

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 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 2014, the statements of financial performance, changes in net assets, cash flows and comparison of budget and actual amounts 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 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 the financial statements based on conducting the 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. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, 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. I was unable to obtain sufficient appropriate audit evidence regarding property, plant and equipment. Management could not provide me with supporting documentation to confirm how property, plant and equipment had been assessed for impairment and how the useful lives of the assets had been reassessed. I was unable to confirm property, plant and equipment by alternative means. Consequently, I was unable to determine whether any adjustment was necessary relating to property, plant and equipment stated at R613 181 108 in note 7 to the financial statements.
5. In addition, the municipality did not recognise investment property in terms of SA Standards of GRAP, GRAP 16 *Investment property*. Investment property was incorrectly included in land and buildings, resulting in property, plant and equipment being overstated and investment property being understated. I was unable to determine the full extent of the misstatement, as it was impracticable to do so. Additionally, there was a resultant impact on the surplus for the period and the accumulated surplus.

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. Management could also not provide sufficient appropriate audit evidence to substantiate the use of average readings during the year. I was unable to confirm revenue from water and electricity by alternative means. Consequently, I was unable to determine whether any adjustment was necessary relating to revenue from water and electricity stated at R22 066 616 (2013: R18 504 897) in note 23 to the financial statements.
7. I was unable to obtain sufficient appropriate audit evidence regarding service charges for refuse and sewerage income, due to the municipality billing for properties not on the valuation roll. In addition, incorrect tariffs were used for billing refuse and sewerage, while certain properties receiving services were not billed. I was unable to confirm revenue from refuse and sewerage by alternative means. Consequently, I was unable to determine whether any adjustment was necessary relating to revenue from refuse and sewerage stated at R15 477 860 in note 23 to the financial statements.

Receivables from exchange transactions

8. I was unable to obtain sufficient appropriate audit evidence that management had properly accounted for receivables from exchange transactions, due to management not providing sufficient supporting information for the interest raised on outstanding debtor balances. I was unable to confirm receivables from exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to receivables from exchange transactions stated at R8 582 444 in note 3 to the financial statements.

Receivables from non-exchange transactions

9. I was unable to obtain sufficient appropriate audit evidence that management had properly accounted for receivables from non-exchange transactions, due to management not providing sufficient supporting information for the interest raised on outstanding debtor balances. I was unable to confirm receivables from non-exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to receivables from non-exchange transactions stated at R3 709 782 in note 4 to the financial statements.

General expenses

10. The municipality did not have adequate systems to ensure that both capital and operating expenditure was classified correctly in terms of SA Standards of GRAP, GRAP 1 *Presentation of financial statements*. Misclassifications were identified in general expenses, which should have been capitalised to property, plant and equipment. Consequently, general expenses were overstated and property, plant and equipment was understated by R2 758 765. Additionally, there was a resultant impact on the surplus for the period and the accumulated surplus.

Grants and subsidies paid

11. The municipality did not have adequate systems to ensure that both capital and operating expenditure was classified correctly in terms of SA Standards of GRAP, GRAP 1 *Presentation of financial statements*. Misclassifications were identified in grants and subsidies paid, which should have been capitalised to property, plant and equipment. Consequently, grants and subsidies paid were overstated and property, plant and equipment was understated by R2 167 882. Additionally, there was a resultant impact on the surplus for the period and the accumulated surplus.

Repairs and maintenance

12. The municipality did not have adequate systems to ensure that both capital and operating expenditure was classified correctly in terms of SA Standards of GRAP, GRAP 1 *Presentation of financial statements*. Misclassifications were identified in repairs and maintenance, which should have been capitalised to property, plant and equipment. Consequently, repairs and maintenance were overstated and property, plant and equipment was understated by R1 048 110. Additionally, there was a resultant impact on the surplus for the period and the accumulated surplus.

Contracted services

13. The municipality did not have adequate systems to ensure that both capital and operating expenditure was classified correctly in terms of SA Standards of GRAP, GRAP 1 *Presentation of financial statements*. Misclassifications were identified in contracted services, which should have been capitalised to property, plant and equipment. In addition, there were duplicate invoices expensed for contracted services. Consequently, contracted services were overstated by R1 034 117; property, plant and equipment was understated by R695 955; and other creditors were overstated by R338 162. Additionally, there was a resultant impact on the surplus for the period and the accumulated surplus.

