

REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF LETSEMENG LOCAL MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2009

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Letsemeng Local Municipality which comprise the statement of financial position as at 30 June 2009, 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 notes, as set out on pages [xx] to [xx].

The 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 the Statements of Generally Recognised Accounting Practices (Statements of GRAP) and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and for such internal control as the accounting officer determines is necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

The Auditor-General's responsibility

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) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on conducting the 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 described 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.
4. Paragraph 11 *et seq.* of the Statement of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is not effective for this financial year, I have determined that my audit of any disclosures made by the municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.

Property, plant and equipment

5. As a result of the audit findings detailed below, I was unable to obtain sufficient appropriate audit evidence to conclude on the existence, completeness and valuation of and rights to property, plant and equipment with a carrying value of R134 947 060 (2008: R123 707 966) presented in the statement of financial position and disclosed in note 4 to the financial statements. My audit report on the financial statements for the year ended 30 June 2008, dated 27 March 2009 was modified accordingly.
 - (a) Contrary to the Standard of Generally Accepted Municipal Accounting Practice, *GRAP 17: Property, Plant and Equipment* which states that the economic benefits or service potential

of R3 781 526 in respect of property, plant and equipment under construction, as included in note 4 to the financial statements. Since the municipality's accounting records did not permit the application of reasonable alternative audit procedures, I was unable to obtain all the information and explanations I considered necessary to gain adequate audit assurance as to the valuation and existence of property, plant and equipment.

- (g) According to *GRAP 03: Accounting policies, changes in accounting estimates and errors*, an entity shall disclose the nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in future periods, except for the disclosure of the effect on future periods when it is impracticable to estimate that effect. It was noted that the useful lives of property, plant and equipment were revised, which implies a change in accounting estimate. The nature and amount of the change in accounting estimate were not included in the financial statements. Further, supporting documentation regarding the reasons for change in useful lives of property, plant and equipment could not be obtained. Although Directive 4 of the Accounting Standards Board granted the municipality a three-year period to comply with the measurement of property, plant and equipment, it states that if depreciation is applied the municipality should consider all the related elements of the depreciation calculation.
- (h) The municipality was unable to supply sufficient and appropriate audit evidence relating to additions to property, plant and equipment to an amount of R6 647 543. Therefore the valuation and existence of and rights to property, plant and equipment could not be confirmed. Since the municipality's accounting records did not permit the application of reasonable alternative audit procedures, I was unable to obtain all the information and explanations I considered necessary to confirm the valuation and existence of and rights to additions to property, plant and equipment as disclosed in the statement of financial position.
- (i) The management of the Letsemeng Local Municipality did not provide me with sufficient appropriate audit evidence in respect of journals to a debit amount of R870 184 and a credit amount of R1 044 300 recorded under property, plant and equipment. Since the municipality's accounting records did not permit the application of reasonable alternative audit procedures, I was unable to obtain all the information and explanations I considered necessary to confirm the valuation and existence of property, plant and equipment as disclosed in the statement of financial position.
- (j) As a result of the audit finding detailed in paragraph 9 of this report, the existence, completeness and valuation of property plant and equipment could not be confirmed due to a lack of supporting documentation for debit journals totalling R1 517 815 and credit journals totalling R1 185 441.

Irregular expenditure

- 6. The municipality did not disclose the following irregular expenditure totalling R812 093 (2008: R11 131 808), as required by section 125(2)(d) of the MFMA. My audit report on the financial statements for the year ended 30 June 2008, dated 27 March 2009, was modified accordingly.
 - (a) Expenditure totalling R32 994 (2008: R5 471 105) was incurred in contravention of the municipality's *Supply Chain Management Policy* and chapter 11 of the MFMA. Consequently, this expenditure is considered to be irregular expenditure as defined in section 1 of the MFMA.

