

Report of the auditor-general to Eastern Cape Provincial Legislature and the council on Nelson Mandela Bay Metropolitan Municipality

Report on the consolidated and separate financial statements

Qualified opinion

1. I have audited the consolidated and separate financial statements of the Nelson Mandela Bay Metropolitan Municipality set out on pages ... to ..., which comprise, the consolidated and separate statement of financial position as at 30 June 2017, and the consolidated and separate 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 consolidated and separate 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 my report, the consolidated and separate financial statements present fairly, in all material respects, the consolidated and separate financial position of the Nelson Mandela Bay Metropolitan Municipality as at 30 June 2017, and its consolidated and separate financial performance and cash flows for the year then ended in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Act of South Africa (MFMA) and Division of Revenue Act of South Africa (DoRA).

Basis for qualified opinion

Property, plant and equipment (PPE)

3. The municipality did not assess whether there were any indications that its expectations about the useful lives of PPE had changed, as required by SA Standard of GRAP 17, *Property, plant and equipment*. I was also unable to confirm the PPE balance, through alternative means. Consequently, I was unable to determine if any further adjustments to PPE disclosed at R15,1 billion in the consolidated and separate statement of financial position and depreciation stated at R589,1 million in the consolidated and separate statement of financial performance were necessary.

Creditors- exchange transactions

4. I was unable to obtain sufficient appropriate audit evidence for retention creditors due to the poor status of accounting records. I was unable to confirm these retentions by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to retentions stated at R 207,1 million (2016: R186, 8) in note 7 to the consolidated and separate financial statements.

Irregular expenditure

5. The municipality did not include all irregular expenditure in the notes to the consolidated and separate financial statements, as required by section 125(2)(d) of the MFMA. This resulted from payments made in contravention of the supply chain management requirements. Additionally, I was unable to obtain sufficient appropriate audit evidence to confirm the irregular expenditure included in the note 44.2 to the consolidated and separate financial statements. I was unable to confirm irregular expenditure by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the irregular expenditure stated at R11, 5 billion (2016: R3,4 billion) in the consolidated and separate financial statements.

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 consolidated and separate financial statements section of my 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) together with 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.

Emphasis of matters

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

Restatement of corresponding figures

10. As disclosed in note 40 to the consolidated and separate financial statements, the corresponding figures for 30 June 2016 have been restated as a result of errors discovered during the year in the consolidated and separate financial statements of the municipality for the year ended, 30 June 2017.

Unauthorised expenditure

11. As disclosed in note 44.1 to the consolidated and separate financial statements, unauthorised expenditure of R555,7 million (2016: R123,8 million) was incurred mainly due to an increase in the non-cash provision relating to employee benefits which exceeded the approved budget.

Fruitless and wasteful expenditure

12. As disclosed in note 44.3 to the consolidated and separate financial statements, fruitless and wasteful expenditure of R621,4 million (2016: R607, 3 million) has accumulated over a number of years and has not been recovered, written off or condoned.

Material losses and impairments

13. As disclosed in note 15 to the consolidated and separate financial statements, the municipality has cumulative debt impairment provisions of R1,9 billion (2016: R2 billion). In addition, as disclosed in the consolidated and separate statement of financial performance and note 26 to the consolidated and separate financial statements, debt impairments totalling R437,8 million (2016: R625,5 million) have been expensed. This relates to impairment of debtors as per credit management policy of the municipality.
14. As disclosed in note 35.10 to the consolidated and separate financial statements, water losses of 35,5% amounting to R169,7 million (2016: 41,1% amounting to R170 million) were incurred during the financial year. This was due to faulty meters, illegal connections and meter tempering.
15. As disclosed in note 35,12 to the consolidated and separate financial statements, estimated revenue foregone amounting to R145,1 million (2016: R130 million) has been disclosed due to all consumers not being billed for water and electricity. This was due to challenges with aging infrastructure (meters), as well as meter tempering for both electricity and water.

Other matter

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

Unaudited disclosure notes

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

Responsibilities of the accounting officer for the financial statements

18. The accounting officer is responsible for the preparation and fair presentation of the consolidated and separate financial statements in accordance with the SA standards of GRAP and the requirements of the MFMA and the DoRA, and for such internal control as the accounting officer determines is necessary to enable the preparation of consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.
19. In preparing the consolidated and separate financial statements, the accounting officer is responsible for assessing the 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 accounting officer 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 consolidated and separate financial statements

20. My objectives are to obtain reasonable assurance about whether the consolidated and separate 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 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 the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of consolidated and separate financial statements.

21. A further description of my responsibilities for the audit of the consolidated and separate financial statements is included in the annexure to the auditor's report.

Report on the audit of the annual performance report

Introduction and scope

22. 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 material findings on the reported performance information against predetermined objectives for selected development programmes presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
23. 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 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.
24. 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 programmes presented in the annual performance report of the municipality for the year ended 30 June 2017:

Programmes	Pages in the annual performance report
KPA 2: Integrated Service delivery To A Well-Structured City	xx – xx
KPA 3: Inclusive Economic Development and Job Creation	xx – xx

25. 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.
26. I did not identify any material findings on the usefulness and reliability of the reported performance information for the selected programmes.

Other matters

27. I draw attention to the matters below:

Achievement of planned targets

28. The annual performance report on pages xx to xx; xx to xx contains information on the achievement of planned targets for the year and explanations are also provided for the under achievement of a number of targets.

