof had not been adequately implemented as findings on the usefulness of performance information were identified due to lack of monitoring and review of reported performance information.
34. Management also did not establish effective monitoring and evaluation components or processes both within its finance and strategic planning directorates to regularly review and monitor management's compliance with laws, regulations and internally designed policies and procedures due to lack of skills within the municipality. As a result, significant non-compliance issues were noted that could have been prevented.

Bloemfontein

20 January 2015



**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*