

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 ... to ..., which comprise the statement of financial position as at 30 June 2016, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of 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 these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2015 (Act No. 1 of 2015) (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 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 misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the

financial statements.

5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Property plant and equipment

6. The municipality did not recognise property, plant and equipment in accordance with GRAP 17, *Property, plant and equipment*. The municipality incorrectly recognised land and buildings that are not in its control and also did not account for all items of property, plant and equipment in the asset register, resulting in property, plant and equipment being overstated by R19 319 071 (2014-15: understated by R11 400 205) . Additionally, there was a resultant impact on the depreciation expense, deficit for the period and on the accumulated surplus. In addition, I was unable to obtain sufficient appropriate audit evidence regarding property, plant and equipment due to lack of an adequate asset management system. I was unable to confirm the assets by alternative means. Consequently, I was unable to determine whether any further adjustments to property, plant and equipment stated at R 568 867 825 (2014-15: R 565 774 216) in note 8 to the financial statements were necessary.

Service charges

7. The municipality did not recognise revenue from service charges in accordance with GRAP 9, *Revenue from exchange transactions*. Service charges relating to sewerage, sanitation and refuse removal were incorrectly recognised, resulting in both service charges and receivables from exchange transactions being overstated by R2 788 377(2014-15: R8 034 354). The municipality also did not have adequate systems to account for the billing of service charges for water and electricity, which resulted in service charges being materially misstated. I was unable to determine the impact on the service charges, as it was impracticable to do so. Additionally, there was a resultant impact on the deficit for the period and on the accumulated surplus. Furthermore, I was unable to obtain sufficient appropriate audit evidence for service charges relating to electricity due to the status of the accounting records. I was unable to confirm the service charges by alternative means. Consequently, I was unable to determine whether any further adjustments to the service charges stated at R 40 347 912 in note 18 to the financial statements, were necessary.

Property rates

8. The municipality did not recognise revenue from property rates in accordance with GRAP 23, *Revenue from non-exchange transactions*. Property rates were incorrectly calculated due to a lack of reconciliation between the accounting system and the valuation roll, resulting in both property rates and receivables from non-exchange transactions being overstated by R3 399 642. Additionally, there was a resultant impact on the deficit for the period and on the accumulated surplus. Furthermore, I was unable

to obtain sufficient appropriate audit evidence for property rates due to the status of the accounting records. I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any further adjustments to the property rates stated at R 15 112 134 in note 22 to the financial statements, were necessary.

Unauthorised expenditure

9. I was unable to obtain sufficient appropriate audit evidence for unauthorised expenditure, as sufficient information was not available for the calculation of the amount to be disclosed. I could not confirm the unauthorised expenditure by alternative means. Consequently, I was unable to determine whether any adjustment to unauthorised expenditure stated at R194 260 391 in note 43 to the financial statements, was necessary.

General expenses

10. The municipality did not have adequate systems to ensure that general expense transactions have been correctly classified in terms of GRAP 1, *Presentation of financial statements*. This resulted in general expenses being overstated by R377 936 and administration expenses being understated by R377 936. In addition, I was unable to obtain sufficient appropriate audit evidence for general expenses due to inadequate record management. I was unable to confirm the expenditure by alternative means. Consequently, I was unable to determine whether any further adjustments to the general expenses stated at R33 462 628 in note 32 to the financial statements, were necessary.

Cash flow statement

11. The municipality did not present the cash flow statement in accordance with GRAP 2, *Cash flow statements*. The cash flows from operating activities and investing activities relating to the previous year's figures were misstated as the impact of restatements made to the statement of financial position was not correctly included in the cash flow calculations, resulting in the corresponding figures of the cash flow statement being misstated by R9 446 917.

Material losses

12. The municipality did not disclose water and electricity distribution losses, as required by section 125(2)(d) of the MFMA. As the municipality did not maintain adequate records of water and electricity usage, I was unable to determine the full extent of the understatement of distribution losses, as it was impracticable to do so.

