

# REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND THE COUNCIL ON THE LETSEMENG LOCAL MUNICIPALITY

## 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 2011, 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, and the accounting officers report 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 the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and Division of Revenue Act of South Africa 2010 (Act No. 1 of 2010) (DoRA) and for such internal control as management determines 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. As required by section 188 of the Constitution of South Africa, 1996 and section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*. Because of the matters described in the basis for disclaimer of opinion paragraphs, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion

### Basis for Disclaimer of opinion

#### Property, plant and equipment

4. Property, plant and equipment, including both infrastructure and movable assets, could not be physically verified due to the fact that the asset register did not contain adequate descriptions, serial numbers, locations and conditions of property, plant and equipment to physically confirm the existence and completeness of the assets. The municipality's accounting records did not permit the application of reasonable alternative audit procedures as monthly reconciliations were not performed between the fixed asset register and general ledger, and an asset count was also not performed at year-end. I was therefore unable to obtain sufficient appropriate audit evidence to confirm the existence and completeness, valuation of, and rights to, property, plant and equipment with a carrying value of R160 792 644 (2010: R151 524 775) presented in the statement of financial position and disclosed in note 3 to the financial statements.
5. Several transactions totalling R575 794 were incorrectly classified as repairs and maintenance and should have been classified as fixed assets. Property, plant and equipment is therefore understated while expenses are overstated with this amount.

#### Finance lease assets

6. Sufficient appropriate audit evidence could not be provided to confirm the fair value of the finance leased assets. I was unable to confirm if the assets were valued at the lower of the fair value and present value of the minimum lease payments as required by paragraph 34 of GRAP 13, *Leases*. As a result of the limitation the valuation of finance lease assets with a cost price of R2 335 821, accumulated depreciation of the

leased assets amounting to R727 129 and the corresponding capitalised lease liability disclosed under long term liabilities amounting to R1 847 136 could also not be confirmed. Furthermore, due to this limitation I was unable to confirm the accuracy of the interest paid on finance leases as recorded in the general ledger amounting to R274 707. The municipality's accounting records did not permit the application of reasonable alternative audit procedures.

### **Inventory**

7. As a result of the audit findings detailed below and that the municipality's accounting records did not permit the application of reasonable alternative audit procedures, I was unable to obtain sufficient appropriate audit evidence to confirm the existence, valuation and completeness of inventory with a carrying value of R1 895 466 presented in the statement of financial position and disclosed in note 8 to the financial statements.
  - (a) Supporting documentation used for the determination of the fair value (net realisable value) of inventory items totalling R40 758 was not presented for audit purposes.
  - (b) Several purchase invoices for items on the inventory listing totalling R676 564 were requested for audit purposes but were not presented for audit purposes.
  - (c) A detailed stock listing was not available and the municipal stores were not organised in an appropriate manner to facilitate an accurate count.
  - (d) Several items of inventory were counted on a test count basis and differences were identified between the manual inventory listing at year-end and the counted stock. Supporting documentation to reconcile these differences totalling R1 085 462 were requested but were not submitted.
  - (e) Based on the schedule obtained from the municipality, water inventory was only valued in some of the water reservoirs held by the municipality as some of the water reservoirs could not be accurately measured as at 30 June 2011. The water in the municipal pipes infrastructure was also not valued or accounted for in the annual financial statements.

### **Accounts payable**

8. The supplier statements for the creditors totalling R2 062 620 could not be obtained and as a result the completeness of the creditor balances at year-end could not be confirmed. The municipality's accounting records did not permit the application of reasonable alternative audit procedures. Consequently, I was unable to obtain sufficient appropriate audit evidence to confirm the completeness of accounts payable of R5 108 832 (2010: R23 975 102) presented in the statement of financial position and disclosed in note 20 to the financial statements.

### **Revenue**

9. Certain water and electricity meter readings did not agree with the consumption captured on the system. Differences were noted between the debtor account statements and the recalculations performed for water and electricity, that resulting in an understatement of revenue from service charges and consumer receivables by R3 352 590. During the financial year services for refuse and sewerage charged were not amended on the system as the debtor type changed from residential to business, while the services charged on the accounting system were still charged for residential. This resulted in an understatement of revenue from services and accounts receivable totalling R232 862.
10. Estimates were made in 2009-10 financial year on a recurring basis and no actual consumption data was available for certain water meter readings. Management could still not provide sufficient appropriate audit evidence to confirm the completeness and accuracy of the water service charges of the prior year amounting to R1 591 635 as included in note 23 to the financial statements. Since the municipality's accounting

records did not permit the application of reasonable alternative audit procedures, I was unable to confirm the completeness and accuracy of these water service charges for the prior year.

### **Employee costs**

11. I could still not confirm that journals that increased employee-related costs of the previous financial year by R3 072 383 should have been processed or were recorded in the correct accounts and at the correct amounts, as they were still not supported by appropriate supporting documentation. Since the municipality's accounting records did not permit the application of reasonable alternative audit procedures, I was unable to confirm the completeness and accuracy of the employee-related costs for the prior year as included in note 31 to the financial statements.

