

**REPORT OF THE AUDITOR-GENERAL TO THE SETSOTO MUNICIPAL COUNCIL
AND THE FREE STATE LEGISLATURE ON THE FINANCIAL STATEMENTS AND
PERFORMANCE INFORMATION OF THE SETSOTO LOCAL MUNICIPALITY FOR
THE YEAR ENDED 30 JUNE 2009**

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Setsoto local municipality which comprise the statement of financial position as at 30 June 2009, and the statement of financial performance, the statement of changes in net assets and the 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].

The 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 basis of accounting determined by the National Treasury, as set out in accounting policy note 01 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 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.

The Auditor-General's responsibility

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 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 read with *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 about 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. 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.
6. 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.

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

Basis for qualified opinion

Property, plant and equipment

8. The existence of assets of R328 451 486 disclosed in the statement of financial position and note 8 to the financial statements could not be audited satisfactorily to enable me to express an opinion on whether these assets disclosed in the financial statements existed at year end. Below are some of the matters which could not be resolved during the audit:
 - 8.1 Assets recorded on the asset register and valued at R 328 451 486 for which no evidence exist that an assets verification or count were performed in the 2008/09 financial year. Several redundant assets could not be traced to their location during the year. This is also in contravention of section 63 of the MFMA, because the existence of assets disclosed in the financial statements and recorded in the assets register was not verified by the municipality.
 - 8.2 Assets, mainly community assets, with a value of R39,5 million (2008: R56,4 million) is shown in the asset register which could not be physically located at the time of the audit. The reasons why these assets could not be located are inter alia:
 - (a) Items are not clearly described that could facilitate easy identification
 - (b) The various components that makes up these assets / inventory is not documented
 - (c) The specific locations are not recorded in the assets register
 - (d) Evidence of ownership could also not be presented for audit
 - (e) Personnel of the municipality were unable to identify some of these assets during the assets verification visit
 - 8.3 As a result of these shortcomings I was not able to determine that the assets valued at R39,5 million actually exist and is bona fide assets of the municipality and leads to a limitation on the scope of our audit of assets.
 - 8.4 Assets with a book value of R113 083 014 according to the asset register did not have descriptions of their physical location or other references so as to trace it. The existence of these assets could in the absence of sufficient appropriate evidence about their location not be verified.
9. Capital spending during the year of R9 million could not be traced to appropriate, sufficient audit evidence such as payment vouchers, invoices, delivery notes, etc to determine the correctness, recording, accuracy and validity of this amount.

Payments for goods and services and fixed assets

10. VAT allocation on payments of goods and services and purchases of fixed assets of could be materially understated or overstated owing to errors that were identified with the allocation of VAT during the audit which amounted to R135 932 and R235 003 respectively that is a result of computation errors that occurred on the financial system throughout the financial year that caused the financial system to calculate value added tax at incorrect percentages. The error was not identified and isolated to a specific period, consequently, I did not obtain sufficient appropriate evidence that this has been addressed and therefore the total effect of any understatements or understatements could not be determined.

Unspent conditional grants

11. Sufficient and appropriate supporting documentation and reconciliation with regard to unspent conditional grants of R16 441 778 (2008: R24 672 590) disclosed as a current liability in the statement of financial position and notes 14 and 23.2 to the financial statements could again not be submitted for audit purposes. Consequently, I have also not been able to verify the existence of the liability of R16 441 778.
12. No explanations of conditions still to be met and other relevant information is disclosed for unspent conditional grants of R16 441 778 (2008: R24 672 590) that is disclosed in note 15 to the financial statements, which is also inconsistent with section 123(1)(e) of the MFMA.

Inventory

13. The results of the 2008/09 inventory count was not reliable for the purposes of determining the value of inventory at year end owing to inter alia the final report and changes to the inventory account balance was not approved by the accounting officer / council. I could not perform alternative procedures to verify the completeness and existence of inventory at year end, consequently, I was unable to obtain sufficient, appropriate evidence to support the amount of R573 880 (2008: R551 972) in the statement of financial position and note 4 to the financial statements.

Presentation of the cash flow

14. The accuracy of the cash flow could not be verified due to the following:
 - 14.1 Employee costs of R43 881 236 could not be verified.
 - 14.2 Disposals of R602 315 were netted off against payments of fixed assets of R62 030 011.
 - 14.3 Debit and credit non cash items of R45 328 115 and R63 342 respectively could not be verified.

