

Report of the auditor-general to Free State Legislature and the council on the Setsoto Local Municipality

Report on the audit of the financial statements

Qualified opinion

1. I have audited the financial statements of the Setsoto Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2020, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget information with actual information for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. In my opinion, except for the effects and the possible effects of the matters described in the basis for qualified opinion section of this auditor's report, the financial statements present fairly, in all material respects, the financial position of the Setsoto Local Municipality as at 30 June 2020, and its financial performance and cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act 56 of 2003 (MFMA) and the Division of Revenue Act 16 of 2019 (Dora).

Basis for qualified opinion

Property plant and equipment

3. The municipality did not review the useful lives and residual values of property, plant and equipment at each reporting date in accordance with the requirements of GRAP 17, *Property, plant and equipment*. As a result, property, plant and equipment with a gross carrying amount of R628 000 000 (2019: R2 246 358) had a zero carrying amount while still being in use. I was unable to determine the impact on the net carrying amount of property, plant and equipment, depreciation and impairment loss, as it was impracticable to do so. In addition, the municipality did not classify property, plant and equipment in accordance with GRAP 17 as assets relating to infrastructure: road, pavement, bridges and storm water were incorrectly classified as land. Consequently, land was overstated and infrastructure: road, pavement, bridges and storm water understated by R12 793 226.
4. I was unable to obtain sufficient appropriate audit evidence that management had properly accounted for property, plant and equipment, due to the status of the accounting records. Assets included in the fixed asset register could not be physically verified and supporting information was not provided for disposals and WIP additions. I was unable to confirm these assets by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to property, plant and equipment, stated at R2 838 585 796 (2019: R2 864 987 638) in note 11 to the financial statements.

Revenue service charges

5. I was unable to obtain sufficient appropriate audit evidence for service charges, as the municipality did not have adequate systems in place to account for the billing of municipal services. Internal controls were also not established to account for the sales of prepaid electricity. I was unable to confirm the service charges by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to service charges, stated at R189 848 624 (2019: R178 270 347) in note 22 to the financial statements.

Capital commitments

6. The municipality did not disclose all capital commitments in the notes to the financial statements, as required by GRAP 17, *Property, plant and equipment*. The municipality committed to capital projects and made payments for ongoing projects, however, the commitments were not disclosed, resulting in commitments being understated by R6 764 044.

Government grants and subsidies

7. I was unable to obtain sufficient appropriate audit evidence that government grants and subsidies had been properly accounted for, as adequate records were not maintained for project expenditure incurred from conditional grant funding. I was unable to confirm the government grants and subsidies by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to government grants and subsidies stated at R308 252 655 in note 27 to the financial statements. This also has an impact on unspent conditional grants.

Context for the opinion

8. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of this auditor's report.
9. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' International code of ethics for professional accountants (including International Independence Standards) (IESBA code) as well as other ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.
10. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

Material uncertainty relating to going concern

11. Note 51 to the financial statements indicates that the municipality incurred a net loss of R38 745 438 during the year ended 30 June 2020. The municipality owed Eskom R32 779 491 (2019: R25 110 583) as at 30 June 2020. These events or conditions, along with other matters set forth in note 51, indicate that a material uncertainty exists that may cast significant doubt on the municipality's ability to continue as a going concern.

Emphasis of matters

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

Irregular expenditure

13. As disclosed in note 45 to the financial statements, irregular expenditure of R92 455 092 (2019: R82 846 851) was incurred due to non-compliance with supply chain management (SCM) requirements.

Unauthorised expenditure

14. As disclosed in note 43 to the financial statements, unauthorised expenditure of R127 354 819 (2019: R616 848 443) was incurred due to overspending of the budget.

Fruitless and wasteful expenditure

15. As disclosed in note 44 to the financial statements, fruitless and wasteful expenditure of R4 333 747 (2019: R2 979 591) was incurred due to interest and penalties on arrear payments to creditors.

Restatement of corresponding figures

16. As disclosed in note 53 to the financial statements, the corresponding figures for 30 June 2019 were restated because of errors in the financial statements of the municipality at, and for the year ended, 30 June 2020.

Material uncertainty relating to claims against the municipality

17. With reference to note 52 to the financial statements, the municipality is the defendant in various lawsuits. The ultimate outcome of these matters could not be determined and no provision for any liabilities that may result were made in the financial statements.

Material losses

18. As disclosed in note 47 to the financial statements, material water distribution losses of R15 425 713 (2019: R15 342 187) and electricity distribution losses of R11 112 061 (2019: R8 928 564) were incurred by the municipality mainly due to leakages, burst water pipes, line losses, tampering and theft.