### **Operating expenditure**

12. Management did not provide sufficient appropriate audit evidence to confirm the accuracy and occurrence of expenditure transactions of the previous financial year amounting to R5 678 054. Since the municipality's accounting records did not permit the application of reasonable alternative audit procedures, I was unable to obtain reasonable assurance that all these expense transactions of the prior year were accurately recorded and classified in the financial records of the municipality as disclosed in the statement of financial performance.

### **Disclosure**

13. The disclosure of prior period errors was not disclosed as required by paragraph 49 of GRAP 3, *Accounting policies, changes in accounting estimates and errors*. The following detail should have been disclosed:
  - (a) The nature of the prior period error
  - (b) For each prior period presented the amount of the correction for each financial statement line item affected
  - (c) The amount of the correction at the beginning of the earliest prior period presented.

### **Disclaimer of opinion**

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

### **Emphasis of matters**

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

### **Irregular expenditure**

16. As disclosed in note 49 to the financial statements, the municipality incurred irregular expenditure of R23 306 433 as proper procurement processes had not been followed.

### **Unauthorised expenditure**

17. As disclosed in note 47 to the financial statements, the municipality incurred unauthorised expenditure of R4 877 820 as the actual expenditure incurred exceeded the budget vote.

### **Financial sustainability**

18. As disclosed in note 45 to the financial statements, the municipality is experiencing serious difficulties with regard to debt collection. The municipality also did not settle its debt within 30 days as required by the MFMA and is significantly dependent on the

national and provincial governments for its continued sustainability. These conditions, along with other matters, point to the existence of a material uncertainty that may cast significant doubt on the municipality's ability to continue as a going concern. The municipality may therefore be unable to realise its assets and discharge its liabilities in the normal course of business.

#### **Additional matters**

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 annexures and, accordingly, I do not express an opinion thereon.

### **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

21. In accordance with the PAA and in terms of *General notice 1111 of 2010*, issued in *Government Gazette 33872 of 15 December 2010*, I include below my findings on the annual performance report as set out on pages XX to XX and material non-compliance with laws and regulations applicable to the municipality.

#### **Report on predetermined objectives**

##### **Presentation of information**

22. The reported performance against predetermined objectives was deficient in respect of the following criterion:
- Performance against predetermined objectives was not reported using the National Treasury guidelines.
23. The following audit findings relate to the above criterion:

##### **Reasons for major variances between planned and actual reported targets were not provided in the report on predetermined objectives**

- Adequate explanations for major variances between the planned and the actual reported targets for objectives were not provided, as required in terms of the relevant reporting guidance. In total, all of the reported targets with major variances were not explained.
- Measures taken to improve performance were not provided in the performance report, as required in section 46(1)(c) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA). In total, 100% of the reported targets where improvement is required were not explained.

##### **Usefulness of information**

24. The reported performance information was deficient in respect of the following criterion:
- Consistency: The reported objectives, indicators and targets are not consistent with the approved service delivery budget implementation plan.
25. The following audit finding relates to the above criterion:

##### **Reported indicators and targets are not consistent when compared with the planned indicators and targets**

- The actual achievements with regard to 39% of all planned indicators and targets specified in the service delivery budget implementation plan for the year under

review were not included in the annual performance report.

### **Reliability of information**

26. The reported performance information was deficient in respect of the following criteria:

- Validity: The reported performance did not occur and does not pertain to the entity.
- Accuracy: The amounts, numbers and other data relating to reported actual performance have not been recorded and reported appropriately.
- Completeness: All actual results and events that should have been recorded have not been included in the reported performance information.

27. The following audit finding relates to the above criteria:

#### **The validity, accuracy and completeness of reported performance against indicators and targets could not be confirmed as no supporting source information was provided**

- For the selected objectives the validity, accuracy and completeness of 100% of the reported targets selected could not be established as sufficient appropriate audit evidence was not provided.

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

#### **Strategic planning and performance management**

28. The municipality did not adopt a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players as required by sections 38, 39, 40 and 41 of the MSA and Municipal Planning and Performance Management Regulations 7 and 8.

29. The accounting officer of the municipality could not submit any evidence that the results of the assessment on the performance of the municipality during the first half of the financial year were submitted to the National Treasury and the provincial treasury, as required by section 72(1)(b) of the MFMA.

#### **Budgets**

30. The municipality incurred expenditure in excess of the limits of the amounts provided for in the votes in the approved budget, in contravention of section 15 of the MFMA.

31. The annual budget of the municipality is not based on the development priorities and objectives as well as the performance targets set by the municipality in its IDP as required by regulation 6 of the Municipal Planning and Performance Management Regulations, 2001.

#### **Annual financial statements**

32. 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 capital assets, current assets, liabilities, revenue, expenditure and disclosure items identified by the auditors were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.