Prior period errors

9. Due to material weaknesses in the financial accounting and management processes, the municipality was unable to provide me with sufficient appropriate audit evidence in respect of journal entries passed to various accounts to correct prior period errors as included in note 24 to the financial statements. In the absence of appropriate supporting documentation, I was unable to determine whether all the adjustments that might have been necessary regarding prior period errors were indeed processed. These corrections of prior year errors were not made retrospectively nor did the financial statements include appropriate disclosures in this regard, as required by GRAP 3: *Accounting Policies, Changes in Accounting Estimates and Errors*. Further, various journals were passed in the year ended 30 June 2007 and 2008 to effect the conversion from IMFO and to correct prior period errors which could still not be supported by sufficient appropriate audit evidence. Since the municipality's accounting records did not permit the application of reasonable alternative audit procedures, I was unable to obtain all the information and explanations I considered necessary to gain reasonable assurance that the financial position of Letsemeng Local Municipality as at 30 June 2008 was fairly presented in the accompanying financial statements. Due to the lack of supporting documentation, I was unable to quantify the extent to which the corresponding figures are misstated.

Accumulated surplus

10. As a result of the audit findings detailed below, I was unable to obtain sufficient appropriate audit evidence regarding the existence and valuation of the accumulated surplus amounting to R37 664 784 (2008: R 38 454 893) as presented in the statement of changes in net assets. My audit report on the financial statements for the year ended 30 June 2008, dated 27 March 2009, was modified accordingly.
- (a) The management of the Letsemeng Local Municipality did not provide me with sufficient appropriate audit evidence in respect of journals to a debit amount of R2 500 245 and a credit amount of R1 119 647 recorded in the accumulated surplus account with regard to depreciation corrections. Since the municipality's accounting records did not permit the application of reasonable alternative audit procedures, I was unable to obtain all the information and explanations I considered necessary to gain adequate audit assurance as to the valuation and existence of accumulated surplus.
- (b) As a result of the audit finding detailed in paragraph 9 above sufficient appropriate audit evidence could not be obtained in respect of journals to a debit amount of R3 640 489 and a credit amount of R1 525 170 recorded in the accumulated surplus account as included in note 24.6: prior period errors to the financial statements. Since the municipality's accounting records did not permit the application of reasonable alternative audit procedures, I was unable to obtain all the information and explanations I considered necessary to gain adequate audit assurance as to the valuation and existence of the corresponding balance of accumulated surplus.
- (c) Sufficient appropriate audit evidence could not be obtained in respect of journals to a debit amount of R982 388 and a credit amount of R7 718 recorded in the accumulated surplus account. Since the municipality's accounting records did not permit the application of reasonable alternative audit procedures, I was unable to obtain all the information and explanations I considered necessary to gain adequate audit assurance as to the valuation and existence of accumulated surplus.

had not yet been used. Therefore, I was unable to determine whether revenue from prepaid electricity is materially overstated and payments received in advance are materially understated. Further, the management of the Letsemeng Local Municipality did not provide me with sufficient appropriate audit evidence in respect of revenue from prepaid electricity totaling R4 574 759. Since the municipality's accounting records did not permit the application of reasonable alternative audit procedures, I was unable to obtain all the information and explanations I considered necessary to confirm the accuracy, cut-off and occurrence of the revenue.

17. The management of the Letsemeng Local Municipality did not provide me with sufficient appropriate audit evidence to substantiate a journal to the value of R1 583 626 recorded in the interest received account during the year ended 30 June 2009. Since the municipality's accounting records did not permit the application of reasonable alternative audit procedures, I was therefore unable to confirm the occurrence and accuracy of this transaction.
18. The management of the Letsemeng Local Municipality did not provide me with sufficient appropriate audit evidence to confirm the accuracy, occurrence and completeness of revenue from electricity readings to an amount of R7 171 000, as disclosed in note 15 of the financial statements. The municipality's accounting records did not permit the application of reasonable alternative audit procedures.
19. The management of the Letsemeng Local Municipality did not provide me with sufficient appropriate audit evidence to confirm the accuracy, completeness and occurrence of revenue from water readings to an amount of R2 747 649, as disclosed in note 15 of the financial statements. The municipality's accounting records did not permit the application of reasonable alternative audit procedures.

Unspent conditional grants and receipts

20. As a result of the audit finding detailed below and in paragraph 13 of this report, I was unable to confirm the existence and valuation of and rights and obligations relating to unspent conditional grants and receipts to the sum of R5 791 977 (2008: R4 386 399) as disclosed in note 9 to the financial statements. The municipality's accounting records did not permit the application of reasonable alternative audit procedures.
21. The management of the Letsemeng Local Municipality did not provide me with sufficient appropriate audit evidence in respect of journals to a debit amount of R5 771 290 and a credit amount of R17 150 939 recorded in the unspent conditional grants and receipts account. Since the municipality's accounting records did not permit the application of reasonable alternative audit procedures, I was unable to obtain all the information and explanations I considered necessary to gain adequate audit assurance as to the valuation and existence of unspent conditional grants and receipts account. My audit report on the financial statements for the year ended 30 June 2008, dated 27 March 2009, was modified accordingly.