Adjustment of material misstatements

29. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of basic service delivery KPA 2: integrated service delivery to a well-structured city. As management subsequently corrected the misstatements, I did not raise any material findings on the usefulness and reliability of the reported performance information.

Report on audit of compliance with legislation

Introduction and scope

30. 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.

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

Consolidated and separate Annual financial statements, performance and annual reports

32. The consolidated and separate 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 on Provisions and Revenue identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements and limitations resulted in the consolidated and separate financial statements receiving a qualified audit opinion.

Expenditure management

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

34. Effective steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The expenditure disclosed does not reflect the full extent of the irregular expenditure incurred as indicated in the basis for qualification paragraph.

35. Effective steps were not taken to prevent fruitless and wasteful expenditure amounting to R18,2 million, as disclosed in note 44.3 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA.

Budget management

36. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R555,7 million as disclosed in note 44.1 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by a provision relating to employee related costs.

Consequence management

37. Unauthorised expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a) of the MFMA.
38. Irregular expenditure and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.

Procurement and contract management

39. Contracts were awarded to providers 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.
40. 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).
41. Contracts and quotations were awarded to bidders that did not score the highest points in the evaluation process, as required by section 2(1)(f) of Preferential Procurement Policy Framework Act and Preferential Procurement Regulations. Similar non-compliance was also reported in the prior year.
42. Bid documentation for procurement of commodities designated for local content and production, did not stipulate the minimum threshold for local production and content as required by Preferential Procurement Regulation 9(1).
43. Commodities designated for local content and production, were procured from suppliers who did not submit a declaration on local production and content as required by Preferential Procurement Regulation 9(1).
44. Contracts were extended or modified without the approval of a properly delegated official, in contravention of SCM regulation 5.
45. The performance contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
46. Persons in service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest, in contravention of SCM regulation 46(2)(e) the code of conduct for staff members issued in terms of the Municipal Systems Act.

Asset management

47. 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.

Other information

48. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report which includes the audit committee's report, mayor's foreword and executive summary, municipal manager overview. The other information does not include the consolidated and separate financial statements, the auditor's report thereon and those selected programmes presented in the annual performance report that have been specifically reported on in the auditor's report.
49. My opinion on the consolidated and separate 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.
50. 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 consolidated and separate financial statements and the selected programmes presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
51. I did not receive the other information prior to the date of this 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 this auditor's report and re-issue an amended report as appropriate, however, if it is corrected this will not be necessary.

Internal control deficiencies

52. I considered internal control relevant to my audit of the consolidated and separate financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance thereon. The matter reported below is limited to the significant internal control deficiencies that resulted in the qualification of audit opinion and findings on compliance with legislation included in this report.

Leadership

53. Leadership did not take decisive steps to implement consequence management for poor performance of senior management and implement action plans, as evidenced by the recurring weaknesses in key controls surrounding financial and records management as well as compliance. Additionally, policies and procedures were not designed and implemented in a manner that promoted a sound control environment for financial and compliance management.

Financial management

54. The suspension of the chief financial officer during the year along with vacancies in the financial management unit adversely impacted on the quality of consolidated and separate financial statements and compliance reports. As a result key internal controls and monitoring processes that were fundamental to reliable reporting were not actively managed.

Other reports

55. I draw attention to the following engagements conducted by various parties that had, or could have, an impact on the matters reported in the municipality's consolidated and separate financial statements, reported performance information, compliance with applicable legislation and other related matters. These reports did not form part of my opinion on the consolidated and separate financial statements or my findings on the reported performance information or compliance with legislation.

56. An independent consultant investigated an allegation of possible misappropriation of the municipality's assets at the request of the municipality, which covered the period 01 July 2016 to 30 June 2017. The investigation was concluded on 31 July 2017 and resulted in criminal proceedings against three employees. These proceedings are currently in progress with the South African Police Services.

Auditor-General

East London

07 December 2017



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 consolidated and separate financial statements, and the procedures performed on reported performance information for selected programmes and on the Municipality’s compliance with respect to the selected subject matters.

Consolidated and separate financial statements

2. In addition to my responsibility for the audit of the consolidated and separate financial statements as described in the auditor’s report, I also:
 - identify and assess the risks of material misstatement of the consolidated and separate 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 consolidated and separate 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 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 the auditor’s report. However, future events or conditions may cause a Municipality to cease to continue as a going concern.
 - evaluate the overall presentation, structure and content of the consolidated and separate financial statements, including the disclosures, and whether the consolidated and separate 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 here applicable, related safeguards.

Annexure – Auditor-general’s responsibility for the audit

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

Financial statements

6. In addition to my responsibility for the audit of the consolidated and separate financial statements as described in the auditor’s report, I also:
 - identify and assess the risks of material misstatement of the consolidated and separate 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 consolidated and separate 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 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 consolidated and separate financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the consolidated and separate financial statements. My conclusions are based on the information available to me at the date of the auditor’s report. However, future events or conditions may cause a Municipality to cease to continue as a going concern.
 - evaluate the overall presentation, structure and content of the consolidated and separate financial statements, including the disclosures, and whether the consolidated and separate financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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7. 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.

8. 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 here applicable, related safeguards.