Opinion

15. In my opinion, except for the 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 Setsoto local municipality as at 30 June 2009 and its financial performance and its cash flows for the year then ended, in accordance with Statements of Generally Recognised Accounting Practice (Statements of GRAP) and in the manner required by the MFMA.

Emphasis of matters

Without qualifying my opinion, I draw attention to the following matters on which I do not express a qualified opinion:

Basis of accounting and amendments to the applicable basis of accounting

16. The municipality's policy is to prepare financial statements on the basis of accounting determined by the Accounting Standards Board (ASB), as set out in accounting policy note 1 to the financial statements.

Going concern

17. The municipality's is facing significant risks that impact on its ability to function as a going concern. Management's assessment of these risks is disclosed in note 47 of the financial statements.

Unauthorised, irregular or fruitless and wasteful expenditure

18. The municipality disclosed unauthorised and irregular expenditure in terms of section 125(d) of the MFMA in note 37 to the financial statements:
- 18.1 Unauthorised expenditure of R2 599 032 arising from the exceeding of the previous year budget and reported in the previous year report is disclosed in note 37.1 to the financial statements and the payment of a credit card of R40 000 for which no sufficient, appropriate evidence existed at year end.
- 18.2 As disclosed in note 37.3 to the financial statements, the municipality incurred long-term debt of R5 139 560 without the required prior approval of the mayor or the municipal council and failed to inform the community in accordance with section 21A of the Municipal System Act, 2000 (Act No 32 of 2000) (MSA) of the proposed debt that it has taken up.
- 18.3 Details of irregular expenditure of R2,1 million is disclosed in note 37.3 as a result of services acquired in contravention of the supply chain regulations.
- 18.4 Irregular expenditure of R16 448 702 (2008: R24 672 590) representing unspent conditional grants not backed by an equivalent investment since monies has been spent in previous years in contravention of section 43(2) of DoRa, 2008, is disclosed in note 37.3 to the financial statements.

18.5 Details of irregular expenditure are disclosed in note 37.3 to the financial statements in respect of irregular payments made to councillors.

Restatement of corresponding figures

19. As disclosed in note 36 to the financial statements, the corresponding figures for 30 June 2008 have been restated as result of errors discovered during prior years in the financial statements of the municipality that were corrected retrospectively in the current year.

Other matters

Unaudited supplementary schedules

20. 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 pages XX to XX does not form part of the financial statements and is presented as additional information. Accordingly I do not express an opinion thereon.

Non-compliance with applicable legislation

Municipal finance management act, 2003 (MFMA)

21. No reports on the mid year budget and performance assessment were submitted to the mayor, national treasury and the provincial treasury as required by section 72(1)(b) of the MFMA.

22. The accounting officer did not submit to the mayor, in terms of section 69(3) of the MFMA, a draft service and budget implementation plan for the budget year and drafts of the annual performance agreements as required in terms of section 57(1)(b) of the MSA for the municipal manager and all senior managers.

23. The audit committee only convened three times and not four times as required by section 166(4)(b) of the MFMA.

24. Section 62(1)(c)(i) of the MFMA states that the accounting officer of a municipality must ensure that the municipality has maintained effective, efficient and transparent systems of financial and risk management and internal control. Sufficient and appropriate audit evidence to proof that an IT steering committee and risk management committee was operational during the year was not obtained.

25. Sections 74(1) of the MFMA prescribes that the accounting officer of a municipality must submit to the National Treasury, the provincial treasury, the department for local government in the province or the Auditor-General such information, returns, documents, explanations and motivations as may be prescribed or as may be required. The National Treasury issued MFMA circular 34 requiring that municipalities complete a report for each contract awarded above the value of R100 000 (VAT included). The municipality did not submit to the National Treasury these reports for contracts ranging between R200 000 and R2 314 634 totalling R6 962 650.

26. Section 127(3) of the MFMA states that if the mayor, for whatever reason, is unable to table in the council annual report of the municipality, within seven months after the end of the financial year to which the report relates, the mayor must promptly submit to the council written explanations setting out reasons for the delay. The annual report was approved by council only on 31 March 2009 which is in contravention with section 127(3) of the MFMA.
27. Section 127(5) of the MFMA states that immediately after the annual report is tabled in council, the accounting officer, in accordance with section 21A of the MSA must make public the annual report and invite the local community to submit representations in connection with the annual report. Evidence that this was complied with was not obtained during the audit.
28. The municipality did not report the overdrawn bank account of R12 411 248 to the National Treasury as required by section 70(2) of the MFMA. (EX.48)

Governance framework

Internal control deficiencies

29. 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 deficiencies in the system of internal control, which led to the qualification of opinion. The root causes are categorised according to the five components of an effective system of internal control. (The number listed per component can be followed with the legend below the table.) In some instances deficiencies exist in more than one internal control component.

Par. No.	Basis for qualified opinion	CE	RA	CA	IC	M
8 – 9	Property, plant and equipment	5	2	3	1	1
10	Payments for goods and services and fixed assets	5	2	3		1
11 – 12	Unspent conditional grants	5	2	3		1
13	Inventory	5	2	3		1

Overall reflections / conclusion on the governance framework based on internal control deficiencies

- 30. Factors influencing the qualification of PPE and inventory mainly centre on poor record keeping and accountability. Existing procedures are not followed through and it is as if no consequences follow as a result of any non compliance with internal procedures.
- 31. The lack of an effective internal monitoring system and timely review of transactions together with an outdated computerised information system had contributed to the qualification on these items which makes management controls ineffective.
- 32. Independent review of financial statements before submitting it to me for auditing could have prevented these qualifications of the cash flow statement.

Legend	
CE = Control environment	
The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.	1
Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.	2
Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.	3
Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting.	4
The accounting officer/accounting authority does not exercise oversight responsibility over financial reporting and internal control.	5
Management's philosophy and operating style do not promote effective control over financial reporting.	6
The entity does not have individuals competent in financial reporting and related matters.	7
RA = Risk assessment	
Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting.	1
The entity does not identify risks to the achievement of financial reporting objectives.	2
The entity does not analyse the likelihood and impact of the risks identified.	3
The entity does not determine a risk strategy/action plan to manage identified risks.	4
The potential for material misstatement due to fraud is not considered.	5
CA = Control activities	
There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.	1
General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.	2
Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.	3
Actions are not taken to address risks to the achievement of financial reporting objectives.	4
Control activities are not selected and developed to mitigate risks over financial reporting.	5
Policies and procedures related to financial reporting are not established and communicated.	6

Legend	
Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system.	7
IC = Information and communication	
Pertinent information is not identified and captured in a form and time frame to support financial reporting.	1
Information required to implement internal control is not available to personnel to enable internal control responsibilities.	2
Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel.	3
M = Monitoring	
Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting.	1
Neither reviews by internal audit or the audit committee nor self -assessments are evident.	2
Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken.	3

Key governance responsibilities

33. 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 key governance responsibilities, which I have assessed as follows:

No.	Matter	Y	N
	Clear trail of supporting documentation that is easily available and provided in a timely manner		
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.	X	
	Quality of financial statements and related management information		
2.	The financial statements were not subject to any material amendments resulting from the audit.		X
3.	The annual report was submitted for consideration prior to the tabling of the auditor's report.		X
	Timeliness of financial statements and management information		
4.	The annual financial statements were submitted for auditing as per the legislated deadlines section 126 of the MFMA.	X	
	Availability of key officials during audit		

No.	Matter	Y	N
	Clear trail of supporting documentation that is easily available and provided in a timely manner		
5.	Key officials were available throughout the audit process.	X	
	Development and compliance with risk management, effective internal control and governance practices		
6.	Audit committee		
	<ul style="list-style-type: none"> The municipality had an audit committee in operation throughout the financial year. 		X
	<ul style="list-style-type: none"> The audit committee operates in accordance with approved, written terms of reference. 	X	
	<ul style="list-style-type: none"> The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA. 		X
7.	Internal audit		
	<ul style="list-style-type: none"> The municipality had an internal audit function in operation throughout the financial year. 	X	
	<ul style="list-style-type: none"> The internal audit function operates in terms of an approved internal audit plan. 	X	
	<ul style="list-style-type: none"> The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA. 	X	
8.	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.		X
9.	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.		X
10.	The information systems were appropriate to facilitate the preparation of the financial statements.		X
11.	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 95(c)(i) of the MFMA.		X
12.	Delegations of responsibility are in place, as set out in section 79 of the MFMA.	X	
	Follow-up of audit findings		
13.	The prior year audit findings have been substantially addressed.		X
14.	SCOPA/Oversight resolutions have been substantially	X	