Material impairment

19. As disclosed in note 5 to the financial statements, consumer receivables were impaired by R185 239 119 (2019: R176 469 525).

Other matters

Unaudited disclosure notes

20. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA in the financial statements. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion on it.

Unaudited supplementary schedules

21. The supplementary information set out on pages XX to XX 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 on them.

Responsibilities of the accounting officer for the financial statements

22. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the SA Standards of GRAP and the requirements of the MFMA and 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.
23. In preparing the financial statements, the accounting officer is responsible for assessing the Setsoto Local Municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the appropriate governance structure either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

Auditor-general's responsibilities for the audit of the financial statements

24. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
25. A further description of my responsibilities for the audit of the financial statements is included in the annexure to this auditor's report.

Report on the audit of the annual performance report

Introduction and scope

26. In accordance with the Public Audit Act 25 of 2004 (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance

information against predetermined objectives for the selected key performance area (KPA) presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.

27. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators/measures included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.
28. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected KPA presented in the annual performance report of the municipality for the year ended 30 June 2020:

KPA	Pages in the annual performance report
KPA 1 – Basic service delivery and infrastructure	x – x

29. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
30. The material findings in respect of the usefulness and reliability of the selected development objective are as follows:

KPA 1 – Basic service delivery and infrastructure

Percentage of construction of cyferfontein raw water abstraction pump station: Earth works, casted concrete reinforcement walls and roof mechanical concrete doors completed

31. The reported target of 45% did not agree with the planned target of 40% as per the approved integrated development plan.

Various indicators

32. The achievements reported in the annual performance report materially differed from the supporting evidence provided for the indicators listed below:

Indicator description	Reported achievement
Percentage of water pipes repaired.	99.89%
Percentage of water meters repaired or replaced.	88.46%
Percentage of sewer pipes repaired	94%
Percentage of unblocked sewer spillages	99.48%
Percentage of repaired/replaced sewer manholes	100%

Indicator description	Reported achievement
Percentage of buckets removed	87.38%
Percentage of VIP and septic tanks serviced	12.89%

Other matters

33. I draw attention to the matters below.

Achievement of planned targets

34. Refer to the annual performance report on pages x to x for information on the achievement of planned targets for the year. This information should be considered in the context of the qualified opinion expressed on the usefulness and reliability of the reported performance information in paragraphs 31 to 32 of this report.

Adjustment of material misstatements

35. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of KPA 1: Basic services and infrastructure. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are reported above.

Report on the audit of compliance with legislation

Introduction and scope

36. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the municipality's compliance with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express an assurance.

37. The material findings on compliance with specific matters in key legislation are as follows:

Annual financial statements, performance and annual report

38. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements on revenue, non-current liabilities and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.

Expenditure management

39. Money owed by the municipality was not always paid within 30 days or an agreed period, as required by section 65(2)(e) of the MFMA.

40. Reasonable steps were not taken to prevent irregular expenditure of R92 455 092 disclosed in note 45 to the financial statements, as required by section 62(1)(d) of the MFMA.

41. Reasonable steps were not taken to prevent fruitless and wasteful expenditure R4 333 747 disclosed in note 44 to the financial statements, in contravention of section 62(1)(d) of the MFMA.
42. Reasonable steps were not taken to prevent unauthorised expenditure of R127 354 819 disclosed in note 43 to the financial statements, in contravention of section 62(1)(d) of the MFMA.

Revenue management

43. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.
44. Revenue due to the municipality was not calculated monthly, as required by section 64(2)(b) of the MFMA.

Procurement and contract management

45. Some goods and services with a transaction value below R200 000 were procured without obtaining the required price quotations, in contravention of SCM regulation 17(1)(a) and (c). Similar non-compliance was also reported in the prior year.
46. Some quotations were accepted from bidders who did not submit 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). Similar non-compliance was also reported in the prior year.
47. Some quotations were accepted from bidders whose tax matters had not been declared by the South African Revenue Service to be in order, in contravention of SCM regulation 43. Similar non-compliance was also reported in the prior year.
48. Some construction contracts were awarded to contractors that did not qualify for the contract in accordance with section 18(1) of the Construction Industry Development Board Act 38 of 2000 (CIDB Act) and CIDB regulations 17 and 25 (7A). This non-compliance was identified in the procurement processes for the construction of a 500 mm diameter pump line from Cyferfontein to the new water treatment works in Senekal/ Matwabeng.
49. Sufficient appropriate audit evidence could not be obtained that all extensions or modifications to contracts were approved by a properly delegated official, as required by SCM regulation 5.
50. Sufficient appropriate audit evidence could not be obtained that the performance of some of the contractors or providers was monitored monthly, as required by section 116(2)(b) of the MFMA.
51. Sufficient appropriate audit evidence could not be obtained that the contract performance and monitoring measures and methods were sufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.

