

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 have audited the financial statements of the Letsemeng Local Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2013, the statement of financial performance, statement of changes in net assets and the cash flow statement for the year then ended, the statement of comparison of budget and actual amounts, and 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 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 the Division of Revenue Act of South Africa, 2012 (Act No. 5 of 2012) (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. My responsibility is to express an opinion on these financial statements based on my audit. I 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 I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements.
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

Service charges

6. I was unable to obtain sufficient appropriate audit evidence regarding revenue from the sale of water and electricity included in the service charges income as the meter reading books were incomplete and inaccurate. I was unable to confirm revenue from sale of water and electricity by alternative means. Consequently, I was unable to determine whether any adjustments relating to revenue from sale of water stated at

R4 466 907 and sale of electricity stated at R14 037 990 in note 23 to the financial statements were necessary.

Irregular expenditure

7. The municipality did not disclose all the irregular expenditure in the notes to the financial statements, as required by section 125(2)(d)(i) of the MFMA. The municipality incurred expenditure in contravention with the Municipal Supply Chain Management (SCM) Regulations, resulting in irregular expenditure being understated by R1 356 760. In addition the irregular expenditure was disclosed inclusive of Value Added Tax (VAT) resulting in irregular expenditure being overstated by R2 128 285. I was unable to confirm the irregular expenditure by alternative means.

Consequently, I was unable to determine whether any adjustments to irregular expenditure stated at R67 665 993 (2012: R49 004 625) in note 47 to the financial statements was necessary.

Aggregation/accumulation of immaterial uncorrected misstatements

8. The financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements making up the statement of financial position:
- Other PPE reflected as R8 457 909 is overstated by R1 070 111
 - Consumer debtors reflected as R3 147 403 is overstated by R632 406
 - Receivables reflected as R13 078 775 is overstated by R582 868
 - VAT receivables reflected as R4 427 635 is overstated by R326 532.

Qualified opinion

9. In my opinion, except for the effect 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 Letsemeng Local Municipality as at 30 June 2013 and its financial performance and cash flows for the year then ended, in accordance with SA Standard of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

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

Restatement of corresponding figures

11. As disclosed in note 41 to the financial statements, the corresponding figures for 30 June 2012 have been restated as a result of errors discovered during 2013 in the annual financial statements of the Letsemeng Local Municipality at, and for the year ended, 30 June 2012.

Material losses

12. As disclosed in note 48 to the financial statements, material losses to the amount of R10 473 401 (2012: R3 802 636) were incurred as a result of illegal connections and burst pipes.

Additional matter

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

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. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

16. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages xx to xx of the annual report.

17. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned development objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury's *Framework for managing programme performance information (FMPPI)*.

18. The reliability of the information in respect of the selected development objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

19. The material findings are as follows:

Usefulness of information

20. Section 46 of the Municipal Systems Act, 2000 (Act no. 32 of 2000) (MSA) requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved. Adequate and reliable corroborating evidence could not be provided for 94% (>20%) measures taken to improve performance as disclosed in the annual performance report. The municipality's records did not permit the application of alternative audit procedures.

Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the reliability of the measures taken to improve performance.

21. The MSA, section 41(c) requires that the actual achievements against all planned indicators and targets must be reported annually. The annual performance report submitted for audit purposes did not include the actual performance of 80% (>20%) of the planned objectives, 87% (>20%) of the planned indicators and 89% (>20%) of the planned targets specified in the Service Delivery Budget Implementation Plan (SDBIP) for the year under review. I did not obtain sufficient appropriate audit evidence to satisfy myself that the information systems recording and documenting of actual achievements

against targets as well as a lack of review and monitoring of the completeness of reporting documents by management, internal audit and the audit committee.

22. The National Treasury *FMPPi* requires that it must be possible to validate the processes and systems that produce the indicator. A total of 100% (>20%) of the indicators were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. I did not obtain sufficient appropriate audit evidence to satisfy myself that the performance indicators were verifiable.
23. The National Treasury *FMPPi* requires that indicators should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 98% (>20%) of the indicators were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. The municipality could not provide sufficient appropriate audit evidence to confirm that the performance indicators were well defined.
24. The National Treasury *FMPPi* requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 83% (>20%) of the targets were not specific in clearly identifying the nature and the required level of performance. This was due to the lack of determination from management to ensure compliance with the prescripts or guides issued by the National Treasury in relation to the predetermined objectives.
25. The National Treasury *FMPPi* requires that performance targets be measurable. The required performance could not be measured for a total of 83% (>20%) of the targets. This was due to the lack of determination from management to ensure compliance with the prescripts or guides issued by the National Treasury in relation to the predetermined objectives.
26. The National Treasury *FMPPi* requires that the time period or deadline for delivery be specified. A total of 83% (>20%) of the targets were not time bound in specifying a time period or deadline for delivery. This was due to the lack of determination from management to ensure compliance with the prescripts or guides issued by the National Treasury in relation to the predetermined objectives.
27. The National Treasury *FMPPi* requires that the indicator should relate logically and directly to an aspect of the institution's mandate, the realisation of strategic goals and objectives. A total of 100 %(> 20%) of indicators did not relate logically and directly to an aspect of the institution's mandate and realisation of strategic goals and objectives as per the SDBIP. This was due to the lack of development and implementation of proper performance planning and management practices to provide for the development of performance indicators and targets included in the SDBIP.