No.	Matter	Y	N
	Clear trail of supporting documentation that is easily available and provided in a timely manner		
	implemented.		
	Issues relating to the reporting of performance information		
15.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.		X
16.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.		X
17.	A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the Setsoto local municipality against its mandate, predetermined objectives, outputs, indicators and targets section 68 of the MFMA.	X	
18.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.	X	

Overall reflections / conclusion on the governance framework based on internal control deficiencies

Quality of financial statements and related management information

It was the first time implementation of full GRAP accounting framework and the fact that the financial statements were drawn up in-house with limited knowledge of GRAP are some of the factors that contributed to the material amendments to the financial statements.

Development and compliance with risk management, effective internal control and governance practices and prior year audit findings

An unawareness or ignorance of what the roles and responsibilities of the audit committee together with ineffective communication and the failure by management to develop and maintain cost effective internal control environment contributes to these shortcomings in key governance responsibilities.

Issues relating to the reporting of performance information

The framework for reporting on performance information requires further refinements to include all stakeholders and to educate them of their roles and responsibilities and to provide for an effective monitoring and reporting tool.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

34. I have reviewed the performance information as set out on pages xx to xx.

The accounting officer's responsibility for the performance information

35. 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).

The Auditor-General's responsibility

36. 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.

37. 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.

38. 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

Content of integrated development plan

39. 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 sections 26(i) and 41(1)(b) of the MSA and regulation 12 of the Municipal Planning and Performance Management Regulations, 2001. (ex.33, Ex.107)

Existence and functioning of a performance audit committee

40. The Setsoto local municipality did not appoint and budget for a performance audit committee, nor was another audit committee utilised as the performance audit committee, as required by regulation 14(2) of the Municipal Planning and Performance Management Regulations, 2001. (Ex.1)

Lack of adoption or implementation of a performance management system

41. The Setsoto local municipality did not implement a framework that describes and represents how the municipality's cycle and processes of performance planning,

monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players, as required in terms of regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001 and section 38(1) of the Municipal Systems Act, 2000. (Ex.37) (Ex.70)

Usefulness and reliability of reported performance information

42. The following criteria were used to assess the usefulness and reliability of the information on the municipality's performance with respect to the objectives in its annual performance plan:

- **Consistency:** Has the municipality reported on its performance with regard to its objectives, indicators and targets in its approved annual performance plan?
- **Relevance:** Is the performance information as reflected in the indicators and targets clearly linked to the predetermined objectives and mandate. Is this specific and measurable, and is the time period or deadline for delivery specified?
- **Reliability:** Can the reported performance information be traced back to the source data or documentation and is the reported performance information accurate and complete in relation to the source data or documentation?

The following audit findings relate to the above criteria:

Inconsistently reported performance information

43. The Setsoto local municipality has not reported throughout on its performance with regard to its indicators as per the approved annual performance plan. Details in this regard are as follows:(Ex.109)

Performance Indicator

- To ensure that effluent discharge comply with DWAF requirements
- Develop electricity master plan
- Number of roadblocks conducted
- Number of hours escort duty performed
- Number of hours point duty performed
- Number of persons attending driver awareness/education programs
- Number of street names erected per town per month

Lack of appropriate information systems generating performance information

44. Sufficient appropriate audit evidence with regard to the reported performance information of the following indicators could not be obtained, as the information system used for generating performance information was not appropriate to facilitate the preparation of accurate and complete actual performance information. (Ex.109)

Performance Indicator

- To ensure that effluent discharge comply with DWAF requirements
- Develop electricity master plan
- Number of roadblocks conducted
- Number of hours escort duty performed
- Number of hours point duty performed
- Number of persons attending driver awareness/education programs
- Number of street names erected per town per month

OTHER REPORTS

Performance audits

45. No performance audits performed during the year.

Special audits

46. No special audits performed during the year.

APPRECIATION

47. The assistance rendered by the staff of the Setsoto local municipality during the audit is sincerely appreciated.

Bloemfontein

30 November 2009



A U D I T O R - G E N E R A L
S O U T H A F R I C A