



Auditing to build public confidence

**AUDITOR - GENERAL
SOUTH AFRICA**



SAKHISIZWE LOCAL MUNICIPALITY

Audit Report

For the year ended 30 June 2019



**AUDITOR - GENERAL
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Auditing to build public confidence

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

Report on the audit of the financial statements

Qualified opinion

1. I have audited the financial statements of the Sakhisizwe 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, cash flow statement and statement of comparison of budget information with actual information 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 possible effects of the matters described in the basis for qualified opinion section of this report, the financial statements present fairly, in all material respects, the financial position of the Sakhisizwe 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 (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, 2018 (Act no.1 of 2018) (Dora).

Basis for qualified opinion

Bulk purchases

3. I was unable to obtain sufficient appropriate audit evidence for bulk electricity purchases, as the municipality did not have adequate systems in place to verify the goods received before recording the entries in the financial records. I could not confirm whether the goods were actually received by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to bulk purchases stated at R12,6 million disclosed in note 28 and electrical distribution losses of R3,5 million disclosed in note 43 to the financial statements.

Receivables from non-exchange transactions

4. The municipality did not account for receivables from non-exchange transactions according to GRAP 1, *Presentation of financial statements*, as disclosed in note 8. The following deficiencies were identified:
 - Debtors that meet the category for impairment were not impaired

- Interest was not charged on outstanding debt
 - Properties not on the valuation roll were charged rates
 - Properties owned and occupied by the municipality were charged property rates.
5. As a result, receivables from non-exchange transactions disclosed in note 8 to the financial statements are overstated by R24,4 million and the revenue from non-exchange transactions overstated by the same amount.

Receivables from exchange transactions

6. The municipality did not account for receivables from exchange transactions according to GRAP 1, *Presentation of financial statements*, as disclosed in note 7. The following deficiencies were identified:
- Properties not on the valuation roll were charged for refuse, but there is no confirmation that they are under the demarcation of the municipality.
 - Properties owned and occupied by the municipality were charged refuse and listed as debtors.
7. As a result, receivables from exchange transactions disclosed in note 7 to the financial statements are overstated by R28,5 million and the revenue from exchange transactions overstated by the same amount.

Vat receivable

8. The municipality did not account for Vat receivable as per GRAP 1, *Presentation of financial statements*. The Vat receivable disclosed in the financial statements did not include all unpaid vat complied invoices at year-end. As a result, Vat receivable disclosed in note 9 to the financial statements is understated by R3,3 million and accumulated surplus by R3,3 million.

Payables from exchange transactions

9. The municipality did not recognise all outstanding amounts meeting the definition of a liability in accordance with GRAP 1, *Presentation of financial statements*. As the municipality did not maintain adequate records of outstanding payments for goods and services received but not yet paid at year-end, I was unable to determine the full extent of the understatement of retentions as it was impracticable to do so. Consequently, I was unable to determine whether any adjustments were necessary to payables from exchange transactions stated at R18,2 million (2018: R25,8 million) disclosed in note 15 to the financial statements.

Context for the opinion

10. 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 separate financial statements section of this auditor's report.
11. I am independent of the municipality in accordance with 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.
12. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

Emphasis of matters

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

Unauthorised expenditure

14. As disclosed in note 40 to the financial statements, the municipality incurred unauthorised expenditure of R10,3 million as a result of expenditure exceeding the total approved budget.

Irregular expenditure

15. As disclosed in note 42 to the financial statements, the municipality incurred irregular expenditure of R2,3 million as a result of non-compliance with supply chain management processes.

Fruitless and wasteful expenditure

16. As disclosed in note 41 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R1,5 million as a result of penalties and interest.

Material distribution losses

17. As disclosed in note 43 to the financial statements, material electricity distribution losses of R3,5 million (2018: R2,4 million) was incurred, which represents 28% (2018: 21%) of the total electricity used.

Restatement of corresponding figures

18. As disclosed in note 36 to the financial statements, the corresponding figures for 30 June 2018 have been restated as a result of an error discovered during the 2019 financial year.

Material impairments debtors

19. As disclosed in note 27 to the financial statements, material impairments of R2,3 million (2018: R11,4 million) were incurred as a result of a movement in the debt impairment provision of irrecoverable trade debtors.

