

Report of the auditor-general to Free state legislature and 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 2018, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget information with actual amounts 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 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 2018, and its financial performance and cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practise (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2017 (Act No. 3 of 2017) (Dora).

Basis for qualified opinion

Property, plant and equipment

3. I was unable to obtain sufficient appropriate audit evidence that Property, plant and equipment for the current year had been properly accounted for, due to the status of the accounting records, supporting schedules and asset register. I was unable to confirm the Property, plant and equipment by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to Property, plant and equipment stated at R3 041 432 898 in the financial statements.

Investment property

4. I was unable to obtain sufficient appropriate audit evidence that Investment property for the current year had been properly accounted for, due to differences in supporting information and the Investment property register. I was unable to confirm the Investment property by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to Investment property stated at R68 198 668 in the financial statements.

Cash flow statement

5. The municipality did not disclose the cash flow amounts in the financial statements in accordance with GRAP 2, *Cash flow statements*. I identified material differences between the disclosed amounts and the actual amounts according to the accounting records that could not be supported with sufficient appropriate audit evidence. I was unable to confirm the cash flow statement by alternative means.

Context for the opinion

6. 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.
7. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* (IESBA code) and the 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.
8. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

Material uncertainty related to going concern

9. I draw attention to the matter below. My opinion is not modified in respect of this matter.
10. I draw attention to note 53 to the financial statements, which indicates that the municipality incurred a net loss of R47 060 412 during the year ended 30 June 2018. As stated in note 53, these events or conditions, along with other matters as set forth in note 53, 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

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 43 to the financial statements, the corresponding figures for 30 June 2017 have been restated as a result of errors in the financial statements of the municipality at, and for the year ended, 30 June 2018.

Material losses

13. As disclosed in note 48 to the financial statements, material water losses of R7 044 679 (2017: R3 747 572) were incurred, which represents 26% (2017: 11%) of the total water purchased. These estimated water losses included distribution to townships with unmetered water.

Material impairment

14. As disclosed in note 5 to the financial statements, consumer receivables were impaired by R157 730 761 (2017: R165 119 394).

Unauthorised expenditure

15. As disclosed in note 44 to the financial statements, non-budgeted expenditure of R17 301 739 (2017: R245 531 480) was incurred during the year under review and previous year, which resulted in unauthorised expenditure.

Irregular expenditure

16. As disclosed in note 46 to the financial statements, irregular expenditure of R98 765 998 (2017: R32 972 664) was incurred, mainly due to non-compliance with supply chain management (SCM) requirements.

Fruitless and wasteful expenditure

17. As disclosed in note 45 to the financial statements, fruitless and wasteful expenditure of R3 350 092 (2017: R1 188 124) was incurred mainly due to interest on arrear payments to creditors.

Other matters

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

Unaudited disclosure notes

19. 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 thereon.

Unaudited supplementary information

20. The supplementary information set out on page xx to xx does not form part of the financial statements and is presented as additional information. I have not audited this information and accordingly, I do not express an opinion thereon.

Service delivery and Infrastructure

21. The audit revealed areas of concern regarding planning, project management and monitoring of infrastructure projects. The required documents could not all be produced but it appears that projects were often not fully completed and that the quality of work was compromised. This has a negative impact on the delivery of services as the funds are not always used effectively and efficiently to provide services and to achieve the desired impact of value for money as indicated in the examples below.
22. Signs of distress with the construction of a 3 km paved road and storm water drainage in Marquard/Moemaneng were observed. The drainage system was inadequate thus increasing the risk of water seeping into the surface and structural layers causing damage in future. Stone pitching constructed at the drainage outlet deteriorated significantly and is an indication of poor workmanship. This may result in the initial objective being defeated in the longer term if not corrected, resulting in ineffective service delivery to the community. The contractor was not monitored properly, as the instance of poor quality workmanship should have been rectified.
23. With regard to the upgrading of bulk water supply from Caledon to Meulspuit, Clocolan and Marquard, it was found that the two pumps were installed; however, one pump was faulty and not commissioned. The pumps were installed to pump adequate water to supply towns around the municipality; therefore, the pump that is not functional puts pressure on the other pump and may hamper service delivery to the community.

24. The upgrading of recreational facilities at Meqheleng commenced in the 2010-11 financial year at a total cost of approximately R68 million according to the asset register and was completed in the 2015-16 financial year. However, the opening of the stadium was delayed resulting in the facility being unused. The municipality started to use the facility on an *ad hoc* basis and more frequently as from July 2018, three years subsequent to completion of the project. The community was deprived of using this facility directly after completion and it does not seem as if the return on this significant investment to benefit the community has been fully obtained.

Responsibilities of the accounting officer for the financial statements

25. 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.
26. 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

27. 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.
28. 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

29. In 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 material findings on the reported performance information against predetermined objectives for the selected key performance areas (KPAs) presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
30. 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.