33. The annual performance report did not contain a comparison of the performance of the municipality of each external service provider with development priorities, objectives and performance indicators set out in its integrated development plan, as required by section 46 of the MSA.

### **Audit committees**

34. The municipality did not have an audit committee in operation for a significant part of the financial year and as a result the audit committee did not substantially fulfil its responsibilities for the year, as required by section 166(1) of the MFMA.
35. The performance audit committee or another committee functioning as the performance audit committee did not perform the following, as required by Municipal Planning and Performance Management Regulation 14:
  - Meet at least twice during the financial year
  - Review the quarterly reports of the internal auditors on their audits of the performance measurements of the municipality
  - Review the municipality's performance management system and make recommendations in this regard to the council of the municipality
  - Submit an auditor's report to the council regarding the performance management system at least twice during the financial year.

#### **Internal audit**

36. The internal audit unit did not substantially fulfil its responsibilities and did not function as required by section 165(2) of the MFMA for the financial year as the internal auditor due to following:
  - The internal audit reports have not been submitted to the audit committee for its review during the current financial year. The audit committee only approved two of the reports relating to quarter 1 of 2010-11 at the audit committee meeting held on 1 July 2011.
  - The internal audit unit did not report to the audit committee on the municipality's internal audit, internal controls, accounting procedures and practices and compliance with the MFMA and other applicable legislation.
37. The internal auditors of the municipality did not audit the performance measurements on a continuous basis and no evidence could be obtained that quarterly reports for the 2010-11 financial year were submitted to the municipal manager and the performance audit committee, as required by Municipal Planning and Performance Management Regulation 14.

#### **Procurement and contract management**

38. Bids were not always evaluated by bid evaluation committees, which consisted of at least one SCM practitioner of the municipality, as per the requirements of SCM regulation 28(2).
39. Final awards and/or recommendation of awards to the accounting officer were not always made by an adjudication committee, which consisted of at least four senior managers of the municipality and did not include the chief financial officer, as per the requirements SCM regulation 29(2).
40. The preference point system was not applied in all procurement of goods and services above R30 000, as required by section 2(a) of the Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000) and SCM regulation 28(1)(a).
41. For payments between R10 000 and R30 000, none of the winning suppliers indicated whether they were in service of the state in the previous 12 months or provided rates clearance certificates, as required by chapter 3, part 2 paragraph 2.3.1 of the supply chain management (SCM) policy.
42. Goods and services with a transaction value between R10 000 and R200 000 were procured without obtaining written price quotations from at least three different prospective providers, as per the requirements of SCM regulation 17(a) and (c).
43. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as per the requirements of SCM regulations 19(a) and 36(1).

44. Awards were made to providers whose tax matters had not been declared by the South African Revenue Services to be in order, as required by SCM regulation 43.
45. Construction contracts were awarded to contractors that did not qualify for the contract in accordance with the prescripts of the Construction Industry Development Board.
46. A list of accredited prospective providers was not in place for procuring goods and services through quotations, as required by SCM regulation 14(1)(a).

#### **Expenditure management**

47. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
48. The accounting officer did not take reasonable steps to prevent unauthorised and irregular expenditure, as required by section 62(1)(d) of the MFMA.
49. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which accounted for creditors of the municipality, as required by section 65(2)(b) of the MFMA.
50. The accounting officer did not always report to the South African Police Service the cases of alleged irregular expenditure that constituted theft and fraud, as required by section 32(6) of the MFMA.

#### **INTERNAL CONTROL**

51. In accordance with the PAA and in terms of *General notice 1111 of 2010*, issued in *Government Gazette 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the findings on compliance with laws and regulations included in this report.

#### **Leadership**

52. The accounting officer did not take appropriate action to address the lack of discipline in the finance and SCM directorates, resulting in non-compliance with applicable legislation. This, in turn, resulted in irregular expenditure.
53. The occurrence of material irregular expenditure during the year under review indicates that integrity and ethical values were not developed and understood and did not set the standard for sound corporate governance.

#### **Financial and performance management**

54. The financial staff members of the municipality were not sufficiently skilled to ensure that the daily financial activities are fully and correctly recorded in the records of the municipality. Management did also not ensure that adequate controls were in place to detect and correct errors in the financial records.
55. 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.
56. The accounting officer did not regularly review and monitor management's compliance with laws, regulations and internally designed policies and procedures. As a result, significant non-compliance issues were noted that could have been prevented.

#### **Governance**

57. Internal controls were not selected and developed to adequately prevent, detect and correct material non-compliance with laws and regulations.
58. The audit committee did not function throughout the year as the audit committee was dissolved during December 2011 and the first meeting after the new audit committee was established was only held on 1 July 2011.
59. Although the municipality has an internal audit division, it is not adequate for the purposes of the audit as the audit committee was not effective for a substantial part of the financial year and internal audit therefore did not function effectively during the year under review.

Bloemfontein

30 November 2011



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*