Asset management

52. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

53. Capital assets were disposed of without the municipal council having, in a meeting open to the public, decided on whether the assets were still needed to provide the minimum level of basic municipal services, as required by section 14(2)(a) and 14(2)(b) of the MFMA.

Strategic planning and performance management

54. The performance management system and related controls were inadequate as it did not describe how the performance reporting processes should be conducted, as required by municipal planning and performance management reg 7(1).

Conditional grants

55. I was unable to obtain sufficient appropriate audit evidence that the municipal infrastructure grant was spent for its intended purposes in accordance with the applicable grant framework, as required by section 17(1) of the Dora.
56. I was unable to obtain sufficient appropriate audit evidence that the regional bulk infrastructure grant was spent for its intended purposes in accordance with the applicable grant framework, as required by section 17(1) of the Dora.
57. I was unable to obtain sufficient appropriate audit evidence that the water services infrastructure grant was spent for its intended purposes in accordance with the applicable grant framework, as required by section 17(1) of the Dora.

Other information

58. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements, the auditor's report and the selected objective presented in the annual performance report that has been specifically reported in this auditor's report.
59. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion on it.
60. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected objectives presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
61. I did not receive the other information prior to the date of the auditor's report. When I do receive and read this information, if I conclude that there is a material misstatement therein, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to retract the auditor's report and re-issue an amended report as appropriate. However, if it is corrected this will not be necessary.

Internal control deficiencies

62. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance on it. 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.
63. Management did not always exercise oversight to ensure that accurate and reliable information was submitted on time, as there were material misstatements in the financial statements and annual performance report that required adjustments during the audit.
64. Management did not implement effective human resource management to ensure that adequate and sufficiently skilled resources were in place and that performance was monitored. There were significant vacancies in key management positions as well as support staff positions in finance and SCM units during the financial year under review.
65. Management did not ensure that the action plan to address the prior year findings is adequately implemented. This resulted in repeat findings being reported in the current financial year, due to a slow response by management.
66. The formal processes to effectively monitor compliance with key legislation were inadequate, which resulted in non-compliance with legislation in certain cases.
67. In certain instances, management did not ensure that internal control processes were adequately designed and implemented to prevent non-compliance with SCM requirements. Management relied on internal control processes to ensure compliance with procurement requirements, however it is evident from the increase in the amount of irregular expenditure in the current year that these internal control processes were ineffective and subject to abuse, due to a lack of consequence management.

Material irregularities

68. In accordance with the PAA and the Material Irregularity Regulations, I have a responsibility to report on material irregularities identified during the audit.

Material irregularities in progress

69. I identified material irregularities during the audit and notified the accounting officer, as required by material irregularity regulation 3(2). By the date of this auditor's report, the response of the accounting officer was not yet due. These material irregularities will be included in the next year's auditor's report.

Other reports

70. In addition to the investigations relating to material irregularities, I draw attention to the following engagement being conducted by the Hawks, which had, or could have, an impact on the matters reported in the municipality's financial statements, reported performance information, compliance with applicable legislation and other related matters. This report did not form part of my opinion on the financial statements or my findings on the reported performance information or compliance with legislation.
71. The municipality was under investigation by the Directorate for Priority Crime Investigation (Hawks) due to alleged fraud and corruption relating to the awarding of certain contracts by the municipality during 2018-19. By the date of this report, the investigation was still ongoing.

Auditor-General

Bloemfontein

31 March 2021



**AUDITOR - GENERAL
SOUTH AFRICA**

Auditing to build public confidence

Annexure – Auditor-general’s responsibility for the audit

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements and the procedures performed on reported performance information for selected objectives and on the municipality’s compliance with respect to the selected subject matters.

Financial statements

2. In addition to my responsibility for the audit of the financial statements as described in this auditor’s report, I also:
 - identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error; design and perform audit procedures responsive to those risks; and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations or the override of internal control
 - obtain an understanding of internal control relevant to the audit 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
 - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer
 - conclude on the appropriateness of the accounting officer’s use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists relating to events or conditions that may cast significant doubt on the ability of the Setsoto Local Municipality to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor’s report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify my opinion on the financial statements. My conclusions are based on the information available to me at the date of this auditor’s report. However, future events or conditions may cause a municipality to cease operating as a going concern
 - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and determine whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation
 - obtain sufficient appropriate audit evidence regarding the financial information of the entity. I am responsible for the direction, supervision and performance of the audit. I remain solely responsible for my audit opinion.

Communication with those charged with governance

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and, where applicable, the actions taken to eliminate threats or the safeguards applied.