Government grant reserve

22. As detailed in paragraph 5(c) of this report, owing to deficiencies in the fixed asset register I was unable to perform all the audit procedures that I considered necessary to confirm the existence, valuation and completeness of property, plant and equipment or to substantiate the ownership thereof. Since the government grant reserve is calculated based on the fixed asset register and the source of funding indicated in the register, I was unable to obtain sufficient appropriate audit evidence to conclude on the existence, completeness and valuation of the government grant reserve to the sum of R62 744 179 (2008:

Expenditure

27. The management of Letsemeng could still not provide me with sufficient appropriate audit evidence in respect of bulk purchases of electricity and water for the year ended 30 June 2008. Due to the extent of the weaknesses identified in the system of control over bulk purchases and the lack of supporting documentation, there were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance as to the accuracy, completeness and occurrence of the corresponding figure for bulk purchases to the sum of R4 047 583, as disclosed in note 21 to the financial statements.
28. Contrary to the requirements of the Statement of Generally Recognised Accounting Practice, GRAP 1: *Presentation of Financial Statements*, the accrual basis of accounting was not consistently applied by the municipality for the year ended 30 June 2008. Telephone and electricity expenditure was only recognised for the period until 25 May 2008. Bulk electricity purchases of at least R494 248 were not recognised. The corresponding figure for bulk purchases of electricity, as disclosed in note 21 to the financial statements, is understated by R494 248 and the corresponding figure for payables, as disclosed in note 7 to the financial statements, is understated by the same amount. Due to the lack of supporting documentation I was unable to quantify the extent to which telephone expenditure, as disclosed in note 29, and the corresponding figure for payables, as disclosed in note 7 to the financial statements, are misstated. The municipality's system of control over expenditure did not permit the application of reasonable alternative audit procedures.
29. The management of the Letsemeng Local Municipality did not provide me with sufficient appropriate audit evidence to confirm the accuracy and occurrence of expenditure transactions amounting to R1 809 788 (2008: R608 362). I could also not obtain sufficient appropriate audit evidence in respect of journals amounting to R809 064 recorded in the expenditure account for the year ended 30 June 2008. The system of control over the recording and classification of expenditure was not adequate and as a result there were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all these expense journals and transactions had occurred and were accurately recorded and classified in the financial records of the municipality.
30. As a result of the audit finding detailed in paragraph 34 of this report, I was unable to confirm the occurrence and completeness of expenditure for the year ended 30 June 2008 in respect of corresponding payables. The municipality's accounting records did not permit the application of reasonable alternative audit procedures.
31. Contrary to the Statement of Generally Recognised Accounting Practice, GRAP1: *Presentation of Financial Statements*, which defines expenses as a decrease in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets, or increases in liabilities that result in a decrease in net assets, the municipality recognised inter-departmental charges of R7 974 806 for the year ended 30 June 2008. These charges do not represent an outflow or consumption of assets or increase in liability, therefore resulting in an overstatement of operating expenditure as disclosed in note 29, and other income as disclosed in note 17 to the financial statements for the year ended 30 June 2008.

37. My audit report on the financial statements for the year ended 30 June 2008, dated 27 March 2009, was modified accordingly.

