

Report of the auditor-general to Eastern Cape Provincial Legislature and the council of Port St. Johns Local Municipality

Report on the audit of the consolidated and separate financial statements

Qualified opinion

1. I have audited the consolidated and separate financial statements of Port St. Johns Local Municipality set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2018, and the consolidated and separate statement of financial performance, consolidated and separate statement of changes in net assets and consolidated and separate cash flow statement and consolidated and separate statement of comparison of budget and actual amounts 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 possible effects of the matter described in the basis of qualified opinion paragraph, the consolidated and separate financial statements present fairly, in all material respects the consolidated and separate financial position of the Port St. Johns Local Municipality as at 30 June 2018, and its consolidated and separate 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 of South Africa, 2003 (Act No.56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2017 (Act No.3 of 2017) (DoRA).

Basis for qualified opinion

Irregular expenditure

3. I was unable to obtain sufficient and appropriate audit evidence that management had properly accounted for all irregular expenditure. Due to a lack of systems to identify contraventions of the supply chain management (SCM) requirements it was impracticable to confirm the full extent of irregular expenditure. Consequently, I was unable to determine whether any adjustment to the irregular expenditure as disclosed in note 44 to the consolidated and separate financial statements at R139,2 million (2017: R127,5 million) was necessary.

Employee related costs

4. I was unable to obtain sufficient and appropriate audit evidence that management had properly accounted for employee related costs. This was due to employee files which had been burnt during strikes at the municipality. Due to a lack of systems it was impracticable to confirm the full extent of the misstatement. I was not able to confirm the employee related costs by alternative means. Consequently, I was unable to determine whether any adjustment to the employee related costs in the consolidated and separate statement of financial performance and as disclosed in note 26 to the consolidated and separate financial statements at R71,3 million was necessary.

Receivables from non-exchange transactions

5. I was unable to obtain sufficient appropriate audit evidence for the for receivables from non exchange transactions due to the status of the accounting records. The municipality did not have adequate systems of internal control for the recording of all transactions and events and could not reconcile these to the consolidated and separate financial statements. I could not confirm receivables from non exchange by alternative means. Consequently, I was unable to determine whether any adjustments were necessary for receivables from non exchange and contributions to allowance, as disclosed in note 4 and note 5 to the consolidated and separate financial statements stated at R32,9 million and R6.3 million, respectively.

Payables from exchange transactions

6. I was unable to obtain sufficient and appropriate audit evidence that the municipality had properly accounted for leave pay provision included in payables from exchange transactions in the consolidated and separate statement of financial position and the notes to the financial statements. Due to a lack of systems it was impracticable to confirm the full extent of the misstatement. Consequently, I was unable to determine whether any adjustment to the payables from exchange in the consolidated and separate statement of financial performance and as disclosed in note 12 to the consolidated and separate financial statements stated at R21,7 million, was necessary.

Cash flow statement

7. The municipality did not have adequate processes in places to ensure that payments in the consolidated and separate cash flow statement included in the financial statements was recorded in terms of the Standard of GRAP 2, *Cash flow statements*. As a result, payments in the cash flows from suppliers, purchase of fixed assets, finance lease payments and grants and subsidies paid was understated by an amount of R17,5 million.
8. I was unable to obtain sufficient and appropriate audit evidence that payments in the consolidated and separate cash flow statement was properly accounted for. I was unable to confirm the payments by alternative means. Consequently, I was unable to determine whether any adjustment to payments for contracted services, stated at R6,6 million in the cash flow statement, was necessary.

General expenses

9. The municipality did not have adequate processes in places to ensure that all general expenses in the financial statements was recorded in terms of GRAP 1, *Presentation of financial statements*. Consequently, general expenses in the statement of financial performance and in note 33 to the financial statements was overstated by an amount of R15,5 million. This also has an impact on the surplus for the year and on the accumulated surplus.

Commitments

10. The municipality did not maintain adequate records to ensure commitments disclosed in note 36 to the consolidated and separate financial statements was recorded in terms of GRAP 1, *Presentation of financial statements*. As a result, commitments as disclosed in note 36 to the consolidated and separate financial statement is understated by R9,1 million.

