

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 2015, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget information with actual information 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 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, 2014 (Act No. 10 of 2014) (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 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 municipality'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 municipality'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. I was unable to obtain sufficient appropriate audit evidence regarding property, plant and equipment, as the municipality did not provide me with adequate documentation to support the values of the assets. 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 R587 062 860 (2013-14: R600 078 299) in note 4 to the financial statements. In addition, the municipality did not recognise property, plant and equipment in accordance with SA Standards of GRAP, GRAP 17 *Property, plant and equipment*. Land that does not belong to the municipality was incorrectly recognised as land and buildings, the municipality did not recognise all its items of property, plant and equipment in the asset register, and work in progress of the municipality was not correctly calculated, resulting in property, plant and equipment being overstated by R51 274 906 (2013-14: R49 345 459). Additionally, there was a resultant impact on the deficit for the period and on the accumulated surplus.

Service charges

7. The municipality did not recognise revenue from exchange transactions in accordance with SA Standards of GRAP, GRAP 9 *Revenue from exchange transactions*. Revenue from service charges was incorrectly recognised, resulting in both service charges and receivables from exchange transactions being overstated by R8 066 157. Additionally, there was a resultant impact on the deficit for the period and on the accumulated surplus. In addition, during 2013-14, I was unable to obtain sufficient appropriate audit evidence for revenue from service charges and to confirm the revenue by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to revenue from service charges stated at R27 071 658 in note 23 to the financial statements. My audit opinion on the financial statements for the period ended 30 June 2014 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Property rates

8. The municipality did not recognise revenue from non-exchange transactions in accordance with SA Standards of GRAP, GRAP 23 *Revenue from non-exchange transactions*. Property rates were not correctly 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 R1 264 891. Additionally, there was a resultant impact on the deficit for the period and on the accumulated surplus.

Heritage assets

9. I was unable to obtain sufficient appropriate audit evidence regarding heritage assets, as the municipality did not provide me with adequate documentation to support the values of the heritage assets. I was unable to confirm heritage assets by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to heritage assets stated at R3 929 468 (2013-14: R3 929 468) in note 6 to the financial statements. In addition, the municipality did not recognise property, plant and equipment in accordance with SA Standards of GRAP, GRAP 103 *Heritage assets*. Assets that are part of property, plant and equipment were incorrectly recognised as heritage assets, resulting in property, plant and equipment being understated by R786 848 and heritage assets being overstated by R786 848.

Inventory

10. The municipality did not recognise inventory in accordance with SA Standards of GRAP, GRAP 12 *Inventory*. Inventory was not correctly 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. Additionally, there was a resultant impact on the deficit for the period and on the accumulated surplus.

General expenses

11. During 2013-14, I was unable to obtain sufficient appropriate audit evidence regarding general expenses and to confirm the general expenses by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to general expenses stated at R26 414 371 in note 38 to the financial statements. My audit opinion on the financial statements for the period ended 30 June 2014 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Payables from exchange transactions

12. I was unable to obtain sufficient appropriate audit evidence regarding unknown deposits included in payables from exchange transactions, as the municipality could not provide adequate documentation and reconciliations for the unknown deposits due to the status of the accounting records. I was unable to confirm unknown deposits by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to unknown deposits stated at R2 532 789 (2013-14: R1 106 471) in note 20 to the financial statements.

Aggregation of immaterial uncorrected misstatements

13. The financial statements were materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following items included in the statement of financial position and the statement of financial performance:

- Repairs and maintenance reflected as R3 711 456 were overstated by R680 079 (2013-14: R912 795)
- Payables from exchange transactions reflected as R9 483 238 were understated by R541 860
- General expenses reflected as R28 948 940 were understated by R262 000

In addition, I was unable to obtain sufficient appropriate audit evidence and to confirm the following item by alternative means:

- General expenses of R570 170 as included in the disclosed balance of R28 948 940

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 2015 and its financial performance and cash flows for the year then ended, in accordance with 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 48 to the financial statements, the corresponding figures for 30 June 2014 have been restated as a result of errors discovered during 2014-15 in the financial statements of the municipality at, and for the year ended, 30 June 2014.

Material losses

17. As disclosed in note 56 to the financial statements, material water and electricity losses of R14 153 082 (2013-14: R5 539 563) were incurred as a result of tampered meters, illegal connections and poorly maintained infrastructure.

Material impairments

18. As disclosed in note 14 to the financial statements, a provision for the impairment of debtors amounting to R47 577 240 (2013-14: R32 313 735) was made with regard to consumer debts amounting to R65 960 022 (2013-14: R43 449 368).

Material underspending of conditional grants

19. As disclosed in note 18 to the financial statements, the municipality materially underspent its conditional grants by R12 890 949 (2013-14: R13 713 326).

Irregular expenditure

20. As disclosed in note 55 to the financial statements, the municipality incurred irregular expenditure of R19 825 423 (2013-14: R20 398 448) during the year under review mainly due to non-compliance with supply chain management (SCM) requirements. In addition, the full extent of irregular expenditure is still being determined.

Additional matters

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

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 thereon.

Unaudited disclosure notes

23. 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

24. In accordance with the Public Audit Act of South Africa, 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 for 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 these matters.

Predetermined objectives

25. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected key performance area presented in the annual performance report of the municipality for the year ended 30 June 2015:
 - Key performance area: service delivery and infrastructure development, on pages x to x

26. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
27. 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 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).
28. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
29. The material findings in respect of the selected key performance area are as follows:

Key performance area: service delivery and infrastructure development

Usefulness of reported performance information

30. Section 41(1)(c) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) 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. A total of 23% of the reported indicators were not consistent with those in the approved IDP. This was due to the municipality not performing a detailed review of the annual performance report before submitting it for audit purposes.
31. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 44% of the indicators were not verifiable. This was due to a lack of proper systems and processes as well as technical indicator descriptions.