Bulk purchases

14. The municipality did not have adequate systems to ensure that classes of operating expenditure were classified correctly in terms of SA Standards of GRAP, GRAP 1 *Presentation of financial statements*. Misclassifications were identified in bulk purchases paid, which should have been expensed to general expenses. In addition, the same invoices were captured in both the current and the prior year, while input value-added tax (VAT) was not claimed on some invoices of bulk purchases in the current year. Consequently, bulk purchases were overstated by R1 018 233; general expenses were understated by R564 544; and the VAT receivable was understated by R142 903. It was impracticable for me to determine which other account was affected by the duplicate invoices recognised for bulk purchases, due to inadequate systems. Additionally, there was a resultant impact on the surplus for the period and the accumulated surplus.

Payables from exchange transactions

15. I was unable to obtain sufficient appropriate audit evidence that management had properly accounted for other creditors included in payables from exchange transactions, due to the status of the accounting records and a lack of reconciliations. I was unable to confirm other creditors by alternative means. Consequently, I was unable to determine whether any adjustment to other creditors stated at R1 106 471 in note 12 to the financial statements was necessary.

Irregular expenditure

16. The prior year irregular expenditure was disclosed inclusive of VAT, resulting in irregular expenditure being overstated. I was unable to determine the full extent of the misstatement, as it was impracticable to do so. This had a consequential impact on the current year closing balance of irregular expenditure of R88 064 441 (2013: R67 665 993) in note 42.3 being overstated.

Cash flow statement

17. I was unable to obtain sufficient appropriate audit evidence regarding the cash flow statement and related notes for the current and prior years, due to the material effect of misstatements and limitations placed on my audit of various components of the financial statements. I was unable to confirm the cash flow statement by alternative means. Consequently, I was unable to determine whether adjustments were necessary to the amounts disclosed in the cash flow statement.

Aggregation of immaterial uncorrected misstatements

18. I was unable to obtain sufficient appropriate audit evidence regarding the following items making up the statement financial position, which had a cumulative effect on the financial statements:

- Unspent conditional grants of R417 171 as included in the disclosed balance of R13 713 326
- Inventory of R373 198 (2013: R373 238) as included in the disclosed balance of R373 198 (2013: R373 198)

I was unable to confirm these amounts by alternative means. As a result, I was unable to determine whether any adjustment to these items was necessary.

Disclaimer of opinion

19. 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 the financial statements.

Emphasis of matters

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

Material losses

21. As disclosed in note 43.7 to the financial statements, material water and electricity losses of R5 539 563 (2013: R8 986 973) were incurred as a result of tampered meters and illegal connections.

Material impairments

22. As disclosed in note 3 to the financial statements, a provision for the impairment of debtors amounting to R23 598 777 (2013: R19 230 745) was made with regard to consumer debts amounting to R32 181 221 (2013: R23 456 537).

Unauthorised expenditure

23. As disclosed in note 42.1 to the financial statements, the municipality incurred unauthorised expenditure of R16 746 453 (2013: R5 379 867) during the year under review, due to overspending of the budget.

Material underspending of conditional grants

24. As disclosed in note 13 to the financial statements, the municipality materially underspent its conditional grants by R13 713 326 (2013: R1 878 724), due to instability in management.

Restatement of corresponding figures

25. As disclosed in note 39 to the financial statements, the corresponding figures for 30 June 2013 have been restated as a result of errors discovered during 2014 in the financial statements of the municipality at, and for the year ended, 30 June 2013.

Additional matter

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

Unaudited disclosure notes

27. 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

28. 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 development priorities 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

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

- Development priority 3: technical department on pages x to x

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

31. 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* (FMPPPI).

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

33. The material findings in respect of the selected development priority are as follows:

Development priority 3: technical department

Usefulness of reported performance information

34. The FMPPPI requires the following:

- Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. All (100%) of the indicators were not well defined.

- Performance indicators must be verifiable, meaning that it must be possible to validate the processes and systems that produced the indicator. A total of 56% of the indicators were not verifiable.

This was because management did not adhere to the requirements of the FMPPI due to a lack of proper systems and processes.

Additional matter

35. I draw attention to the following matter:

Achievement of planned targets

36. Refer to the annual performance report on pages 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 development priority reported in paragraph 34 of this report.

Compliance with legislation

37. 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:

Strategic planning and performance management

38. The adopted integrated development plan (IDP) did not reflect and identify a financial plan, the key performance indicators and targets, as required by sections 26 and 41 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) as well as municipal planning and performance management regulation 2(1)(c).
39. The municipality did not give effect to its IDP or conduct its affairs in a manner that was consistent with its IDP, as required by section 36 of the MSA, section 21(2)(a) of the MFMA and municipal planning and performance management regulation 6.
40. The municipality did not establish a performance management system, as required by section 38(a) of the MSA.