Property rates

11. The municipality did not have adequate processes in place to ensure that all property rates in the consolidated and separate financial statements were recorded in terms of GRAP 23, *Revenue from non exchange transactions*. The municipality did not have a process to identify properties on which property rates should be billed. As a result, property rates as disclosed in note 23 to the consolidated and separate financial statements and the statement of financial performance were understated by an amount of R5,9 million. This also has an impact on the surplus for the year and on the accumulated surplus.

Context for the opinion

12. 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 this auditor's report.
13. 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.
14. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

Emphasis of matters

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

Material impairments – receivables from exchange transactions

16. As disclosed in note 3 to the consolidated and separate financial statements, material impairments for receivables from exchange transactions to the amount of R6,1 million (2017: R5,2 million) respectively were incurred as a result of non-payment by trade debtors.

Unauthorised expenditure

17. As disclosed in note 42 to the consolidated and separate financial statements, unauthorised expenditure to the amount of R2,6 million was incurred.
18. As disclosed in note 42 to the consolidated and separate financial statements, unauthorised expenditure to the amount of R123,7 million that was incurred in the previous years was not investigated.

Fruitless and wasteful expenditure

19. As disclosed in note 43 to the consolidated and separate financial statements, fruitless and wasteful expenditure to the amount of R1,2 million (2017: R1,6 million) was incurred.

20. As disclosed in note 43 to the consolidated and separate financial statements, fruitless and wasteful expenditure to the amount of R24,3 million that was incurred in the previous years was not investigated.

Basis of presentation

21. As disclosed in note 1.2 to the consolidated and separate financial statements, the financial statements of the municipal entity are prepared in accordance with the company's own accounting policies.

Material underspending of the conditional grant

22. As disclosed in the consolidated and separate statement of comparison of budget and actual amounts, and in note 14 to the consolidated and separate financial statements, the municipality underspent its conditional grants by R11,3 million. This was due to the labour unrest at the municipality.

Other matters

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

Unaudited disclosure notes

24. 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 consolidated and separate financial statements and accordingly we do not express an opinion thereon.

Unaudited supplementary information

25. The supplementary information set out on pages xx to xx does not form part of the consolidated and separate financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

Responsibilities of the accounting officer for the consolidated and separate financial statements

26. The accounting officer is responsible for the preparation and fair presentation of the consolidated and separate financial statements in accordance with the GRAP and requirements of the MFMA and 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.

27. 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 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 consolidated and separate financial statements

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

Report on the audit of the annual performance report

Introduction and scope

30. 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 priorities presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
31. 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.
32. 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 development priorities presented in the annual performance report of the municipality for the year ended 30 June 2018:

Development priorities	Pages in the annual performance report
KPA 2 – basic service delivery	x – x
KPA 4 – local economic development	x – x

33. 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.

34. The material findings in respect of the usefulness and reliability of the selected development priorities are as follows:

KPA 2 – Basic service delivery

Usefulness

Various Indicators

35. The reported targets were not consistent when compared to the planned targets.

Planned and reported indicators	Planned and reported targets	Reported actual achievement
No. of KM constructed for Jambeni Access Road	2.5 Km for Jambeni AR by June 2018 Completed	Not achieved
No. of KM constructed for gravel Bhuje gravel Access Road	5 km Completed Bhuje AR by June 2018	Not achieved
% of Project implemented for construction of Lujazo Bridge	25% scope of work for Lujazo Bridge Completed by June 2018	Not achieved
No. of KM Constructed for Njeni gravel Access Road	Njeni AR Completed by June 2018	Not achieved
No. of KM Constructed for Zinyosini gravel access road	7.5 km of access road completed by June 2018	Not achieved
% of Progress for implementation of Roads Maintenance Plan	100%(130km of roads Maintained) BY June 2018	Not achieved
No. of maintained streetlights	100 Streetlights maintained	Not achieved
No of Park home delivered	1 Park home delivered BY June 2018	Not achieved
% of Progress on the Development of Outdoor Gymnasium	100% scope of work for Outdoor Gymnasium completed	Not achieved
% of Progress on the implementation of Cemetery Management System	100% Functional Cemetery Management by June 2018	Not achieved
% of Progress on the Construction of Shelter for Beach Equipment	100% Scope of work completed by June 2018	Not achieved
No. of conducted crime awareness campaigns	2 Crime awareness campaigns conducted by June 2018	Not achieved
No. of Community development programmes convened	1 Recreational Programme convened by June 2018	Not achieved