Other matter

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

Unaudited disclosure notes

21. 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 the accounting officer for the financial statements

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

24. 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 separate financial statements.

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

Report on the audit of the annual performance report

Introduction and scope

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 the selected programme 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 programme presented in the annual performance report of the municipality for the year ended 30 June 2019:

| Programme | Pages in the annual performance report |
|---|--|
| Programme 1 – basic services and infrastructure 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 programme are as follows:

Programme 1 – basic service delivery and infrastructure development

Various indicators

31. I was unable to obtain sufficient appropriate audit evidence for the reported achievements of indicators relating to this programme. 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 of the indicators listed below:

| No. | KPI | Target as per the SDBIP | Actual reported performance |
|-----|---|--|-----------------------------|
| 1 | Number of km of roads maintained by 30 June | 10 km of roads maintained by 30 June 2019 | Met |
| 2 | Number of meters paved roads by 30 June 2018 - (Qokolo Koppitjie) | 400 m of paved roads (Qokolo Koppitjie) by 30 June 2019 | Met |
| 3 | Number of meters paved roads by 30 June 2019 - (Elliot Streets) | 400 m of paved roads (Elliot Streets) by 30 June 2019 | Met |
| 4 | Number of km of paved road by June 2019 - (California) | 1 km of paved roads (California) by 30 June 2019 | Not met |
| 5 | Number of km of paved road by June 2019 - (Ekuthuleni) | 2 km of paved roads (Ekuthuleni) and storm water by 30 June 2019 | Not met |
| 6 | % of completion of the sports field by June 2019 | Construction of sports field by 30 June 2019 | Met |
| 7 | % of completion of the community hall by June 2019 | 100% construction/ refurbishment of community hall by 30 June 2019 | Not met |

| | | | |
|---|---|---|-----|
| 8 | Number of maintained street lights by June 2019 | All street to be maintained street lights by 30 June 2019 | Met |
|---|---|---|-----|

Number of maintained street lights by June 2019

32. The planned target for the number of maintained street lights by June 2019 are not specific in clearly identifying the measure as they do not specify the actual number of street lights to be maintained.

Various indicators

33. The reasons for the variance between the planned targets and the reported achievements were not explained in the annual performance report for the indicators listed below:

| No. | KPI | Target as per the SDBIP | Actual reported performance |
|-----|--|--|-----------------------------|
| 4 | Number of km of paved road by June 2019 - (California) | 1 km of paved roads (California) by 30 June 2019 | Not met |
| 5 | Number of km of paved road by June 2019 - (Ekuthuleni) | 2 km of paved roads (Ekuthuleni) and storm water by 30 June 2019 | Not met |
| 7 | % of completion of the community hall by June 2019 | 100% construction/ refurbishment of community hall by 30 June 2019 | Not met |

Various indicators

34. The reported achievement is not consistent with the planned target for the following indicators:

| No. | KPI | Target as per the APR | Actual reported performance |
|-----|---|---|-----------------------------|
| 1 | Number of km of roads maintained by 30 June | 10 km of roads maintained by 30 June 2019 | Met |

| No. | KPI | Target as per the APR | Actual reported performance |
|-----|---|--|-----------------------------|
| 2 | Number of meters paved roads by 30 June 2018 - (Qokolo Koppitjie) | 400 m of paved roads (Qokolo Koppitjie) by 30 June 2019 | Met |
| 3 | Number of meters paved roads by 30 June 2019 - (Elliot Streets) | 400 m of paved roads (Elliot Streets) by 30 June 2019 | Met |
| 4 | Number of km of paved road by June 2019 - (California) | 1 km of paved roads (California) by 30 June 2019 | Not met |
| 5 | Number of km of paved road by June 2019 - (Ekuthuleni) | 2 km of paved roads (Ekuthuleni) and storm water by 30 June 2019 | Not met |
| 6 | % of completion of the sports field by June 2019 | construction of sports field by 30 June 2019 | Met |
| 7 | % of completion of the community hall by June 2019 | 100% construction/ refurbishment of community hall by 30 June 2019 | Not met |
| 8 | Number of maintained street lights by June 2019 | All street to be maintained street lights by 30 June 2019 | Met |

Other matter

35. I draw attention to the matter below.

Achievement of planned targets

36. Refer to the annual performance report on pages 8 to 24 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 31 to 34 of this report.