Reliability of information

28. The National Treasury *FMPPi* requires that institutions should have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets.

I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of information presented with respect to the strategic objectives of Service Delivery and Infrastructure, Good Governance and Community Participation and Local Economic Development. This was due to limitations placed on

the scope of my work due to the municipality not reporting on the planned objectives, indicators and targets with respect to these key performance reports.

Compliance with laws and regulations

29. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the general notice issued in terms of the PAA, are as follows:

Strategic planning and performance management

30. The IDP adopted by the municipality for the year under review does not reflect the key performance indicators and targets, as required by sections 26 and 41 of the MSA.

31. The municipality did not establish a performance management system, as required by section 38(a) of the MSA.

32. The municipality did not set key performance indicators, including input indicators, output indicators and outcome indicators, in respect of each of the development priorities and objectives set out in the IDP, as required by section 41(1)(a) of the MSA and the Municipal planning and performance management regulation 1 and 9(1)(a).

33. The annual performance report for the year under review does not include in the annual report measures taken to improve performance, as required by section 46(1) of the MSA.

34. The municipality did not have and maintain effective, efficient and transparent systems of financial and risk management and internal controls as required by section 62(1)(c)(i) of the MFMA.

Budgets

35. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

36. Sufficient appropriate audit evidence could not be obtained that monthly budget statements were submitted to the mayor, as required by section 71(1) of the MFMA.

Annual financial statements, performance and annual report

37. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA.

Expenditure management

38. Money owing by the municipality was not always paid within 30 days or an agreed period, as required by section 65(2)(e) of the MFMA.

Revenue management

39. An effective system of internal control for revenue was not in place, as required by section 64(2)(f) of the MFMA.

Conditional grants received

40. The municipality did not submit quarterly performance reports to the transferring national officer, the Free State Provincial Treasury and the National Treasury, within 30 days after the end of each quarter, as required by section 12(2)(c) of the DoRA.
41. The municipality did not submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(5) of the DoRA.
42. The municipality did not submit its implementation plans to the National Treasury to address weaknesses in financial management, as required by the Division of Revenue Grant Framework, Gazette No.35399.

HR management

43. Job descriptions were not established for all posts in which appointments were made in the current year, in contravention of section 66(1)(b) of MSA.

Procurement and contract management

44. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) and (c).
45. Quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy in contravention of SCM regulation 16(b) and 17(b).
46. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a).
47. Bid specifications were not always drafted by the bid specification committee which were composed of one or more officials of the municipality as required by SCM regulation 27(3).
48. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding were advertised for a required minimum period of days, as required by SCM regulation 22(1) and 22(2).
49. Contracts and quotations were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding and quotations, in contravention of SCM Regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations.
50. Awards were made to bidders other than those recommended by the bid evaluation committee without ratification by the accounting officer, as required by SCM regulation 29(5)(b).
51. 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) (PPPFA) and SCM regulation 28(1)(a).
52. Contracts and quotations were awarded to bidders based on preference points that were not allocated and calculated in accordance with the requirements of the PPPFA and its regulations.
53. Contracts were awarded to bidders that did not score the highest points in the evaluation process, as required by section 2(1)(f) of PPPFA.

54. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act and CIDB regulation 18.
55. Contracts and quotations were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.
56. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).

Internal control

57. I considered internal control relevant to my audit of the financial statements, the annual 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 annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

58. The leadership of the municipality have not been able to ensure effective oversight over all aspects of financial and performance reporting and compliance to laws and regulations. This was brought about by weaknesses in the support structures of the local municipality most notably in the areas of human resources, capacity constraints and the design and implementation of formal processes and systems to produce reliable information.

Financial and performance management

59. The internal control environment of the municipality remains weak and lacks critical policies and procedures. Daily and monthly control processes and reconciliations are not being done and a lack of systems and controls over the collection, collation and verification of performance information results in unreliable and unverifiable performance reporting. Management has not implemented processes that ensure consequences for poor performance which has resulted in weak staff discipline within the municipality.

Governance

60. The governance structures have not influenced an improvement in the control environment of the municipality which is mainly attributable to the fact that the internal audit division is not adequately resourced and functioning and the recommendations from the audit committee is not being implemented.

OTHER REPORTS

Investigation

61. The investigation regarding the prior year prepaid electricity by SAPS was finalised and no further actions were taken against any of the officials involved. A further investigation into prepaid electricity is being conducted by SAPS. The investigation is still in progress at the reporting date.

Bloemfontein

30 November 2013



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