Planned and reported indicators	Planned and reported targets	Reported actual achievement
Amount utilised for Free Basic Services	5,000,000.00 for Free basic service utilised	Not achieved. Provision of alternative energy has been advertised 2 times but will be re-advertised. Only 50kw of free electricity has been provided to indigent households per month.

No. of KM Constructed for Njeni gravel Access Road

36. The performance measure for the below indicator is not well defined as the target is not specific as the required level of performance is not clearly specified / defined.

Planned and reported indicator	Planned and reported target
No. of KM Constructed for Njeni gravel Access Road	Njeni AR Completed by June 2018

Reliability

Various indicators

37. I was unable to obtain sufficient appropriate audit evidence for the reported achievements of all indicators relating to this development objective. This was due to limitations placed on the scope of my work. I was unable to confirm the reported achievements by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievements in the annual performance report.

KPA 4 – Local economic development

Usefulness

Various indicators

38. The reported targets were not consistent when compared to the planned targets.

Planned and reported indicator	Planned and reported target	Reported actual achievement
No. of wards provided with agricultural inputs	10 wards provided with agricultural inputs by June 2018	Not achieved procurement was approved towards the end of the financial year
No. of Cooperatives Trained	10 Cooperatives trained by June 2018	Not achieved 12 members of cooperatives
No. of Trained Farmers	40 Farmers to trained by June 2018	Not achieved
No. of internship opportunities given to new graduates	30 students by June 2018	Not achieved

Planned and reported indicator	Planned and reported target	Reported actual achievement
No. of projects supported through Agri-park development	One Project site successfully supported with all inputs by June 2018	Not achieved - Agri-park awareness was held and Draft business plans were developed
No. of trained Waste Recycling Cooperatives	1 Waste Recycling Cooperative trained by June 2018	Not achieved
% of the of the CWP implemented	100% of CWP implemented by June 2018	100% CWP site plan implemented

39. The performance measure for the below indicator is not well defined as the target is not specific as the required level of performance is not clearly specified/ defined.

Cultural celebrations hosted

Planned and reported indicator	Planned and reported target
Cultural celebrations hosted	Cultural celebrations hosted

Reliability

40. I was unable to obtain sufficient appropriate audit evidence for the reported achievements of all indicators relating to this development objective. This was due to limitations placed on the scope of my work. I was unable to confirm the reported achievements by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievements in the annual performance report.

Other matters

41. I draw attention to the matters below.

Achievement of planned targets

42. Refer to the annual performance report on pages ... to ... for information on the achievement of 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 in paragraphs xx to xx of this report.

Unaudited supplementary schedules

43. The supplementary information set out on pages xx to xx does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not report thereon.

Adjustment of material misstatements

44. 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 and Local economic development. Those that were not corrected are reported above.

Introduction and scope

45. 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.
46. The material findings on compliance with specific matters in key legislations are as follows:

Annual financial statements, performance and annual reports

47. 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 identified by the auditors in the submitted financial statements were not adequately corrected and the supporting records could not be provided subsequently, which resulted in the consolidated and separate financial statements receiving a qualified audit opinion.
48. The 2016/17 annual report was not tabled in the municipal council within seven months after the end of the financial year, as required by section 127(2) of the MFMA.

Consequence management

49. All of the 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.
50. All of the irregular 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.
51. All of the fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person was liable for the expenditure, as required by section 32(2)(c) of the MFMA.

Procurement and contract management

52. Some of the construction contracts were awarded to contractors that did not qualify for the contracts in accordance with section 18(1) of the CIDB Act and CIDB regulations 17 and 25(7A). This non-compliance was identified in the procurement processes for the R61 to Mrhuleni Access Road.

Strategic planning and performance management

53. The performance management system and related controls were not maintained or were inadequate as it did not describe how the performance planning, monitoring, measurement, review, reporting and improvement processes should be conducted, organised and managed, as required by municipal planning and performance management regulation 7(1).
54. A mid-year performance assessment was not performed by the 25th of January each year, as required by section 72(1)(a)(ii) of the MFMA.

55. Annual performance objectives and indicators were not established for Port St. Johns Development Agency and included in its multi-year business plan, as required by section 93B(a) of the MSA.

Expenditure management

56. I was unable to obtain sufficient appropriate audit evidence that payments from the municipality's bank account were approved by the accounting officer / chief financial officer, as required by section 11(1) of the MFMA.

57. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R126,3, as disclosed in note 42 to the consolidated and separate financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed unauthorised expenditure was caused by overspending of the budget.

58. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The full extent of the irregular expenditure could not be quantified as indicated in the basis for qualification paragraph. The majority of the irregular expenditure was caused by non-compliance with supply chain management regulations.

59. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R25,5 million as disclosed in note 43 to the consolidated and separate financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed fruitless and wasteful expenditure was caused by penalties and interest paid on overdue balances.

60. Expenditure was incurred in excess of the approved budget, in contravention of section 87(8) of the MFMA.

Other information

61. 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. The other information does not include the consolidated and separate financial statements, the auditor's report and those selected development priorities presented in the annual performance report that have been specifically reported in this auditor's report.

62. 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.

63. 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 development priorities presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.

64. 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

65. I considered internal control relevant to my audit of the consolidated and separate financial statements, reported performance material 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 findings on the financial and annual performance report of Port St. Johns Municipality and the findings on compliance with legislation, included in this report.

- There has been instability in both the political and administrative leadership for the latter part of the financial year, which has resulted in leadership not adequately overseeing and monitoring, financial and performance reporting and compliance with legislation. This did not set the correct tone for building a high-performance environment that promotes accountability. As a result, consequence management was also not implemented. Furthermore, the plan to address internal and external findings was not effectively monitored to ensure adherence in a timely manner.
- Leadership has not yet addressed the liquidity of the municipal entity in order to ensure funds were available to settle its liabilities. This municipal entity continued to trade while being insolvent, which amounts to reckless trading. Furthermore, the municipal entity continues to trade post deregistration without the relevant authority to do so.
- Management did not implement daily and monthly controls as designed for the entity's business processes and did not have a proper system of record management that provides for the maintenance of information to be reported in the annual performance report. Compliance with the applicable legislation was not monitored on a regular basis. This is mainly attributable to a lack of credible in year reporting by management in respect of financial, performance management and compliance with legislation which was aggravated by the ongoing labour unrest for three quarters of the financial year.
- The audit committee did not adequately review the financial statements and performance information report prior to submission for external audit, as there were numerous material findings in financial and performance reporting. Furthermore, there is insufficient reporting by internal audit to management which has resulted in inadequate recommendations by the audit committee and this has impacted the effectiveness of both the internal audit and the audit committee.

Other reports

66. I draw attention to the following engagement that 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.
67. After the financial year end, the mayor requested the Directorate for Priority Crime Investigation (Hawks) to conduct an investigation on alleged non-compliance with SCM regulations. The investigation is currently in progress.

East London

13 December 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 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

2. In addition to my responsibility for the audit of the consolidated and separate financial statements as described in this 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 Port St. Johns Local Municipality 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 this auditor’s report. However, future events or conditions may cause a municipality to cease continuing 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
 - obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group to express an opinion on the consolidated and separate financial statements. I am responsible for the direction, supervision and performance of the group 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, related safeguards.