Introduction and scope

37. 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.
38. The material findings on compliance with specific matters in key legislations are as follows:

Strategic and performance management

39. The performance management system and related controls were inadequate as they did not describe how the performance planning, monitoring, measurement, review, reporting and improvement processes should be conducted and managed, as required by municipal planning and performance management regulation 7(1).
40. No KPIs were set in respect of the provision of basic electricity services, as required by section 43(2) of the Municipal Systems Act and municipal planning and performance management regulation 10(a).
41. The Service Delivery Budget Implementation Plan (SDBIP) for the year under review did not include monthly revenue projections by source of collection, the monthly operational and capital expenditure by vote, as required by section 1 of the MFMA.

Annual financial statements and annual report

42. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of trade and other receivables from exchange transactions, receivables from non-exchange transactions, vat receivables, payable from exchange and expenditure resulted in the financial statements receiving a qualified audit opinion.

Expenditure management

43. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
44. Reasonable steps were not taken to prevent irregular expenditure of R2,3 million disclosed in note 42 to the financial statements, as required by section 62(1)(d) of the MFMA. The majority of the irregular expenditure was caused by non-adherence to the supply chain management regulations and preferential procurement regulations.
45. Reasonable steps were not taken to prevent fruitless and wasteful expenditure of R1,5 million disclosed in note 41 to the 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.

46. Reasonable steps were not taken to prevent unauthorised expenditure of R10,25 million disclosed in note 40 to the financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by spending exceeding the budget.

Human resource management

47. Financial interest was not disclosed by the senior managers within 60 days from date of appointment, as required by regulation 36(1)(a) on appointment and conditions of employment of senior managers.
48. I was unable to obtain sufficient appropriate audit evidence that a senior manager signed a performance agreement within the prescribed period, as required by section 57(2)(a) of the MSA.

Consequence management

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

Liability management

50. Short-term debt was not repaid within the financial year, as required by section 45(4) of the MFMA.

Conditional grants

51. Performance in respect of programmes funded by the municipal infrastructure grant was not evaluated within two months after the end of the financial year, as required by section 12(5) of Dora.
52. The Municipal Infrastructure Grant was not spent for its intended purposes in accordance with the applicable grant framework, as required by section 17(1) of the Dora.

Procurement and contract management

53. The performance of some of the contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA. Similar non-compliance was also reported in the prior year.

Other information

54. 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 financial statements, the auditor's report and the selected programme presented in the annual performance report that has been specifically reported in this auditor's report.
55. 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.
56. 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 programme presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
57. I did not receive the other information prior to the date of this auditor's report. When I do receive and read this information and if I conclude that it contains a material misstatement, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to retract this auditor's report and reissue and amended the report as appropriate. However, if it is corrected this will not be necessary.

Internal control deficiencies

58. I considered internal control relevant to my audit of the separate 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.
59. There was a prolonged vacancy in the key position of chief financial officer and the municipal manager was suspended, which resulted in leadership instability that undermined accountability. The absence of this leadership resulted in inadequate direction within the municipality to direct and guide its strategies and operations.
60. The municipality did not develop documented and approved internal policies and procedures to address collection, recording, processing, monitoring and reporting of financial and performance information.
61. Management did not implement daily and monthly controls as designed for the municipality'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 financial statements and performance report.

62. Review and supervision processes were inadequate to monitor compliance with all applicable legislation within the municipality. As a result, non-compliance with legislation was not effectively identified or prevented and municipal officials were not held accountable for transgressions
63. The internal audit unit and audit committee did not exercise their roles in strengthening the control environment within the municipality as numerous material misstatements were identified during the audit. The internal audit unit lacked capacity as it did not have a senior management post and remained ineffective in identifying key matters and addressing the previous year's control deficiencies. The internal audit recommendations were also not adequately addressed by the municipality. This resulted in recurring findings on internal controls, financial statements and compliance matters.

Other reports

64. 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.
65. The municipality appointed an independent firm to investigate cases of misconduct against a senior manager who allegedly awarded contracts irregularly. The investigation was still in progress at the date of signing this report.

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 programme 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 Sakhisizwe Local Municipality’s ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor’s report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of this auditor’s report. However, future events or conditions may cause a municipality to cease 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.