31. 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 2018:

KPA	Pages in annual performance report
Service delivery and infrastructure	x – x

32. I have 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.

33. The material findings in respect of the usefulness and reliability of the selected KPA are as follows:

KPA - Service delivery and infrastructure

Reported achievement not supported by sufficient appropriate audit evidence, i.e. not valid and accurate and complete

Percentage of progress on capital project implementation (new infrastructure)

34. I was unable to obtain sufficient appropriate audit evidence for the reported achievement of 245%. This was due to limitations placed on the scope of my work. I was unable to confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any adjustments were required to the achievement of 245% as reported in the annual performance report.

Reported achievement did not agree with the evidence provided, i.e. not valid and accurate and complete

Number of electricity disconnections and reconnections

35. The achievement for the target of 100 reported in the annual performance report was 100. However, the supporting evidence provided did not agree to the reported achievement and indicated an achievement of 143.

Performance indicators were not well-defined

Various indicators

36. The source information or evidence for achieving the following planned indicators was not clearly defined:

Section	Indicator description
Water and Sewer (Bulk)	Number of Water quality compliance reports
	Number of quality compliance reports
Electricity	Number of reports generated
Water - Operations, Maintenance and Bulk	Number of reports generated
Roads and Stormwater	Number of reports generated
Project Management Unit	Number of reports generated
	Number of reports generated (DES)
Urban Planning and Housing	Number of reports generated
	Number of illegal land use reports
	Number of standing committee reports

Other matters

37. We draw attention to the matters below.

Achievement of planned targets

38. Refer to the annual performance report on pages x to x; 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 34 to 36 of this report.

Adjustment of material misstatements

39. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were in the reported performance information of Service delivery and infrastructure. As management subsequently corrected only some of the misstatements, we 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

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

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

Financial statements, performance reports and annual reports

42. 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 of current assets, non current liabilities, current liabilities and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and/or the supporting records were provided subsequently, but the uncorrected material misstatements

and/ or supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Expenditure management

43. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA
44. Reasonable steps were not taken to prevent irregular expenditure amounting to R49 637 497 as disclosed in note 47 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. Most of the irregular expenditure was caused by non-compliance with SCM regulations mainly in respect of instances where the bid committee did not comply to the composition requirement and where the conditions of local content have not been adhered too.
45. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R3 350 092 as disclosed in note 45 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. Most of the disclosed irregular expenditure was caused by interest and penalties.

Revenue management

46. An effective system of internal control for revenue, as required by section 64(2)(f) of the MFMA, was not in place.

Asset management

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

Procurement and contract management

48. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of SCM regulation 17(a) and (c). Similar non-compliance was reported in the prior year.
49. 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.
50. Sufficient appropriate audit evidence could not be obtained that quotations were only accepted from bidders whose tax matters had been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.
51. Some of the competitive bids were adjudicated by a bid adjudication committee that was not composed in accordance with SCM regulation 29(2). Similar non-compliance was reported in the prior year.
52. Some of the contracts were awarded to and quotations were accepted from bidders that had not scored the highest points in the evaluation process, in contravention of section 2(1)(f) of the Preferential Procurement Policy Framework Act and the Preferential Procurement Regulations.

53. Some of the contracts were awarded to and quotations were accepted from bidders based on functionality criteria that were not stipulated in the original invitation for bidding and quotations, in contravention of the Preferential Procurement Regulations.
54. Bid documentation for procurement of commodities designated for local content and production did not stipulated the minimum threshold for local production and content as required by the Preferential Procurement Regulation 8(2).

Other information

55. 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 those selected KPAs presented in the annual performance report that have been specifically reported in this auditor's report.
56. 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 thereon.
57. 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 KPAs presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
58. I did not receive the other information prior to the date of this auditor's report. When I do receive and read this information and if I conclude that it contains a material misstatement, 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 this auditor's report and reissue an amended report as appropriate. However, if it is corrected this will not be necessary.

Internal control deficiencies

59. 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 thereon. 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.
60. Management did not in all instances exercise oversight to ensure that accurate and reliable information is submitted timeously, as there were material misstatements in the financial statements and annual performance report that required adjustments during the audit.
61. The formal processes to effectively monitor compliance with key legislation were inadequate, which resulted in non-compliance with legislation in certain cases.
62. Instability in key management positions contributed to deficiencies in the control environment.

63. Management did not in certain instances ensure that internal control processes were adequately designed and implemented to ensure cost-effective procurement and to prevent non-compliance with SCM requirements. Management relied on internal control processes to ensure compliance with procurement requirements, but it is evident from the amount of irregular expenditure that these internal control processes were ineffective and subject to abuse.

Auditor-General
Auditor-General

Bloemfontein

30 November 2018



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 KPAs 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 related to events or conditions that may cast significant doubt on the Setsoto Local Municipality’s ability 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 the 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 whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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, related safeguards.