Reliability of reported performance information

32. The FMPPI requires auditees to 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 the reported performance information. This was due to limitations placed on the scope of my work due to the absence of information systems, the fact that the municipality could not provide sufficient appropriate evidence in support of the reported performance information, and the municipality's records not permitting the application of alternative audit procedures.

Additional matters

33. I draw attention to the following matters:

Achievement of planned targets

34. Refer to the annual performance report on pages x to x and 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 and reliability of the reported performance information for the selected key performance area reported in paragraphs 30 to 32 of this report.

Unaudited supplementary schedules

35. The supplementary information set out on pages x to x does 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 thereon.

Compliance with legislation

36. 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:

Strategic planning and performance management

37. The municipality did not establish a performance management system, as required by section 38(a) of the MSA.
38. The adopted IDP did not reflect and identify the key performance indicators (KPIs), targets and a financial plan, as required by sections 26 and 41 of the MSA and municipal planning and performance management regulation 2(1)(e) and 2(3)(a-c).
39. The KPIs set by the municipality did not include indicators on the percentage of households with access to basic levels of water, sanitation, electricity and solid waste removal, as required by section 43(2) of the MSA and municipal planning and performance management regulation 10(a).
40. The annual performance report for the year under review did not include a comparison of the performance with set targets and a comparison with the previous financial year, as required by section 46(1)(b) of the MSA.
41. A performance management system and related controls were not in place, as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting and improvement as well as how it is to be conducted, organised and managed, including determining the roles of the different role players, as required by section 38 of the MSA and municipal planning and performance management regulation 7.

Financial statements and annual report

42. 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 uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Expenditure management

43. 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.
44. An effective system of expenditure control (including procedures for the approval and payment of funds) was not in place, as required by section 65(2)(a) of the MFMA.
45. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

Liability management

46. 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.
47. 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.

Revenue management

48. 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.
49. An effective system of internal control for revenue was not in place, as required by section 64(2)(f) of the MFMA.

Asset management

50. 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

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

Audit committee

52. 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 as well as its overall level of compliance with legislation, as required by section 166(2)(b) of the MFMA.

Procurement and contract management

53. Goods and services with a transaction value below R200 000 were procured without obtaining the required price quotations, contrary to SCM regulation 17(a) and (c).
54. Sufficient appropriate audit evidence could not be obtained that goods and services with a transaction value above R200 000 had been procured by means of inviting competitive bids and that deviations were only approved by the accounting officer if it was impractical to invite competitive bids, contrary to SCM regulations 19(a) and 36(1).
55. Invitations for competitive bidding were not always advertised for the required minimum period, as required by SCM regulation 22(1) and 22(2).
56. 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).
57. Contracts were awarded to bidders based on preference points that had not been allocated in accordance with the requirements of the PPPFA and its regulations.
58. 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, contrary to SCM regulation 13(c).
59. Construction contracts were awarded to contractors that were not registered with the Construction Industry Development Board (CIDB) and did not qualify for the contract in accordance with section 18(1) of the CIDB Act of South Africa, 2000 (Act No. 38 of 2000) and CIDB regulations 17 and 25(7A).
60. Contracts were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, contrary to SCM regulation 43.
61. Bid adjudication was not always done by committees composed in accordance with SCM regulation 29(2).
62. Contracts were awarded to bidders that did not score the highest points in the evaluation process, contrary to section 2(1)(f) of the PPPFA.

Conditional grants and transfers

63. The municipal systems improvement grant allocation was not spent in accordance with the applicable grant framework, in contravention of section 16(1) of the DoRA.

64. The municipality did not evaluate its performance in respect of programmes or functions funded by allocations from the local government financial management grant, municipal systems improvement grant and municipal infrastructure grant, as required by section 12(5) of DoRA.

Human resource management and compensation

65. The competencies of senior managers were not assessed in a timely manner to identify and address gaps in competency levels, as required by municipal regulation on minimum competency levels 13.
66. The municipality did not submit a report on compliance with the prescribed competency levels to the National Treasury and relevant provincial treasury, as required by municipal regulation on minimum competency levels 14(2)(a).
67. The annual report of the municipality did not reflect information on compliance with the prescribed minimum competencies, as required by municipal regulation on minimum competency levels 14(2)(b).

Internal control

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

Leadership

69. The leadership did not take effective steps to ensure that there were consequences for poor performance and transgressions, as none of the unauthorised, irregular as well as fruitless and wasteful expenditure incurred was investigated during the financial year.
70. The leadership did not ensure that vacancies in key positions were filled to facilitate sound financial management, as the position of chief financial officer and head of the SCM unit remained vacant during the financial year under review.
71. The leadership responded very slowly to the key issues affecting the municipality, as the audit action plan of the municipality was not closely monitored to ensure that it was drafted on time and effectively implemented by management.

Financial and performance management

72. Management did not implement a culture that promoted proper record keeping as well as daily and monthly processing and reconciliation of transactions, due to the slow response in implementing the recommendations of the internal and external auditors.
73. Management did not take adequate steps to deal with officials who did not adhere to monthly and quarterly reporting requirements to facilitate sound reporting of financial and performance information. A number of directorates did not report on their performance against predetermined objectives; however, there were no consequences for these officials.

Governance

74. The effectiveness of the internal audit unit and the audit committee was limited by the slow response by the leadership and management in implementing the recommendations made by these two governance structures.

Auditor-General

Bloemfontein

30 November 2015



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