Inventory

13. During 2014-15, the municipality did not recognise inventory in accordance with GRAP 12, *Inventory*. Inventory was incorrectly measured, as the quantities were overstated and the lower of cost and net replacement value was not used, resulting in inventory being overstated by R4 248 688 in the previous year. Additionally, there was a resultant impact on the deficit for the previous year and on the accumulated surplus. My audit opinion on the financial statements for the period ended 30 June 2015 was modified accordingly. My opinion on the period under review's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Qualified opinion

14. In my opinion, except for the possible effects 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 2016 and its financial performance and cash flows for the year then ended, in accordance with the SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

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

Restatement of corresponding figures

16. As disclosed in note 39 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of errors discovered during 2015-16 in the financial statements of the municipality at, and for the year ended, 30 June 2015.

Going concern

17. Note 41 to the financial statements indicated that the municipality incurred a net loss of R 17 602 044 during the year ended 30 June 2016. These conditions, along with other matters as set forth in note 41, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

Material impairments

18. As disclosed in note 4 to the financial statements, receivables from exchange transactions were impaired by R 51 700 821 (2015: R 34 360 239) and, as disclosed in note 5 to the financial statements, receivables from non-exchange transactions were impaired by R 20 391 805 (2015: R 13 217 001).

Irregular expenditure

19. As disclosed in note 45 to the financial statements, the municipality incurred irregular expenditure of R17 498 603 (2014-15: R19 825 423) due to non-compliance with supply chain management (SCM) requirements. At the time of this report, the full extent of irregular expenditure was in the process of being determined.

Additional matter

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

Unaudited disclosure notes

21. 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 on it.

Unaudited supplementary schedules

22. The supplementary information set out on pages x to x 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 them.

Report on other legal and regulatory requirements

23. In accordance with the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives of selected key performance areas presented in the annual performance report, compliance with legislation and 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 them.

Predetermined objectives

24. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information of the following selected key performance areas presented in the annual performance report of the municipality for the year ended 30 June 2016:

- Key performance area: basic service delivery, on page xx
- Key performance area: local economic development, on page xx
- Key performance area: municipal transformation and institutional development, on page xx.

25. I evaluated the usefulness of the reported performance information to determine

whether it was consistent with the planned key performance areas. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information (FMPPI)*.

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

27. The material findings in respect of the selected key performance areas are as follows:

Key performance area: Basic service delivery

Usefulness of reported performance information

28. Section 41(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) requires the integrated development plan (IDP) to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. Important reported targets were not consistent with those in the approved service delivery agreement.

29. The FMPPI requires performance targets to be measurable. Important targets were not measurable.

Reliability of reported performance information

30. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable 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 the reported performance information. This was because of limitations placed on the scope of my work due to the auditee not providing sufficient appropriate evidence in support of the reported performance information.

Key performance area: Local economic development

Reliability of reported performance information

31. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. The reported achievements against planned targets of 50% of indicators were not reliable when compared to the evidence provided.

Key performance area: Municipal transformation and institutional development

Reliability of reported performance information

32. The FMPPi requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. The reported achievements against planned targets of 33% of indicators were not reliable when compared to the evidence provided.

Additional matters

33. I draw attention to the following matters:

Achievement of planned targets

34. Refer to the annual performance report on pages to for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs 28 to 32 of this report.

Adjustment of material misstatements

35. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of basic service delivery, local economic development and municipal transformation and institutional development. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information.

Unaudited supplementary schedules

36. The supplementary information set out on pages to do not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not report on them.

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 material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Annual financial statements

38. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of current liabilities, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided subsequently. However, the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Expenditure management

39. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
40. Reasonable steps were not taken to prevent unauthorised expenditure, as required by section 62(1)(d) of the MFMA.
41. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA.
42. Reasonable steps were not taken to prevent fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Revenue management

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

Asset management

44. 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.

Consequence management

45. Unauthorised expenditure by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(a) of the MFMA.
46. Irregular expenditure by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(b) of the MFMA and municipal budget and reporting regulation 75(1).
47. Fruitless and wasteful expenditure by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(b) of the MFMA and municipal budget and reporting regulation 75(1).