Human resource management and compensation

41. The municipality did not develop and adopt appropriate systems (policies) and procedures to monitor, measure and evaluate the performance of staff, in contravention of section 67(d) of the MSA.

Budgets

42. 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.

Financial statements and annual reports

43. 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 non-current assets, current assets, current liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected but the supporting records that could not be provided resulted in the financial statements receiving a disclaimed audit opinion.

Audit committee

44. The audit committee was not constituted in the manner required by section 166(4)(a) of the MFMA. One member of the audit committee resigned during the year and another member's contract was not renewed. This resulted in the audit committee not having the required minimum of three members. The latest audit committee member position became vacant in March 2014.
45. The audit committee did not review the annual financial statements to provide the council with an authoritative and credible view of the financial position of the municipality, its efficiency and effectiveness, and its overall level of compliance with legislation, as required by section 166(2)(b) of the MFMA.
46. The audit committee did not review all the quarterly internal audit reports on performance measurement, as required by municipal planning and performance management regulation 14(4)(a)(i).
47. The audit committee did not advise the council on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.
48. The audit committee did not advise the council on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA.

Procurement and contract management

49. Goods and services with a transaction value below R200 000 were procured without obtaining the required price quotations, contrary to supply chain management (SCM) regulation 17(a) and (c).
50. Goods and services with a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). One deviation was approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).
51. 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*.
52. Bid adjudication was not always done by committees composed in accordance with SCM regulation 29(2).
53. 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 of South Africa, 2000 (Act No. 5 of 2000) (PPPFA) and SCM regulation 28(1)(a).
54. Contracts and quotations were awarded to bidders based on preference points that had not been calculated in accordance with the requirements of the PPPFA and its regulations.
55. 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).

56. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act of South Africa, 2000 (Act No. 38 of 2000) and CIDB regulation 18.
57. 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.

Expenditure management

58. Reasonable steps were not taken to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
59. An effective system of expenditure control, including procedures for the approval and authorisation of funds, was not in place, as required by section 65(2)(a) of the MFMA.
60. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
61. An adequate management, accounting and information system was not in place which accounted for creditors, as required by section 65(2)(b) of the MFMA.

Revenue management

62. An adequate management, accounting and information system was not in place to account for revenue, as required by section 64(2)(e) of the MFMA.
63. An effective system of internal control for revenue was not in place, as required by section 64(2)(f) of the MFMA.
64. Sufficient appropriate audit evidence could not be obtained that revenue due to the municipality had been calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.
65. Sufficient appropriate audit evidence could not be obtained that accounts for municipal tax and service charges had been prepared on a monthly basis, as required by section 64(2)(c) of the MFMA.
66. Sufficient audit evidence could not be obtained that interest had been charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

Asset management

67. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

Liability management

68. An adequate management, accounting and information system was not in place to account for liabilities, as required by section 63(2)(a) of the MFMA.
69. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the MFMA.

Consequence management

70. Unauthorised, irregular as well as fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by sections 32(2)(a)(ii) and 102(1) of the MFMA.

Environmental management

71. The municipality operated three waste disposal sites without a waste management licence or permit, in contravention of section 20(b) of the National Environmental Management: Waste Act of South Africa, 2008 (Act No. 59 of 2008).

Internal control

72. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the disclaimer of opinion, the findings on the annual performance report and the findings on non-compliance with legislation included in this report.

Leadership

73. The leadership of the municipality did not consider the impact that instability and critical vacancies in key management positions would have on the financial administration of the municipality, which resulted in the municipality obtaining a further regression in the audit outcome.

74. The acting accounting officer and other senior management members were not actively involved with the promotion of daily controls and compliance with policies and procedures. Officials within the municipality were not held accountable for not performing their job functions and there were no consequences for those officials that transgressed policies and procedures. Officials did not have the required competence and skills to perform their job functions, which led to material misstatements being identified through the audit process.

Financial and performance management

75. Management did not ensure that officials performed daily, weekly and monthly reconciliations and updated underlying records and registers in a timely manner. There was no proper documentation protocol, which resulted in there being significant scope limitations. Effective performance systems, processes and procedures as well as the management thereof had not been adequately developed and implemented.

Governance

76. The acting accounting officer did not ensure that senior managers implemented internal and external audit recommendations in a timely manner. The audit committee was not properly constituted and was therefore not available to advise and assist management with the review of the financial statements, annual performance report and annual report.

Bloemfontein

30 November 2014



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence