

# REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND THE COUNCIL ON THE SETSOTO LOCAL MUNICIPALITY

## REPORT ON THE FINANCIAL STATEMENTS

### Introduction

1. I have audited the financial statements of the Setsoto Local Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2013, the statement of financial performance, statement of changes in net assets and the cash flow statement for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

### Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2012 (Act No. 5 of 2012) (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 Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. 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

#### Irregular expenditure

6. I was unable to obtain sufficient appropriate audit evidence that management has identified and recorded all instances of irregular expenditure for the current and prior year as the controls over the system were ineffective and management did not review the whole population to ensure that all instances of irregular expenditure were identified and recorded. I was unable to confirm the irregular expenditure by alternative means. Consequently, I was unable to determine whether any adjustments to irregular expenditure incurred during the

year stated at R23 508 699 (2012: R44 514 337) in note 46 to the financial statements were necessary.

7. The municipality did not include particulars of all irregular expenditure and deviations from supply chain management (SCM) regulations in note 46 to the financial statements, as required by section 125 of the MFMA and the SCM regulation 36(2).

#### **Aggregation/Accumulation of immaterial uncorrected misstatements**

8. The financial statements as a whole are materially misstated due to the cumulative effect of the following individually immaterial uncorrected misstatements in the elements making up the statement of financial position and the statement of financial performance:

- Property plant and equipment are overstated by R5 087 853
- Opening retained income is understated by R3 737 574
- Expenditure is understated by R1 350 279

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

- Revenue from non-exchange transactions disclosed as R4 767 987
- Fines not accounted for in terms of GRAP 23: *Revenue from non-exchange transactions* disclosed as R470 298
- Provision for environmental rehabilitation disclosed as R2 945 966

As a result, I was unable to determine whether any further adjustments to these elements were necessary.

#### **Investment in municipal entity**

9. The financial statements of the municipality could be misstated, as the financial information of the municipal entity established by the council during the prior financial year, namely the Setsoto Integrated Dairy Project, was not consolidated and a consolidated set of financial statements was not presented for auditing, as required by section 126(1) (b) of the MFMA.

#### **Qualified opinion**

10. 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 Setsoto Local Municipality as at 30 June 2013 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**

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

#### **Restatement of corresponding figures**

12. As disclosed in note 54 to the financial statements, the corresponding figures for 30 June 2012 have been restated as a result of errors discovered during the current financial year in the financial statements of the Setsoto Local Municipality at, and for the year ended, 30 June 2012.

### **Material losses and impairments**

13. As disclosed in note 5 and note 48 to the financial statements, material losses to the amount of R180 404 479 (2012: R19 106 140) and R33 108 298 (2012: R33 960 602), respectively, were incurred as a result of a write-off of irrecoverable trade debtors and distribution losses incurred relating to water and electricity.

### **Additional matter**

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

### **Unaudited supplementary schedules**

15. The supplementary information set out on pages 80 to 99 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.

### **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

16. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

#### **Predetermined objectives**

17. I performed procedures to obtain evidence about the usefulness and reliability of the information in the service delivery performance report as set out on pages xx to xx of the annual report.
18. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned development priorities. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury's *Framework for managing programme performance information* (FMPPPI).

The reliability of the information in respect of the selected development priorities is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

19. The material findings are as follows:

#### **Usefulness of information**

20. Section 46 of the Municipal Systems Act (MSA) requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved. Measures to improve performance for a total of 100% of the planned targets not achieved were not reflected in the service delivery performance report. This was due to a lack of monitoring and review of the reporting documents by management.
21. The MSA, section 41(c) requires that the actual achievements against all planned indicators and targets must be reported annually. The service delivery performance report submitted for audit purposes did not include 100% of all planned indicators specified in the service delivery and budget implementation plan for the year under review. This was due to a lack of

monitoring and review of the reporting documents by management.

22. The National Treasury FMPPPI requires that performance targets be measurable. The required performance could not be measured for a total of 100% of the planned targets. This was due to a lack of supporting source documentation for the actual performance information.
23. The National Treasury FMPPPI requires that it must be possible to validate the processes and systems that produce the indicator. A total of 100% of the planned indicators were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to effective mechanisms, systems and processes not being implemented for the collection, recording, processing, monitoring and review of the actual performance information.

#### **Reliability of information**

24. The National Treasury FMPPPI requires that institutions should 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 information presented with respect to the development priorities water, sanitation, roads and storm water, electricity and waste management.

This was due to limitations placed on the scope of my work because the institution could not provide sufficient appropriate evidence in support of the reported performance information.