Receivables

38. An estimate in respect of electricity and water consumption for the period between the last meter-reading date and the year-end has been incorrectly classified and included in other receivables for the year ended 30 June 2008 in note 2 to the financial statements. Had the receivable been correctly classified, consumer receivables for the year ended 30 June 2008 as disclosed in note 1 to the financial statements would have been increased by R325 049, whilst other receivables as at 30 June 2008 would have decreased by the same amounts.
39. I could not obtain evidence that consumer and other receivables had been impaired and subsequently measured at amortised cost using the effective interest method in accordance with the requirements of the South African Statement of Generally Accepted Accounting Practice, IAS 39: *Financial Instruments: Recognition and Measurement*. The municipality only made a general provision for doubtful receivables. As the relevant information was not available I was unable to determine what the impairment charge should have been had IAS 39 been applied correctly. My audit report on the financial statements for the year ended 30 June 2008, dated 27 March 2009, was modified accordingly.
40. As a result of the audit finding detailed in paragraph 9 above sufficient appropriate audit evidence could not be obtained in respect of journals to a debit amount of R38 314 and a credit amount of R1 310 786 recorded in the receivables account as included in note 24: prior period errors. Since the municipality's accounting records did not permit the application of reasonable alternative audit procedures, I was unable to obtain all the information and explanations I considered necessary to gain adequate audit assurance as to the valuation and existence of the corresponding balance of receivables.
41. Based on a recalculation of the provision for bad debt, as included in note 1 to the financial statements, the utilisation of the equitable share for free basic services, totalling R6 903 031, was incorrectly written off against the provision for bad debt as disclosed in note 1 to the financial statements. Consequently, the provision for bad debt in note 1 of the financial statements is understated by R6 903 031 and expenditure for free basic services is understated in the statement of financial performance by the same amount. Consumer receivables, as disclosed in the statement of financial position, is overstated by R6 903 031.
42. I was unable to confirm the existence of consumer receivables, totalling R12 632 037, as disclosed in note 1 to the financial statements due to the fact that no subsequent payments were made. As alternative procedures debtors confirmations could also not be obtained as well as service contracts.

Consumer deposits

43. I was unable to confirm the completeness and valuation of consumer deposits to the sum of R422 281 for the year ended 30 June 2008 presented in the statement of financial position and disclosed in note 6 to the financial statements. This was due to the fact that the municipality did not maintain a register of consumer deposits and perform reconciliations between the consumer deposit control account and the individual debtor accounts. The municipality's accounting records did not permit the application of reasonable alternative audit procedures.

Other matters

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Unaudited supplementary schedules

50. The supplementary information set out on pages 45 to 51 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.

Non-compliance with applicable legislation

Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA)

51. The management of the Letsemeng Local Municipality did not maintain full and proper records in accordance with section 62(1)(b) of the MFMA and did not always submit information, returns, documents, explanations and motivations as required by the Auditor-General in accordance with section 74(1) of the said act.
52. No evidence could be obtained that the mayor had tabled the 2008-09 budget and that the council considered the budget within the time frames as required by section 27(4) of the MFMA.
53. Section 65(2)(e) of the MFMA requires that all money owing by the municipality be paid within 30 days of receiving the relevant invoice or statement. Contrary to this, various incidents were identified where outstanding accounts were not paid within the prescribed time frame.
54. In terms of section 131 of the MFMA, a municipality must address any issues raised by the Auditor-General in an audit report. The mayor of a municipality must ensure compliance by the municipality. Various matters noted in my audit report on the financial statements for the year ended 30 June 2008, dated 27 March 2009, have not yet been resolved by management. As a result, the mayor and management of the Letsemeng Local Municipality did not fulfill their responsibility in terms of section 131 of the MFMA.
55. Quarterly reports were not submitted by the mayor to the council within the time frame as required by section 52(d) of the MFMA.
56. Section 127 of the MFMA requires that the mayor of a municipality must, within seven months after the end of a financial year, table in the municipal council the annual report of the municipality. Contrary to this, evidence could not be obtained that the municipality complied with section 127.

Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA)

57. According to section 11(3)(a) of the MSA, regulations, plans and policies should be established, approved and implemented by the municipality which should govern the different processes and activities of the municipality. Notwithstanding this requirement, it was noted that the municipality has not established or implemented formally documented and approved policy frameworks for the financial transactions and events related to several important business processes.

