

Report of the auditor-general to the Eastern Cape Provincial Legislature and the council on the Ngqushwa Local Municipality

Report on the audit of the financial statements

Qualified opinion

1. I have audited the financial statements of the Ngqushwa Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2019, the 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 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 Ngqushwa Local Municipality as at 30 June 2019, and its financial performance and cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practice (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, 2018 (Act No. 1 of 2018) (Dora).

Basis for qualified opinion

Property, plant and equipment

3. The municipality did not recognise property, plant and equipment in accordance with *GRAP 17: Property, plant and equipment*. The municipality did not depreciate its property, plant and equipment systematically over the lifetime of some of its assets. Furthermore, additions to work in progress included amounts spent in the prior year and assets were identified that were not recorded in the fixed asset register. Consequently, property plant and equipment, as disclosed in note 11 to the financial statements, and accumulated surplus are understated by R30,7 million and R36,1 million respectively; depreciation, as disclosed in note 29 to the financial statements, is understated by R3,2 million; and work in progress opening balance is understated by R2,5 million and repairs and maintenance, as disclosed in note 33 to the financial statements, is understated by R370 923. In addition, I did not receive sufficient appropriate audit evidence for the prior period adjustment on loss on disposal of assets, as disclosed in the prior period error note 38. I was unable to obtain the evidence required by alternative means. As a result, I was unable to determine whether any adjustments to the loss on disposal of assets of R9,3 million were required.

Revenue from exchange transactions – licences and permits

4. I was unable to obtain sufficient appropriate audit evidence for the revenue from exchange transactions disclosed in the statement of financial position. Source documents for licences and permits revenue, as disclosed in note 19 to the financial statements, were not provided. I was unable to obtain the evidence required by alternative means. As a result, I was unable to determine whether any adjustments to the revenue from licences and permits of R1,8 million were required.

Irregular expenditure

5. The municipality did not have proper systems in place to identify and record all irregular expenditure disclosed in note 44 to the financial statements, as required by section 125(2)(d) of the MFMA. This expenditure resulted from payments made in contravention of the supply chain management (SCM) requirements. I was unable to confirm the amount of irregular expenditure by alternative means and it was impracticable to determine the full extent of the understatement of irregular expenditure. Consequently, I was unable to determine whether any adjustments were necessary to the irregular expenditure disclosed at R120,7 million in the financial statements.

Cash flows from operating activities

6. The municipality did not disclose its cash flows from operating activities in line with GRAP 2: *Cash flow statements*. The municipality included amounts on the cash flow statement that did not agree to underlying supporting information for cash flow movements. Consequently, cash paid to suppliers and employees is overstated by R5,9 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 financial statements section of this auditor's report.
8. I am independent of the municipality in accordance with sections 290 and 291 of the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* and, parts 1 and 3 of the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA codes) as well as 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 codes.
9. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

Emphasis of matters

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

Restatement of corresponding figures

11. As disclosed in note 38 to the financial statements, the corresponding figures for the 30 June 2018 were restated as a result of an error in the financial statements of the municipality at, and for the year ended, 30 June 2019.

Material losses/ impairments – trade debtors

12. As disclosed in notes 5 and 6 to the financial statements, material losses of R8,3 million were incurred as a result of a write-off of irrecoverable trade debtors.

Unauthorised Expenditure

13. As disclosed in note 42 to the financial statements, the municipality incurred unauthorised expenditure of R41,7 million, as the total actual expenditure per budget vote exceeded the approved adjustments budget for certain directorates which includes non-cash items.

Other matter

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

Unaudited disclosure notes

15. 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 on it.

Responsibilities of accounting officer for the financial statements

16. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with 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.
17. In preparing the financial statements, the accounting officer is responsible for assessing the Ngqushwa 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

18. 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.
19. A further description of my responsibilities for the audit of the financial statements is included in the annexure to this auditor's report.

Introduction and scope

20. 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.
21. 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.
22. 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 2019:

Development priority	Pages in the annual performance report
KPA 2: Quality basic service delivery and infrastructure development	x – x

23. 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.
24. The material finding in respect of the reliability of the selected development priority is as follows:

KPA 2: Quality basic service delivery and infrastructure development

25. I was unable to obtain sufficient appropriate audit evidence for the reported achievement of the indicator "Number of household electrified by 30 June 2019". 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 reported achievement in the annual performance report.

Other matters

26. I draw attention to the matters below.

Achievement of planned targets

27. 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 finding on the reliability of the reported performance information in paragraph 24 to 25 of this report.

Adjustment of material misstatements

28. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information development priority KPA2 – quality basic service delivery and infrastructure development. As management subsequently corrected only some of the misstatements, I raised a material finding on the 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

29. 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.

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

Annual financial statements

31. The annual 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 identified by the auditors in the submitted financial statements were not adequately corrected and/or the supporting records could not be provided subsequently, which resulted in the financial statements receiving a qualified audit opinion.

Procurement and contract management

32. Some of the 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 the 2017 preferential procurement regulation 8(2). Similar non-compliance was also reported in the prior year. This non-compliance was identified in the procurement processes for the Electrification of 320 Ngqushwa Villages extensions.

33. Some of the goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by supply chain management (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).

Asset Management

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

Revenue Management

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

Consequence Management

37. Unauthorised and fruitless and wasteful expenditure, and some 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)(a) and (b) of the MFMA.
38. Authorisation of unauthorised expenditure amounting to R 7 million was not done through an adjustment budget, as required by section 32(2)(a)(i) of the MFMA.

Expenditure management

39. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The irregular expenditure disclosed does not reflect the full extent of the irregular expenditure incurred as indicated in the basis for qualification paragraph. The majority of the disclosed irregular expenditure was caused by deviations inappropriately used where the preferential procurement process should have been followed.
40. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R102 429, as disclosed in note 43 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed fruitless and wasteful expenditure was caused by incurring interest on overdue payments.
41. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R7 million, as disclosed in note 42 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by depreciation not initially budgeted for.

Strategic planning and performance management

42. The performance management system and related controls were inadequate as the described processes of planning, measurement and reporting were not conducted and managed as required by the Municipal Planning and Performance Management regulation 7(1).

Other information

43. 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 development priorities

presented in the annual performance report that have been specifically reported in this auditor's report.

44. 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.
45. 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 development priorities presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
46. I did not receive the other information prior to the date of this 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

47. 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 on it. 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.
48. Leadership was unable to effectively detect and correct material misstatements in the annual financial statements as there were strong, established reporting and verification processes were not entrenched in the operations of municipality. In addition, leadership did not put measures in place to ensure that appropriate consequences were taken against instances of non-compliance. The municipality did not address a sufficient quantity of prior year audit findings and control deficiencies to maintain an unqualified opinion in the current year and achieve a performance report free from material misstatements.
49. The accounting officer has not effectively implemented daily and monthly controls over the municipality's business processes, resulting in significant misstatements not being detected or corrected in the financial statements, performance information and non-compliance with laws and regulations. Furthermore, management has not managed to effectively store and manage municipal records. Management makes use of consultants to prepare the financial statements, but have not implemented the required controls to ensure that effective oversight over the review of the quality, completeness and accuracy of this work can be assured.
50. The municipality has a functional internal audit and audit committee, however, the internal control weaknesses identified by the external and internal auditors have not been adequately addressed by management. Furthermore, management has been unable to detect and mitigate risks related to internal controls and financial reporting. This has resulted in the annual financial statements being materially misstated.

Other reports

51. 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 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.
52. There are five investigations currently ongoing. These investigations relate to irregular expenditure and have been referred to the disciplinary board and have not yet been finalised.

Auditor-General

Auditor-General

East London

30 November 2019



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 development priority 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 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 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

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.