#### **Compliance with laws and regulations**

25. I performed procedures to obtain evidence that the entity had complied with applicable laws and regulations regarding financial matters, financial management and other related matters. Our findings on material non-compliance with specific matters in key applicable laws and regulations, as set out in the general notice issued in terms of the PAA, are as follows:

#### **Strategic planning and performance management**

26. The municipality did not ensure that the annual objectives and indicators for the municipal entity, Setsoto Integrated Dairy Pty Ltd, are established by agreement with the municipal entity and included in the municipal entity's multi-year business plan, as required by section 93C(a)(iv) of the MSA.
27. The performance of Setsoto Integrated Dairy Pty Ltd was not monitored and annually reviewed as part of the annual budget process, as required by section 93C(a)(v) of the MSA.
28. The municipality did not have and maintain effective, efficient and transparent systems of internal controls, as required by section 62(1)(c)(i) of the MFMA.

#### **Audit committee**

29. The audit committee did not advise the council, accounting officer and management staff on matters relating to internal financial control and internal audits, risk management, accounting policies, effective governance, performance management and performance evaluation, as required by section 166(2)(a) of the MFMA.

30. The audit committee did not advise the council, accounting officer and the management staff on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA.
31. The audit committee did not advise the council, accounting officer and the management staff on matters relating to compliance with the MFMA and DoRA, as required by section 166(2)(a)(vii) of the MFMA.
32. 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 entity, its efficiency and effectiveness and its overall level of compliance with the MFMA and DoRA, as required by section 166(2)(b) of the MFMA.
33. The audit committee did not respond to the council on the issues raised in the audit reports of the Auditor-General, as required by section 166(2)(c) of the MFMA.
34. The audit committee met only three times during the year, which is contrary to section 166(4)(b) of the MFMA.
35. The audit committee did not review the municipality's performance management system and make recommendations to the council, as required by Municipal planning and performance management regulation (MPPMR) 14(4)(a)(ii).b.
36. In one instance the audit committee did not review the quarterly internal audit reports on performance measurement, as required by MPPMR 14(4)(a)(i).
37. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by MPPMR 14(4)(a)(iii).

#### **Budget**

38. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of sections 15 and 87(8) of the MFMA.
39. Quarterly reports were not submitted to the council on the implementation of the budget and financial state of affairs of the municipality within 30 days after the end of each quarter, as required by section 52(d) of the MFMA.

#### **Annual financial statements, performance and annual report**

40. 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 certain components were identified by the auditors in the submitted financial statements and were corrected by management during the audit.
41. The 2011-12 annual report was not tabled in the municipal council within seven months after the end of the financial year, as required by section 127(2) of the MFMA.
42. A written explanation was not submitted to council setting out the reasons for the delay in tabling the 2011-12 annual report in the council, as required by section 127(3) of the MFMA.

43. The accounting officer did not make the 2011-12 annual report public immediately after the annual report was tabled in the council, as required by section 127(5)(a) of the MFMA.
44. The municipal council did not adopt an oversight report, containing comments on the annual report, within two months from the date on which the 2011-12 annual report was tabled, as required by section 129(1) of the MFMA.
45. The accounting officer did not make public the council's oversight report on the 2011-12 annual report within seven days of its adoption, as required by section 129(3) of the MFMA.
46. The annual report for the year under review does not include all the performance of the municipality and measures taken to improve performance, as required by section 46(1)(a) and (c) of the MSA.
47. The annual report for the year under review does not include an assessment by the accounting officer of any arrears on municipal taxes and service charges, the accounting officer's assessment of the municipality's performance against measurable performance objectives for revenue collection from each revenue source and for each budget vote, particulars of any corrective action taken or to be taken in response to issues raised in the audit report and the report of the audit committee, as required by section 121(3)(e)(f)(g)(j) of the MFMA.

#### **Expenditure management**

48. No reports regarding unauthorised, irregular and fruitless and wasteful expenditure indicating the steps taken to recover such expenses from the liable person and to prevent recurrence were submitted to the mayor, MEC and the Auditor-General, as required by section 32(4) of the MFMA.
49. The accounting officer did not take effective steps to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA.
50. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred, accounted for creditors and accounted for payments made, as required by section 65(2)(b) of the MFMA.

#### **Revenue management**

51. Revenue received by the municipality was not reconciled at least on a weekly basis, as required by section 64(2)(h) of the MFMA.

#### **Asset management**

52. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2) of the MFMA.

#### **Procurement and contract management**

53. Goods and services with a transaction value of below R200 000 were not procured by obtaining the required price quotations, as required by SCM regulation 17(a) and (c).
54. Quotations were accepted from prospective providers who are not registered as accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy, in contravention of SCM regulations 16(b) and 17(b).

55. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).
56. Sufficient appropriate audit evidence could not be obtained that bid specifications for procurement of goods and services through competitive bids were drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services, as required by SCM regulation 27(2)(a).
57. Sufficient appropriate audit evidence could not be obtained that bid specifications were drafted by bid specification committees which were composed of one or more officials of the municipality, as required by SCM regulation 27(3).
58. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding were advertised for the required minimum period of days, as required by SCM regulation 22(1) and 22(2).
59. Sufficient appropriate audit evidence could not be obtained that bids were evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality, as required by SCM regulation 28(2).
60. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to and accepted from 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.
61. Sufficient appropriate audit evidence could not be obtained that bid adjudication was always done by committees which were composed in accordance with SCM regulation 29(2).
62. Awards were made to bidders other than those recommended by the bid evaluation committee without ratification by the accounting officer, as required by SCM regulation 29(5)(b).
63. Sufficient appropriate audit evidence could not be obtained that the preference point system was applied in all procurement of goods and services above R30 000, as required by section 2(a) of the Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000) (PPPFA) and SCM regulation 28(1)(a).
64. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to and accepted from suppliers based on preference points that were allocated and calculated in accordance with the requirements of the PPPFA and its regulations.
65. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to and accepted from bidders that scored the highest points in the evaluation process, as required by of section 2(1)(f) of the PPPFA.
66. Contracts were extended without tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.

67. Contracts were extended or modified without the approval of a properly delegated official, as required by SCM regulation 5.
68. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act and CIDB regulation 18.
69. Sufficient appropriate audit evidence could not be obtained that contract and quotations were only awarded to and accepted from providers whose tax matters had been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.
70. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were only awarded to and accepted from bidders who had submitted a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
71. A list of accredited prospective providers was not in place for procuring goods and services through quotations, as required by SCM regulation 14(1)(a).
72. The prospective providers list for procuring goods and services through quotations was not updated at least quarterly to include new suppliers that qualify for listing, and prospective providers were not invited to apply for such listing at least once a year as per the requirements of SCM regulation 14(1)(a)(ii) and 14(2).
73. Sufficient appropriate audit evidence could not be obtained that all contracts and quotations were awarded and accepted in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as expenditure incurred in the current year was based on contracts entered into in prior years for which no procurement process had been followed.

#### **Financial misconduct**

74. Sufficient appropriate audit evidence could not be obtained that investigations were instituted into all allegations of financial misconduct against officials of the municipality, as required by section 171(4)(a) of the MFMA, due to the fact that unauthorised, irregular and fruitless and wasteful expenditure was incurred but was not investigated.

#### **Human resource management and compensation**

75. Job descriptions were not established for all posts in which appointments were made in the current year, in contravention of section 66(1)(b) of the MSA.

#### **Consequences management**

76. Unauthorised expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.
77. Irregular expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.



78. Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.
79. Authorisation of unauthorised expenditure was not done through an adjustment budget, as required by section 32(2) of the MFMA.
80. The council certified unauthorised, irregular and fruitless and wasteful expenditure as irrecoverable without the council committee conducting an investigation to determine recoverability of the expenditure, as required by section 32(2) of the MFMA.

### **Environmental management**

81. The municipality operated two waste disposal sites without a waste management licence or permit, in contravention of section 20(b) of the National Environmental Management: Waste Act, 2008 (Act No. 59 of 2008) and section 20(1) of the Environmental Conservation Act, 1989 (Act No. 73 of 1989).

### **Internal control**

82. We considered internal control relevant to our audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for the qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

### **Leadership**

83. The action plans were not adequately monitored and implemented to address internal control deficiencies identified. In certain instances, staff members of the municipality were not held accountable due to the performance management system not being fully implemented at the municipality. Processes to prevent and detect all unauthorised, irregular and fruitless and wasteful expenditure were not fully established.

### **Financial and performance management**

84. The financial statements were not properly reviewed for completeness and accuracy prior to submission for auditing. This resulted in many findings relating to incorrect disclosure or non-disclosure.
85. In certain instances, staff members of the municipality were not sufficiently skilled to ensure that the daily financial transactions were fully and correctly recorded in the records of the municipality. Internal checking of all financial records and transactions was found to be inadequate.
86. Revenue received was not internally reviewed and reconciled at least on a weekly basis. Unidentified direct bank deposits were not cleared on a regular basis during the financial year.
87. The municipality did not always comply with applicable laws and regulations. No formal processes were in place to monitor compliance with legislation, which resulted in the number of reported non-compliance issues. Consequences for poor performance and non-compliance with laws and regulations were inadequate.

**Governance**

88. The audit committee did not function effectively throughout the year.

*Auditor-General*

Bloemfontein

30 November 2013



**AUDITOR - GENERAL  
SOUTH AFRICA**

*Auditing to build public confidence*