Conditional grants received

48. The municipal infrastructure grant allocation was not spent in accordance with the applicable grant framework, in contravention of section 17(1) of DoRA.
49. The municipality did not evaluate its performance in respect of programmes funded by the municipal infrastructure grant, as required by section 12(5) of DoRA.

Human resource management and compensation

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

Strategic planning and performance management

51. The local community was not consulted by means of a municipal wide structure for community participation or through a forum that enhances community participation in implementing the IDP, as required by section 28 of the Municipal Systems Act and municipal planning and performance management regulation 15(1)(a)(i).
52. The adopted IDP did not reflect and identify the key performance indicators and targets and a financial plan, as required by sections 26 and 41 of the Municipal Systems Act, as well as municipal planning and performance management regulation 2(1)(e) and 2(3)(a to c).
53. The municipality did not establish a performance management system as required by section 38(a) of the Municipal Systems Act and municipal planning and performance management regulation 8.
54. The performance of the municipality was not assessed during the first half of the financial year, as required by section 72(1)(a)(ii) of the MFMA.

Procurement and contract management

55. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of SCM regulation 17(a) and (c).
56. I could not obtain sufficient appropriate audit evidence that goods and services of a transaction value above R200 000 were procured by inviting competitive bids or that deviations approved by the accounting officer were only if it was impractical to invite competitive bids, as required by SCM regulations 19(a) and 36(1).
57. Invitations for competitive bidding were not always advertised for a required minimum period of days, in contravention of SCM regulation 22(1) and 22(2).
58. I could not obtain sufficient appropriate audit evidence that contracts were awarded to

bidders based on points given for criteria that were stipulated in the original invitation for bidding and quotations, as required by SCM regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations.

59. Bid adjudication committees were not always composed in accordance with SCM regulation 29(2).
60. Contracts were awarded to bidders based on preference points that were not allocated or calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000) (PPPFA) and its regulations.
61. Contracts were awarded to bidders that did not score the highest points in the evaluation process, in contravention of section 2(1)(f) of the PPPFA.
62. Contracts were awarded to bidders who did not submit a declaration on whether they were employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
63. Construction contracts were awarded to contractors that did not qualify for the contract, in contravention of section 18(1) of the Construction Industry Development Board Act, 2000 (Act No. 38 of 2000) (CIDB Act) and CIDB regulations 17.
64. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
65. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, in contravention of section 116(2)(c) of the MFMA.

Internal control

66. 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 qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

67. The leadership did not develop action plans and monitor their implementation to address internal control deficiencies. This was because of the slow response to address internal control weaknesses identified and reported, which resulted in a last minute effort during the audit process to try and resolve significant findings.
68. The leadership did not adequately oversee financial and performance reporting and compliance and related internal controls as it did not ensure that there were sound internal controls in the daily operations of the municipality.

69. The leadership did not implement effective human resource management to ensure that adequate and sufficiently skilled resources are in place and that performance is monitored. As a result there was no consequence management for employees not performing their duties at the municipality.

Financial and performance management

70. Management did not implement proper record keeping in a timely manner to ensure that complete, relevant and accurate information is accessible and available to support financial and performance reporting. This was as a result of the slow response in addressing prior year audit findings, vacancies in the finance department and the reliance on consultants to provide information without management taking ownership.

71. Management did not prepare accurate and complete financial and performance reports that are supported and evidenced by reliable information. This was due to the municipality not implementing consequence management for employees not preparing and submitting the required financial and performance information, lack of competencies of officials and the high reliance on consultants.

Governance

72. The accounting officer did not ensure that there is an adequately resourced and functioning internal audit unit that identifies internal control deficiencies and recommends corrective action effectively.

73. The audit committee did not promote accountability and service delivery through evaluating and monitoring responses to risks and providing oversight over the effectiveness of the internal control environment, including financial and performance reporting and compliance with legislation as limited reports were provided to them by the internal audit unit. The audit committee also did not review the financial statements and the annual performance report before it being submitted for audit.

Auditor - General

Bloemfontein

30 November 2016



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence