

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

## Report on the audit of the financial statements

### Qualified opinion

1. I have audited the financial statements of the Ndlambe Local Municipality set out on pages ... to ... which comprise the statement of financial position as at 30 June 2020, statement of financial performance, statement of changes in net assets, 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 Ndlambe Local Municipality as at 30 June 2020, 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 56 of 2003 (MFMA) and the Division of Revenue Act 16 of 2019 (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*. Work-in-progress recorded did not agree with the supporting documentation and was misclassified; depreciation was incorrectly calculated and not all land was recognised. Consequently, work-in-progress in note 9 to the financial statements was overstated by R18,7 million; land was understated by R5,5 million (2019: R6,7 million); buildings is understated by R530 401; accumulated depreciation and depreciation, as disclosed in note 30 to the financial statements, were both overstated by R444 518 (2019: R509 454 understated); and accumulated surplus, as disclosed in the statement of changes in net assets, is overstated by R12,6 million (2019: R7,2 million).
4. In addition, I was unable to physically verify the work in progress or obtain sufficient appropriate audit evidence to confirm that the work in progress recorded in property, plant and equipment exists, as disclosed in note 9 to the financial statements. I was unable to confirm that work in progress exists by alternative means. Consequently, I was unable to determine whether any further adjustment to work in progress of R69,2 million was required.

### Payables from exchange transactions

5. The municipality did not have a system in place to accurately record payables from exchange transactions. Trade payables, retention monies and accrued expenses were recorded at incorrect amounts as they did not agree with the supporting documents. Consequently, payables from exchange transactions, as disclosed in note 15 to the financial statements, was overstated by R14,4 million, and general expenses, as disclosed in note 34 to the financial statements, was overstated by R14,4 million.

### Service charges

6. The municipality did not recognise all revenue from service charges in accordance with GRAP 9, *Revenue from exchange transactions*. The municipality did not have adequate controls to confirm the indigent status of the consumers who were not billed for service charges. In addition, service charges for water and electricity were not billed accurately to consumers as meter readings were not used as a source for billing. Consequently, service charges revenue, as disclosed in note 22 to the financial statements and receivables from exchange transactions, as disclosed in note 5 to the financial statements, were both understated by R7,9 million (2019: R13 million).

### Debt Impairment

7. The municipality recognised debt impairment expenditure inclusive of value-added tax (VAT) when the provision for impairment was raised on receivables from exchange and non-exchange transactions. Systems to accurately identify and adjust for VAT when raising an impairment on the recoverability of receivables were inadequate. Consequently, the debt impairment expenditure, as disclosed in the statement of financial performance, was overstated by R5 million and the VAT payable, as disclosed in note 17 to the financial statements, was overstated by the same amount.

### Irregular expenditure

8. The municipality did not have proper systems in place to identify and record all irregular expenditure incurred in the current year, as 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. Due to the lack of systems, it was impracticable to determine the full extent of the understatement of irregular expenditure disclosed at R389,4 million (2019: R556,2 million) in the financial statements.

### Corresponding figures – Supply chain management regulations

9. The municipality did not have proper systems in place to identify and disclose all prior year deviations from the SCM policy in note 45 to the financial statements, as required by section 36(2) of the SCM Regulations. Due to the lack of systems, it was impracticable to determine the full extent of the understatement of prior year deviations disclosed at R79 million in the comparative column of 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 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' *International code of ethics for professional accountants (including International Independence Standards)* (IESBA code) as well as other 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.
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.

### Restatement of corresponding figures

14. As disclosed in note 41 to the financial statements, the corresponding figures for 30 June 2019 were restated as a result of an error in the financial statements of the municipality at, and for the year ended, 30 June 2020.

### Material losses and impairments

15. As disclosed in note 46 to the financial statements, material water losses of R20,2 million (2019: R27,1 million) were incurred, which represents 43% (2019: 53%) of total water purchased. The losses were predominantly due to physical losses from leaks, burst pipes and reservoir overflows. Furthermore, apparent losses were realised due to metering inefficiencies, meter faults, and unauthorised and unmetered consumption.
16. As disclosed in note 46 to the financial statements, material electricity losses of R6,4 million (2019: R6,3 million) were incurred, which represents 12,8% (2019: 13,6%) of total electricity purchased. The losses were predominantly due to losses in switchgear, overheads lines, obsolete aluminium lines, underground cables and transformers. Furthermore, losses were attributable to metering, tampering and meter readings losses.

### Unauthorised expenditure

17. As disclosed in note 42 to the financial statements, unauthorised expenditure of R308,4 million was incurred in the current year and previous years due to overspending of cash and non-cash items in various municipal departments. This balance is an accumulation of current and previous year amounts and there was no write-off or condonement of this amount in the current and previous year.

### **Fruitless and wasteful expenditure**

18. As disclosed in note 43 to the financial statements, fruitless and wasteful expenditure of R11,1 million was incurred in the current year and previous years due to interest incurred on late payments.

### **Other matter**

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

### **Unaudited disclosure notes**

20. 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. The disclosure requirements 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**

21. 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.
22. In preparing the 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 financial statements**

23. 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.
24. 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**

25. In accordance with the Public Audit Act 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 was engaged to perform procedures to identify findings but not to gather evidence to express assurance.
26. I was engaged to evaluate 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 priority presented in the annual performance report of the municipality for the year ended 30 June 2020:

<b>Development priority</b>	<b>Pages in the annual performance report</b>
Key performance area (KPA) 1 – Basic service delivery	x – x

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

### **KPA 1 – Basic service delivery**

#### **Percentage construction of bulk water infrastructure (project: construction of reservoirs in Thorn Hill)**

28. I was unable to obtain sufficient appropriate audit evidence to support the measure taken to improve performance against the target of 20% as reported in the annual performance report. This was due to limitations placed on the scope of my work. I was unable to confirm the reported measures taken by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported measure taken to improve performance.

#### **Various indicators**

29. I was unable to obtain sufficient appropriate audit evidence that clearly defined the predetermined source information, evidence and method of collection, and that related systems and processes were established to enable consistent measurement and reliable reporting of the actual achievement for the indicator. This was due to insufficient measurement definitions and processes. I was unable to test whether the indicator was well-defined and verifiable by alternative means. As a result, I was unable to audit the reliability of the achievement of various indicators reported against their targets in the annual performance report:

Indicator	Target as per SDBIP	Actual achievement in the annual performance report
6. Percentage construction of bulk water infrastructure (P006 augmentation of the Alexandra Bulk Water Supply)	70%	80%
7. Percentage construction of bulk water infrastructure (P008 construction of link services in Thorn Hill)	100%	100.00%
8. Percentage construction of bulk water infrastructure (Project: construction of reservoirs in Thorn Hill)	20%	0.00%
9. Percentage of households with access to basic sanitation	64%	77.22%
10. Percentage of households with access to water supply	89%	95.35%
43. Percentage of RO plant project completed	100%	38%

## Other matters

30. I draw attention to the matter below.

### Achievement of planned targets

31. 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 28 to 29 of this report.

## Report on the audit of compliance with legislation

### Introduction and scope

32. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the municipality's compliance with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.

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

### **Annual financial statements**

34. 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 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.

### **Consequence management**

35. Unauthorised expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(a) of the MFMA.
36. Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(b) of the MFMA.

### **Asset management**

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

### **Revenue management**

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

### **Expenditure management**

39. Reasonable steps were not taken to prevent irregular expenditure of R55,3 million 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 disclosed irregular expenditure was caused by non-compliance with SCM prescripts and regulations.
40. Reasonable steps were not taken to prevent unauthorised expenditure of R71 million, as disclosed in note 42 to the financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by overspending of the budget per municipal department, on cash and non-cash items.

### **Procurement and contract management**

41. Some goods and services with a transaction value below R200 000 were procured without obtaining the required price quotations, in contravention of supply chain management (SCM) regulation 17(1)(a) and (c).
42. Some quotations were accepted from bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).

43. Some contracts were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding, in contravention of SCM regulations 21(b) and 28(1)(a)(i) and the Preferential Procurement Regulations.
44. Some commodities designated for local content and production were procured from suppliers who did not submit a declaration on local production and content, as required by the 2017 preferential procurement regulations, section 8(5).
45. The performance of some contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA. This non-compliance was identified in the procurement processes for the upgrade of Kenton on Sea main road – phase 4.
46. The contract performance and monitoring measures and methods were not sufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA
47. Awards were made to providers whose directors were in the service of other state institutions in contravention of MFMA 112(j) and SCM regulation 44. Similar awards were identified in the previous year and no effective steps were taken to prevent or combat the abuse of the SCM process, as required by SCM regulation 38(1).
48. 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).
49. Persons in service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest, in contravention of SCM regulation 46(2)(e).

### **Strategic planning and performance management**

50. The performance management system and related controls were inadequate, as they did not describe how the performance measurement, review and reporting processes should be conducted and managed, as required by municipal planning and performance management regulation 7(1).

### **Other information**

51. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report, which includes the executive mayor's report, the audit committee's report and the accounting officer's report as required by the MFMA. The other information does not include the financial statements, the auditor's report and the selected development priority presented in the annual performance report that has been specifically reported in this auditor's report.
52. 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 on it.



53. 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.
54. 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

55. 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.
56. Leadership did not adequately discharge its oversight of the implementation and monitoring of internal controls to ensure sound financial and performance management and compliance with legislation. Consequently, the correct tone was not set to ensure that all municipal officials were held accountable for their actions through consequence management. Furthermore, leadership had developed a plan to address external audit findings but significant shortcomings in this plan contributed to the modified financial opinion, the material performance matters and the repeat findings on compliance.
57. Management did not have adequate controls over daily and monthly processing and reconciliation of transactions, which resulted in an over-reliance on reconciliations, journals and corrections only after year-end. This contributed to the material misstatements in the annual financial statements and performance information.
58. Record keeping within the municipality remains a challenge. The regular process of collecting and reporting on credible information was not always implemented, most notably relating to the collation, collection and verification, storage and reporting of information to support the actual performance as reported in the annual performance report.
59. The municipality did not have a proper risk management process in place, as there were no processes to identify risks and to develop mitigating controls. In addition, the internal audit unit did not review internal controls and compliance with laws and regulations. This was due to a lack of capacity, skills and resources in the internal audit unit and a failure to follow up on issues reported to management. The impaired functioning of the internal audit unit greatly affected the effectiveness of the audit committee.

## Other reports

60. I draw attention to the following engagements conducted by various parties, which 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.
61. Investigations were conducted and finalised in the current year. This related to fraudulent qualifications of employees in the finance division and outstanding monies that were not banked by the traffic service department.

*Auditor - General.*

East London

15 April 2021



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 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 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 concerns basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists relating to events or conditions that may cast significant doubt on the ability of the Ndlambe Local Municipality 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 my 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 operating as a going concern
  - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and determine 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, the actions taken to eliminate threats or the safeguards applied.