32-33	Payables			3	1	
34-37	Receivables	7				
38	Consumer deposits			4		3
39	Financial instruments	7		4		
40	Post employee benefits					3
41	Events after the reporting date			6		1

Overall reflections on the governance framework based on internal control deficiencies

62. Deficiencies in the filing system and a lack of controls over the administration of supporting documentation resulted in delays in supplying documentation as well as the unavailability of documentation. This internal control deficiency is attributed to a shortage of skilled and committed staff members within the municipality.
63. Financial officials have a lack of knowledge regarding the requirements of the GRAP reporting framework.
64. The previous chief financial officer resigned in September 2008 and the current chief financial officer has been serving in an acting capacity since May 2009. The instability of the chief financial officer position resulted in insufficient direction being provided to the municipality with regard to financial reporting requirements.
65. Inadequate leadership oversight in order to establish direction with regard to financial reporting requirements.
66. Due to lack of revision of the organisational structure, capacity constraints have not been addressed.
67. Staff do not have a clear understanding of the accounting framework for assets and the consultants failed to transfer the necessary skills and competencies to the asset management unit in a timely manner.
68. Insufficient control activities, monitoring and supervision of key accounting processes throughout the period under review.
69. Lack of action plans implemented to address audit qualifications reported in the prior periods.
70. Control measures were not implemented to assess, monitor and mitigate non-compliance with applicable legislation which resulted in irregular expenditure.
71. Lack of proper documentation and disclosure notes with regard to balances as disclosed in the financial statements. Although the financial reporting systems maintained by the municipality do support accrual accounting, staff are not trained in order to utilise it. Most of the disclosure notes are not system generated and are only prepared at year-end, which has an impact on the reliability of financial information.

Legend	
CE = Control environment	
The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.	1
Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.	2
Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.	3

No.	Matter	Y	N
4.	The annual financial statements were submitted for auditing as per the legislated deadlines in section 126 of the MFMA.	X	
Availability of key officials during audit			
5.	Key officials were available throughout the audit process.		X
Development of and compliance with risk management, effective internal control and governance practices			
6.	Audit committee		
	<ul style="list-style-type: none"> The municipality had an audit committee in operation throughout the financial year. 		X
	<ul style="list-style-type: none"> The audit committee operates in accordance with approved, written terms of reference. 		X
	<ul style="list-style-type: none"> The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA. 		X
7.	Internal audit		
	<ul style="list-style-type: none"> The municipality had an internal audit function in operation throughout the financial year. 		X
	<ul style="list-style-type: none"> The internal audit function operates in terms of an approved internal audit plan. 		X
	<ul style="list-style-type: none"> The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA. 		X
8.	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.		X
9.	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.		X
10.	The information systems were appropriate to facilitate the preparation of the financial statements.		X
11.	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 62(1)(c)(i) of the MFMA.		X
12.	Powers and duties have been assigned as set out in section 79 of the MFMA.		X
Follow-up of audit findings			
13.	The prior year audit findings have been substantially addressed.		X
14.	SCOPA resolutions have been substantially implemented.		X
Issues relating to the reporting of performance information			
15.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.		X
16.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.		X
17.	A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the Letsemeng Local Municipality against its mandate, predetermined objectives, outputs, indicators and targets as per section 68 of the MFMA.	X	
18.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.		X

85. Lack of prioritising risk management and internal control design and implementation as well as a lack of delegation due to inadequate leadership oversight.

Follow-up of audit findings

86. Lack of action plans implemented in order to address audit qualifications reported in the prior periods due to inadequate leadership oversight.
87. Lack of action plans implemented in order to address SCOPA resolutions reported in the prior periods due to inadequate leadership oversight.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

88. I have reviewed the performance information as set out on pages xx to xx.

The accounting officer's responsibility for the performance information

89. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include an annual performance report prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

The Auditor-General's responsibility

90. 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.
91. 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.
92. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the findings reported below.

Findings on performance information

Non-compliance with regulatory requirements

Lack of effective, efficient and transparent systems and internal controls regarding performance management

Inadequate management oversight and lack of implemented policy and procedures to guide the effective oversight, monitoring and review of performance information resulted in the following findings:

Existence and functioning of a performance audit committee

105. I could not obtain evidence that the municipality had a performance audit committee in operation during the financial year, nor was another audit committee utilised as the performance audit committee, due to inadequate leadership and lack of implemented policy and procedures to guide the effective oversight, monitoring and review of performance information.

Performance information not received in time

106. I was not able to complete an evaluation of the quality of the reported performance information, as set out on pages xx to xx of the annual report, since the information was not received in time due to lack of prioritising the reporting of performance information, the lack of management oversight as well as lack of an effective performance management system.

APPRECIATION

107. The assistance rendered by the staff of the Letsemeng Local Municipality during the audit is sincerely appreciated.

Auditor-General
Bloemfontein

30 November 2009



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence