

REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF THE SETSOTO LOCAL MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2008

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Setsoto Local Municipality which comprise the statement of financial position as at 30 June 2008, statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx].

Responsibility of the accounting officer for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting determined by the National Treasury, as set out in accounting policy note 1 to the financial statements and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2007 (Act No. 1 of 2007 (DoRA). This responsibility includes:
 - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
 - selecting and applying appropriate accounting policies
 - making accounting estimates that are reasonable in the circumstances.

Responsibility of the Auditor-General

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance on whether the financial statements are free from material misstatement.
5. 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.
6. An audit also includes evaluating the:

- appropriateness of accounting policies used
 - reasonableness of accounting estimates made by management
 - overall presentation of the financial statements.
7. Paragraph 11 *et seq.* of the Statement of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is not effective for this financial year, I have determined that my audit of any disclosures made by the Setsoto Local Municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.
8. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis of accounting

9. The municipality's policy is to prepare financial statements on the basis of accounting determined by the National Treasury, as set out in accounting policy note 1 to the financial statements.

Basis for qualified opinion

Consumers and other debtors

10. A difference of R65 430 754 existed between amounts allocated in the DoRA and note 19 to the financial statements which could not be resolved through alternative procedures I deemed appropriate. This difference resulted in me not being able to confirm the completeness of grant and subsidies income of R198 237 909 reflected in note 19 and disclosed on the face of the statement of financial position.
11. Except for a general provision for bad debt as disclosed in note 13 to the financial statements amounting to R78 220 268 which is understated by R35 481 441 according to my calculations, the municipality did not deal with consumer and other receivables as reflected on the face of the statement of financial position and notes 13 and 14 to the financial statements in accordance with the requirements of IAS 39: *Financial Instruments: Recognition and Measurement*. I was unable to determine what the impairment charge should have been since the municipality did not assess whether any evidence existed indicating that a financial asset or a group of financial assets have been impaired as required by paragraph 58 of IAS 39: *Financial Instruments: Recognition and Measurement* and because the municipality's records not permitting the execution of alternative procedures.

Furthermore, the municipality also did not comply with the provisions of paragraph 15 of IAS 32: *Financial instruments: Presentation* and paragraph 31 of IFRS 7: *Financial Instruments: Disclosures* as the municipality did not classify all financial instruments or disclosed information in the financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at year end.

Provisions

12. In terms of section 28(1) of the National Environmental Management Act, 1998 (Act No. 107 of 1998) every person who causes, has caused or may cause significant pollution or degradation of the environment must take reasonable measures to prevent such pollution or degradation from occurring, continuing or recurring. The municipality did not calculate the present value of the future obligation to rehabilitate the municipal dumping sites and made no disclosures in the financial statements as required by paragraphs 18 and 53 of GAMAP 19: *Provisions, contingent liabilities and contingent assets*. The municipality's accounting system did not permit the application of reasonable alternative audit procedures regarding the provision for rehabilitation of the landfill sites and I could therefore not obtain sufficient appropriate audit evidence to determine the valuation thereof. Provisions and expenditure are thus understated by an unknown amount at year end.

Commitments

13. I was unable to obtain sufficient appropriate audit evidence as to the existence, completeness and valuation of capital commitments to the value of R10,3 million (2007: R57,6 million) as disclosed in note 32 to the financial statements. The municipal records and systems also did not permit me to perform reasonable alternative procedures in respect of the disclosure.

Employee related costs

14. I identified differences of R939 544 between the salary information as per the municipal records and the approved salary notches, while management was unable to provide me with sufficient appropriate audit evidence or explanations for the identified differences. As a result I was not able to perform all the procedures that I deemed necessary to confirm the accuracy of salaries amounting to R3 762 840 that is included with the amount as disclosed in the statement of financial performance and note 21 to the financial statements. The municipality's records and systems also did not permit me to perform reasonable alternative procedures in this respect.
15. Prior period errors of R3 223 307 between the current year's opening totals and the previous year's closing totals as disclosed in note 21 to the financial statements were made for which no further disclosures were made in respect of the prior period adjustment as required by paragraphs 42 and 49 of GRAP 3: *Accounting policies, changes in accounting estimates and errors* that requires the municipality to correct prior period errors retrospectively by restating the comparative figures for the prior period in which the error occurred and to disclose the nature of the prior period error and the extent of such an error in the financial statements.

Inventory

16. I was unable to obtain sufficient appropriate audit evidence in respect of amendments made to the inventory balance in the stores trial balance and the general ledger owing to weaknesses identified with the municipality's year end stock taking processes. I was thus unable to obtain sufficient appropriate audit evidence as the completeness of inventories to the value of R551 972 as presented in the statement of financial position. The municipality's records and systems also did not permit me to perform reasonable alternative procedures in this respect.

Unauthorised and irregular expenditure

17. The municipality omitted disclosure of irregular expenditure of R687 587 in lieu of councillor remuneration paid in excess of the upper limits set by the framework of the Remuneration of Public Office-Bearers Act, 1998 (Act No. 20 of 1998). The none disclosure of irregular expenditure in the financial statements is contrary to section 125(2)(d) of the MFMA.
18. Expenditure amounting to R163 631 952 was disclosed on the face of the statement of financial performance while the total operating expenditure approved in the adjusted budget amounted to R161 032 920. The difference of R2 599 032 is considered to be unauthorised since expenditure was incurred in excess of the approved budget. Section 1 of the MFMA defines unauthorised expenditure as any expenditure incurred by a municipality otherwise than in accordance with section 15 or 11 (3), and includes an overspending of the total amount appropriated in the municipality's approved budget. No unauthorised expenditure was disclosed in the annual financial statements.
19. Unspent conditional grants as disclosed in note 7 to the financial statements amounting to R24 672 590 as at 30 June 2008 have not been separately invested as it has been used for purposes other than the conditions by which this funding was made available to the municipality. In terms of section 44(2) of the Division of Revenue Act, 2007 (Act No 1 of 2007) any spending of an allocation in contravention of the act constitutes irregular expenditure in terms of the MFMA. No disclosure in this regard was made in the financial statements.

Property, plant and equipment

20. I could not obtain sufficient appropriate audit evidence that the assets disclosed on the face of the statement of financial position and note 9 to the financial statements existed at year end owing to assets of at least R6 512 979 (2007: R8 923 366) that could not be verified through physical verifications in the current year.

Long term liabilities

21. Included with the long term liabilities is an amount of R6 728 734 in respect of a lease contract but since the municipality did not make an assessment as to the classification of the contract, compliance with the disclosure requirements of

IAS 17: Leases have not been complied with as no information on the lease is disclosed in the financial statements. Furthermore, no accounting policies on leases have been presented in the financial statements as required by paragraph 5 of *GRAP 3: accounting policies, changes in accounting estimates and errors*.

22. Long term liabilities amounted to R23 966 629 is disclosed for which no appropriate accounting policy is included in the financial statements. I therefore could not confirm that the disclosure requirements of paragraphs 15 of *IAS 39: Financial instruments: Recognition and measurement* and paragraphs 58 of *IAS 32: Financial instruments: Presentation* has been met as described in paragraph 11 of this report.

Unspent conditional grants and receipts

23. Unspent conditional grants as disclosed on the statement of financial position and note 7 to the financial statements represent the net result of debit and credit balances of R174 133 301 and R198 805 892 respectively. Since a large portion of these balances have not been allocated to the specific financial statement line item at year end, it is possible that assets and liabilities could be misstated by an unknown amount. Evidence that the provisions of paragraph 15 of *IAS 39: Financial instruments: Recognition and Measurement* regarding the classification and recognition of financial instruments was complied with, was not obtained.

Qualified opinion

24. In my opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had I been able to satisfy myself as to the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Setsoto Local Municipality as at 30 June 2008 and its financial performance and cash flows for the year then ended, in accordance with the basis of accounting determined by the National Treasury, as set out in accounting policy note 1 to the financial statements and in the manner required by the MFMA and DoRA.

OTHER MATTERS

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Internal controls

25. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the inefficiencies in the system of internal control, which led to the qualified opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Consumer and other debtors	X	X	X		
Provisions			X		
Commitments			X		
Employee related costs	X		X		
Inventory		X	X		
Unauthorised and Irregular expenditure	X				
Property, plant and equipment	X		X		
Long term liabilities	X				
Unspent conditional grants	X		X		

Control environment: establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.

Risk assessment: involves the identification and analysis by management of relevant financial reporting risks to achieve predetermined financial reporting objectives.

Control activities: policies, procedures and practices that ensure that management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.

Information and communication: supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allows people to carry out their financial reporting duties.

Monitoring: covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within a process.

