

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 ... to ..., which comprise the statement of financial position as at 30 June 2015, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget information with actual amount for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA standards of GRAP) and the requirements of the MFMA of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2014 (Act No. 10 of 2014) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on the financial statements based on my audit. I conducted my audit in accordance with International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the municipality's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

6. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Setsoto Local Municipality as at 30 June 2015 and its financial performance and cash flows for the year then ended, in accordance with the with the SA standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

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

Restatement of corresponding figures

8. As disclosed in note 55 to the financial statements, the corresponding figures for 30 June 2014 have been restated as a result of errors discovered during 2014-15 in the financial statements of the Setsoto Local Municipality at, and for the year ended, 30 June 2014.

Material losses

9. As disclosed in note 50 to the financial statements, material losses of R16 658 061(2014: R21 690 046) and R20 289 657 (2014: R12 952 459), respectively, were incurred by the municipality as a result of distribution losses relating to electricity and water.

Material impairments

10. As disclosed in note 5 to the financial statements, a provision for impairment of debtors amounting to R127 785 657 (2014: R192 724 645) has been made with regard to consumer debts amounting to R246 820 305 (2014: R260 092 967).

Going concern

11. Note 54 to the financial statements indicates that Setsoto Local Municipality has incurred a deficit of R161 020 538 (2014: R160 826 796). This matter, along with other matters as set forth in note 54, indicates the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

Irregular expenditure

12. As disclosed in note 47 to the financial statements, the municipality incurred irregular expenditure of R401 698 (2014: R74 744 136) during the year under review mainly due to non-compliance with supply chain management (SCM) requirements.

Additional matter

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

Unaudited disclosure notes

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

Report on other legal and regulatory requirements

15. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected key performance areas presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

16. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected key performance areas (KPAs) presented in the annual performance report of the municipality for the year ended 30 June 2015:
- KPA1: Infrastructure and service delivery on pages x to x.
17. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
18. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned key performance area. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
19. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
20. The material findings in respect of the selected key performance areas are as follows:

KPA 1: Infrastructure and services delivery

Usefulness of reported performance information

21. Section 54(1)(c) of the MFMA determines that the service delivery and budget implementation plan adopted by the municipal council may be amended only if the council approves an adjustments budget. Changes to the service delivery and budget implementation plan in the year have to be made in accordance with the process as prescribed in section 28 of the MFMA. Material changes were made to the objectives, indicators and targets in the service delivery and budget implementation plan, without adoption thereof by the municipal council. This was due to lack of oversight from management side.
22. Section 41(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 62% of the reported objectives and 27% of the reported targets were not consistent with those in the approved service delivery and budget implementation plan.

This was due to inadequate monitoring and review by management in compiling planning and reporting documents.

23. Performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use, as required by the FMPPI. Significantly important indicators in relation to water, sanitation, electricity and solid waste were not well defined.

Reliability of reported performance information

24. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. Significantly important targets were not reliable when compared to the source information or evidence provided. This was due to inadequate monitoring of the completeness of source documentation in support of actual achievements and infrequent review of the validity and accuracy of reported achievements against source documentation.

Additional matter

25. I draw attention to the following matter. My conclusion is not modified in respect of this matter:

Achievement of planned targets

26. Refer to the annual performance report on [page(s) x to x] for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected key performance areas reported in paragraph(s) x to xx] of this report.

Adjustment of material misstatements

27. I identified material misstatements in the annual performance report submitted for auditing on the reported performance information for KPA 1: Infrastructure and services delivery. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information.

Compliance with legislation

28. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Strategic planning and performance management

29. The KPIs set by the municipality did not include indicators on percentage of households with access to basic levels of water, sanitation, electricity and solid waste removal, as required by section 43(2) of the MSA and municipal planning and performance management regulation 10(a).

30. Revisions to the service delivery and budget implementation plan were not approved by the council after the approval of the adjustments budget, as required by section 54(1)(c) of the MFMA.
31. The annual performance report for the year under review did not include measures taken to improve performance, as required by section 46 (1)(c) of the MSA.
32. The performance management system and related controls relating to the planning, monitoring, measurement, review and reporting, and how it is conducted, organised and managed, were not maintained as required by sections 38 of the MSA and municipal planning and performance management regulation 7.

Budgets

33. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

Annual financial statements and annual report

34. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, expenditure and disclosure items identified by the auditors in the submitted financial statement were subsequently corrected and the supporting records were provided, resulting in the financial statements receiving an unqualified audit opinion.
35. The oversight report, containing comments on the annual report, was not adopted by council within two months from the date on which the 2013-14 annual report was tabled, as required by section 129(1) of the MFMA.

Human resource management and compensation

36. Sufficient appropriate audit evidence could not be obtained that job descriptions were established for all posts in which appointments were made in the current year, as required by section 66(1)(b) of the MSA.

Expenditure management

37. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure, fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Procurement and contract management

38. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) and (c).

Asset management start here

39. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA .
40. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

Internal control

41. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

The leadership did not always exercise adequate oversight responsibility over compliance with legislation and performance information as well as financial reporting, resulting in material adjustments having to be made to the financial statements submitted for auditing, due to the slow response by management in addressing internal control deficiencies reported in the prior year.

Financial and performance management

42. The financial statements were not properly reviewed for completeness and compliance with the reporting framework prior to submission for auditing. This resulted in findings relating to disclosure and application of the reporting framework.
43. The municipality did not in all instances 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 non-compliance with laws and regulations were inadequate.
44. Inadequate review and monitoring by management during preparation of the annual report on predetermined objectives resulted in the material findings on predetermined objectives.
45. The management of the municipality did not ensure that proper and complete asset registers were maintained during the year. This has resulted in asset registers that contained many errors and required various revisions during the audit to the extent that additional audit work had to be performed.

Auditor-General

Bloemfontein

30 November 2015



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence