



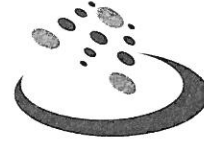
Auditing to build public confidence

AUDITOR - GENERAL
SOUTH AFRICA

Amathole District Municipality (consolidation)

Audit Report

For the year ended 30 June 2018



A U D I T O R - G E N E R A L
S O U T H A F R I C A

The Accounting Officer
Dr TT Mnyimba
Amathole District Municipality
PO Box 320
East London
5200

19 December 2018

Reference: 21289REG17-18

Dear Sir

Report of the Auditor-General on the financial statements and other legal and regulatory requirements of Amathole District Municipality for the year ended 30 June 2018

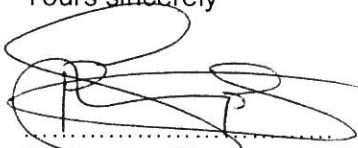
1. The above-mentioned report of the Auditor-General is submitted herewith in terms of section 21(1) of the Public Audit Act of South Africa read in conjunction with section 188 of the Constitution of the Republic of South Africa and section 121(3) of the Municipal Finance Management Act of South Africa(MFMA).
2. We have not yet received the other information that will be included in the annual report with the audited financial statements and have thus not been able to establish whether there are any inconsistencies between this information and the audited financial statements and the reported performance against pre-determined objectives. You are requested to supply this information as soon as possible. Once this information is received it will be read and should any inconsistencies be identified these will be communicated to you and you will be requested to make the necessary corrections. Should the corrections not be made we will amend and reissue the audit report.
3. In terms of section 121(3); 121(4); of the MFMA you are required to include the audit report in the municipality's annual report to be tabled.
4. Until the annual report is tabled as required by section 127(2) of the MFMA and the audit report is not a public document and should therefore be treated as confidential.
5. Prior to printing or copying the annual report which will include the audit report you are required to do the following:
 - Submit the final printer's proof of the annual report to the relevant senior manager of the Auditor-General of South Africa for verification of the audit-related references in the audit report and for confirmation that the financial statements and other information are those documents that have been read and audited. Special care should be taken with the page references in your report, since an incorrect reference could have audit implications.
 - The signature *Auditor-General* in the handwriting of the auditor authorised to sign the audit report at the end of the hard copy of the audit report should be scanned in when

preparing to print the report. This signature, as well as the place and date of signing and the Auditor-General of South Africa's logo, should appear at the end of the report, as in the hard copy that is provided to you. The official logo will be made available to you in electronic format.

6. Please notify the undersigned Deputy Business Executive well in advance of the date on which the annual report containing this audit report will be tabled.
7. Your cooperation to ensure that all these requirements are met would be much appreciated.

Kindly acknowledge receipt of this letter.

Yours sincerely

A handwritten signature in black ink, appearing to be 'Phakamisa Stamper', written over a horizontal dotted line.

Phakamisa Stamper
Deputy Business Executive: ECBU

Enquiries: Mazithi Nxokwana
Telephone: (043) 709 7200
Fax: (043) 709 7300

Report of the auditor-general to Eastern Cape Provincial Legislature and council of Amathole District 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 the Amathole District Municipality and its subsidiary (the group) set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2018, the consolidated and separate statement of financial performance, statement of changes in net assets and cash flow statement and the 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 effect 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 group 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 Practice (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 of South Africa (Act No. 3 of 2017) (DoRA).

Basis for qualified opinion

Property, plant and equipment

3. The group did not account for its property, plant and equipment in accordance with GRAP 17, *Property, plant and equipment* as it does not have an adequate asset management system to record and account for assets. I was unable to obtain sufficient appropriate evidence to confirm the carrying value of property, plant and equipment of R5 billion (2017: R4,7 billion), as disclosed in note 4 to the consolidated and separate financial statements. I could not confirm property, plant and equipment by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to this balance.
4. The group incorrectly accounted for inventory that is held for distribution in the normal course of business as property, plant and equipment, in contravention of GRAP 12, *Inventories*. Consequently inventory disclosed in note 11 to the consolidated and separate financial statements is understated by R506,5 million and property, plant and equipment disclosed in note 4 to the consolidated and separate financial statements is overstated.

Cash flow statement

5. The group incorrectly calculated various line items in the cash flow statement. This resulted in the following line items being misstated as described:
 - Receipts from grants are understated by R47,4 million
 - Payments of employee related costs are overstated by R85,5 million
 - Payments to suppliers are overstated by R50,3 million
 - Purchase of property, plant and equipment is understated by R214,6 million

Commitments

6. The corresponding figure for commitments is overstated as as the group did not account for commitments in accordance with GRAP17, *Property, plant and equipment*. The prior year balance contained numerous misstatements which were not adequately addressed by the group. As a result, the comparative figure disclosed in note 43 to the consolidated and separate financial statements is overstated by R67,6 million.

Context for the opinion

7. 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.
8. I am independent of the group 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.
9. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

Material uncertainty relating to financial sustainability

10. I draw attention to the matter below. My opinion is not modified in respect of this matter.
11. As disclosed in note 59 to the consolidated and separate financial statements, the group is facing a number of financial risks that cast doubt on its ability to sustain its current level of operations in the near future. The key financial risks identified include the following:
 - inability to pay creditors within due dates
 - inability to collect revenue billed
 - net current liability position
12. In addition, the actions taken by management to mitigate the impact of these risks are disclosed in this note.

Emphasis of matters

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

Material impairments

14. As disclosed in note 12 to the consolidated and separate financial statements, material losses amounting to R762,5 million (2016-17: R619,2 million) were incurred as a result of irrecoverable trade receivables.

Restatement of corresponding figures

15. As disclosed in note 46 to the consolidated and separate financial statements, the corresponding figures for 30 June 2017 were restated as a result of an error in the financial statements of the group as at, and for the year ended, 30 June 2018.

Unauthorised expenditure

16. As disclosed in note 48 to the consolidated and separate financial statements, unauthorised expenditure amounting to R50,7 million (2016-17: R59,9 million) was incurred due to overspending on the bad debts and the staff leave provision.

Fruitless and wasteful expenditure

17. As disclosed in note 49 to the consolidated and separate financial statements, fruitless and wasteful expenditure amounting to R2 million (2016-17: R2,3 million) was incurred due to interest and penalties charged on late payments.

Irregular expenditure

18. As disclosed in note 50 to the consolidated and separate financial statements, irregular expenditure amounting to R77,3 million (2016-17: R16,8 million) was incurred due to supply chain management (SCM) transgressions that occurred in the current and prior financial years. The cumulative balance as at 30 June 2018 amounted to R99 million.

Other matters

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

Unaudited disclosure note

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

Unaudited supplementary schedules

21. 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

22. The accounting officer is responsible for the preparation and fair presentation of the consolidated and separate financial statements in accordance with the applicable financial reporting framework and the requirements of 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 consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.
23. In preparing the consolidated and separate financial statements, the accounting officer is responsible for assessing the group'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 group 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

24. 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.
25. 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

26. 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.
27. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.

28. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected 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 and infrastructure investment	x – x
KPA 3 – Local economic development	x – x

29. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

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

31. I did not raise any material findings on the usefulness and reliability of the reported performance information for KPA 3 – Local economic development. The material findings in respect of usefulness and reliability of KPA 2 – Basic service delivery and infrastructure investment are as follows:

KPA 2 – Basic service delivery and infrastructure investment

Reported target was not consistent when compared with planned target

Indicator: SDI 3/1 - Number of local municipalities (LMs) with business licence registration forms complying with municipal health services (MHS) legislation

32. The target approved in the service delivery budget and implementation plan (SDBIP) was four (4) LM's with business licence registration forms complying with MHS legislation. However, the target reported in the annual performance report was one (1) LM with business licence registration forms complying with MHS legislation.

Performance indicators were not well-defined

Various indicators

33. The source of information and the method of calculation for achieving the planned indicator were not clearly defined for the following indicators:

Performance indicator	Definition on the standard operating procedure
SDI 1/1 - Number of households connected to the water supply	Implementation of water projects utilising MIG
SDI 1/2 - Number of refurbished water services infrastructure projects as per the Refurbishment Plan (Dams, WTW's & WWTW's)	Refurbishment of Butterworth/Dutywa and Fort Beaufort WWTW and Dutywa dam
SDI 1/3 - Number of households provided with interim water supply	Interim water supply
SDI 2/1 - Number of households below basic level of service supplied with VIP toilets	Rollout of VIP sanitation projects
SDI 1/5 - Number of programmes implemented according to Water Conservation Demand and Management strategy (WCDM)	Implementation of Water Conservation and Demand Management Initiatives
SDI 6/1 - Eastern regional solid waste site operated and maintained	Phase 2 solid waste transfer station

Performance indicator not verifiable

Indicator: SDI 1/5 - Number of programmes implemented according to WCDM strategy

34. The systems and processes that enable reliable reporting of achievement against the indicator were not adequately designed. Based on the definition provided in the standard operating procedures it is not easy to understand and verify the measurement processes for the indicator.

Reported achievement did not agree with the evidence provided

Indicator: SDI 2/1 - Number of households below basic level of service supplied with VIP toilets

35. The achievement of number of households below basic level of service supplied with VIP toilets reported in the annual performance report was 17 484. However, the supporting evidence provided did not agree to the reported achievement.

Reported achievement not supported by sufficient appropriate audit evidence

Indicator: SDI1/3 - Number of households provided with interim water supply

36. I was unable to obtain sufficient and appropriate audit evidence for the reported achievement of number of households provided with interim water supply. Based on the supporting evidence that was provided, the achievement of the indicator reported could not be corroborated. 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 719 as reported in the annual performance report.

Indicator: SDI 1/5 Number of programmes implemented according to WCDM strategy

37. I was unable to obtain sufficient appropriate audit evidence to support the reported achievement of number of programmes implemented according to the WCDM strategy. This was due to inadequate technical indicator descriptions and formal standard operating procedures that predetermined how the achievement would be measured, monitored and reported. I was unable to confirm the reported achievement of the indicator by alternative means. Consequently, I was unable to determine whether any adjustments were required to the achievement of three (3) programmes implemented as reported in the annual performance report.

Other matters

38. I draw attention to the matters below.

Achievement of planned targets

39. Refer to the annual performance report on pages xx to xx for information on the achievement of planned targets for the year and explanations provided for the under/ over achievement of a number of targets. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs 32 to 37 of this report.

Adjustment of material misstatements

40. I identified material misstatements in the annual performance report submitted for auditing.

41. These material misstatements were in the reported performance information of KPA 2: Basic services and infrastructure investment, I raised material findings on the usefulness and reliability of the reported performance information.

42. As management subsequently corrected the misstatements on KPA 3: Local economic development , I did not raise material findings on the usefulness and reliability of the reported performance information.

Report on the audit of compliance with legislation

Introduction and scope

43. 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.

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

Annual financial statements and annual reports

45. The consolidated and separate 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 property, plant and equipment, cash flow statement and commitments identified in the submitted financial statements were not adequately corrected, which resulted in the financial statements receiving a qualified audit opinion.

Strategic planning and performance management

46. The performance management system and related controls were inadequate as the described processes of planning, monitoring, measurement and reporting were not conducted and managed as intended, as required by municipal planning and performance management regulation 7(1).

Expenditure management

47. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
48. Effective steps were not taken to prevent irregular expenditure amounting to R77,4 million, as disclosed in note 50 to the consolidated and separate financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed irregular expenditure was due non-compliance with SCM regulations.
49. Effective steps were not taken to prevent unauthorised expenditure amounting to R50,8 million, as disclosed in note 48 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 incurred on depreciation, finance costs and bulk purchases.
50. Effective steps were not taken to prevent fruitless and wasteful expenditure amounting to R2 million, as disclosed in note 49 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 interest and penalties on late payments.

Revenue management

51. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

Asset management

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

Consequence management

53. The unauthorised expenditure, irregular and fruitless and wasteful expenditure incurred by the municipality were not investigated to determine if any person is liable for the expenditure, as required by section 32(2) of the MFMA.

Procurement and contract management

54. Some of the competitive bids were adjudicated by a bid adjudication committee that was not composed in accordance with SCM regulation 29(2).
55. Some of the construction contracts were awarded to contractors that did not qualify for the contract in accordance with Construction Industry Development Board (CIDB) regulations 17 and 25(7A).
56. The performance of some of the contractors or service providers were not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
57. Persons in the service of the municipality who 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).

Other information

58. 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.
59. 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.
60. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the 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.
61. The other information was not received prior to the date of this auditor's report. After I receive and read this information and if I conclude that there is 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

62. 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 matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

63. Leadership did not adequately exercise effective oversight of financial reporting, reporting on pre-determined objectives, compliance and related internal controls.
64. Management did not implement daily and monthly financial controls to ensure that the consolidated and separate financial statements and annual performance reports are supported by accurate and complete underlying records.
65. Leadership has responded slowly in addressing consequence management as the cases of unauthorised, irregular and fruitless and wasteful expenditure reported in the previous year have not been investigated.

Other reports

66. 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 financial statements or my findings on the reported performance information or compliance with legislation.
67. At the time of this report, the Office of the Public Protector was conducting an external investigation into alleged procurement irregularities. The investigation was in progress and the expected date of the outcome is unknown.
68. At the time of this report, an external service provider was conducting an investigation into procurement processes, staff appointment processes and debit orders for the past four financial years. The investigation was in progress and the expected date of the outcome is unknown.
69. An external investigation into alleged procurement irregularities was conducted by an external service provider as commissioned by National Treasury. The investigation has been completed and a report was tabled to the council.

Auditor-General

East London

19 December 2018



AUDITOR - GENERAL
SOUTH AFRICA

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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 development priorities 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 group’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 Amathole District Municipality and its subsidiaries 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 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 group to cease continuing 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
 - 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 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.

General