Non-compliance with applicable legislation

Municipal Finance Management Act, 2003 (Act No 56 of 2003)(MFMA)

26. Section 115(1)(b) of the MFMA states that the Accounting Officer of a municipality must take all reasonable steps to ensure that proper mechanisms and separation of duties are in place to minimize the likelihood of fraud, corruption, favouritism, unfair and irregular practices. The municipality did not have a strategy in place to prevent fraud and corruption such as a fraud prevention plan.
27. The accounting officer is responsible for ensuring that the municipality has and maintain effective, efficient and transparent systems of risk management in terms of section 62(1)(c)(1) of the MFMA. In the absence of a risk management policy and a risk management committee was not established to assist the accounting officer in managing risks and to determine appropriate strategies dealing with such risks.

Municipal Systems Act, 2000 (Act No 32 of 2000)(MSA)

28. In terms of section 67 of the MSA, a municipality must develop and adopt appropriate systems and procedures to ensure fair, efficient, effective and transparent personnel administration. The policy regulating personnel matters was only implemented during June 2008.

Matters of governance

29. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of certain key governance responsibilities, which I have assessed as follows:

No.	Matter of governance	Yes	No
	Audit committee		
1(a)	The municipality had an audit committee in operation throughout the financial year.		X
1(b)	The audit committee operates in accordance with approved written terms of reference.		X
1(c)	The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.		X
	Internal audit		
2(a)	The municipality had an internal audit function in operation throughout the financial year.	X	
2(b)	The internal audit function operates in terms of an approved internal audit plan.	X	
2(c)	The internal audit function substantially fulfilled its responsibilities		X

No.	Matter of governance	Yes	No
	for the year, as set out in section 165(2) of the MFMA.		
	Other matters of governance		
3	The annual financial statements were submitted for audit as per the legislated deadlines in Section 126 of the MFMA.	X	
4	The annual report was submitted for the auditor for consideration prior to the date of the auditor's report.		X
5	The financial statements submitted for audit were not subject to any material amendments resulting from the audit.	X	
6	No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.	X	
7	The prior year's external audit recommendations have been substantially implemented.		X
8	The provincial SCOPA resolutions have been substantially implemented.	X	
	Implementation of Standards of Generally Recognised Accounting Practice (GRAP)		
9(a)	The municipality submitted an implementation plan, detailing progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 30 October 2007.	X	
9(b)	The municipality substantially complied with the implementation plan it submitted to the National Treasury and the relevant provincial treasury before 30 October 2007, detailing its progress towards full compliance with GRAP.	X	
9(c)	The municipality submitted an implementation plan, detailing further progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 31 March 2008.	X	

Unaudited supplementary schedules

30. The municipality provided supplementary information in the financial statements on whether resources were obtained and used in accordance with the legally adopted budget, in accordance with GRAP 1 *Presentation of Financial Statements*. The supplementary budget information set out on Appendices A to D do not form part of the financial statements and is presented as additional information. Accordingly I do not express an opinion thereon.

OTHER REPORTING RESPONSIBILITIES

REPORT ON PERFORMANCE INFORMATION

31. I was engaged to audit the performance information.

Responsibility of the accounting officer for the performance information

32. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

Responsibility of the Auditor-General

33. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.

34. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

35. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Audit findings (performance information)

Non-compliance with regulatory requirements

36. In terms of section 53(1)(c)(ii) of the MFMA the mayor must take all reasonable steps to ensure that the service delivery and budget implementation plan (SDBIP) is approved within 28 days after approval of the budget. Through inspection of the budget and the SDBIP I noticed that the budget was approved on 31 May 2007 but the SDBIP only on 07 August 2007 which is almost two months after the budget was approved. Management could not provide me with evidence that the council and the MEC were informed of the delay in approval of the SDBIP in terms of section 53(2) of the MFMA.

37. I was unable to obtain sufficient appropriate audit evidence that the performance agreements signed for section 55 and 57 managers were aligned to the IDP and the Performance Management System of the municipality. The performance agreements were based on the SDBIP for the 2007/08 financial year but when scrutinising this document, I identified that various outcome indicators, which forms the basis for the performance agreements, had no measurable objectives recorded.

Content of integrated development plan

38. The integrated development plan of the Setsoto local municipality did not include the key performance indicators and performance targets determined in terms of its performance management system, as required by section 26(i) of the MSA.

Existence and functioning of a performance audit committee

39. The Setsoto local municipality did not appoint and budget for a performance audit committee, neither was another audit committee utilised as the performance audit committee.

No reporting of performance information

40. The entity has not reported performance against predetermined objectives, as required by section 46 of the MSA.

APPRECIATION

41. The assistance rendered by the staff of the Setsoto Local Municipality during the audit is sincerely appreciated.

Auditor-General.
Bloemfontein

30 November 2008



A U D I T O R - G E N E R A L