

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

## Report on the audit of the financial statements

### Qualified opinion

1. I have audited the financial statements of the Enoch Mgijima Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2020, the statement of financial performance, statement of changes in net assets, cash flow statement and the 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 impact 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 Enoch Mgijima 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 on 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

#### Payables from exchange transactions

3. I was unable to obtain sufficient appropriate audit evidence that retention fees for capital projects had been properly accounted as underlying records to substantiate these fees were not provided. I was unable to confirm retention fees by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to retention fees, stated at R6,3 million in note 12 to the financial statements.
4. In addition, the municipality did not correctly account for payables from exchange transactions in accordance with GRAP 1, *Presentation of financial statements* as unallocated deposits at end of the financial year were not all reported in note 12 to the financial statements. As a result, payables from exchange transactions was understated by R5,2 million and accumulated surplus was overstated by the same amount.

#### Irregular expenditure

5. The municipality did not identify and disclose all irregular expenditure in the financial statements, as required by 125(2)(d)(i) of the MFMA. Expenditure incurred in contravention of the supply chain management (SCM) requirements resulted in irregular expenditure of R13,1 million (2019: R71,3 million) being identified during the audit, which was not disclosed. I was unable to determine the full extent of the irregular expenditure that should have been disclosed as it was impracticable to do so by alternative means. Accordingly, I could not

determine the adjustment required to the irregular expenditure, disclosed at R52,6 million (2019: R518,9 million) in note 47 to the financial statements.

### **Fruitless and wasteful expenditure**

6. The municipality did not identify and disclose all fruitless and wasteful expenditure in the financial statements, as required by section 125(2)(d)(i) of the MFMA. Expenditure incurred in vain of R46,2 million identified during the audit was not disclosed. I was unable to determine the full extent of the fruitless and wasteful expenditure that should have been disclosed as it was impracticable to do so by alternative means. Accordingly, I could not determine the adjustment required to the fruitless and wasteful expenditure, disclosed at R4,1 million in note 46 to the financial statements.

### **Aggregation of immaterial uncorrected misstatements**

7. Expenditure in the statement of financial performance was materially misstated by R18,5 million due to the cumulative effect of individually immaterial uncorrected misstatements in the following items:
  - Employee-related costs, stated at R318,8 million is overstated by R7,1 million.
  - Depreciation and amortisation, stated at R56,6 million is overstated by R3,6 million (2019: R3,6 million).
  - Contracted services, stated at R27,3 million is overstated by R3,2 million.
  - General expenses, stated at R56,1 million is overstated by R2,3 million.
  - Bulk purchases, stated at R247,5 million is overstated by R2,0 million.
  - Repairs and maintenance, stated at R5,6 million is overstated by R0,3 million.

### **Corresponding figures**

#### **Value added tax (VAT) receivable**

8. I was unable to obtain sufficient appropriate evidence for the VAT receivable as the municipality did not have adequate systems in place to record all amounts due to them by the South African Receiver of Revenue. I was unable to confirm the VAT receivable by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the VAT receivable comparative amount, stated at R8,4 million in the statement of financial position.

#### **Receivables from exchange transactions**

9. I was unable to obtain sufficient appropriate evidence for the receivables from exchange transactions as the municipality did not have adequate supporting information for the restatement of the comparative amount. I was unable to confirm the receivables from exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the receivables from exchange transactions comparative amount, stated at R95,7 million in the statement of financial position.

## Employee benefit obligation

10. The municipality did not have adequate systems in place to monitor and report on the accrual for leave. In these circumstances, I was unable to obtain sufficient appropriate evidence to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the accrual for leave comparative amount, disclosed at R34,2 million in note 14 to the financial statements.

## Receivables from non-exchange transactions

11. The municipality did not recognise receivables from non-exchange transactions in accordance with GRAP 104, *Financial instruments*. This was due to inadequate systems for recording and accounting for impairment. As a result, receivables from non-exchange transactions comparative amount disclosed in note 4 to the financial statements, was understated by R43,8 million and debt impairment was overstated by the same amount.

## Property, plant and equipment

12. The municipality did not recognise property, plant and equipment in accordance with GRAP 17, *Property, plant and equipment* (PPE) due to the incorrect valuation of assets on initial recognition and calculation of depreciation. As a result, the comparative amount for PPE as disclosed in note 9 to the financial statements, was overstated by R81,9 million. Consequently, the comparative amount for accumulated surplus was overstated by R78,3 million and the comparative amount for accumulated depreciation as disclosed in note 9, was overstated by R3,6 million.

## Context for the opinion

13. 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.
14. 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.
15. 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

16. I draw attention to the matter below. My opinion is not modified in respect of this.
17. Note 44 to the financial statements indicates that challenges threaten the financial viability and going concern status of the municipality, including an operating deficit at the year end. As stated in the note, these events and conditions, along with other matters as set forth in the

## **Emphasis of matters**

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

### **Material underspending of government grants**

19. As disclosed in note 15 to the financial statements, the municipality materially underspent its grants allocation to the value of R56,5 million. This is due to the delays in the implementation of capital projects as a result of the national state of disaster and lockdown as disclosed in note 52 to the financial statements.

### **Material losses**

20. As disclosed in note 48 to the financial statements, material electricity losses of R61,8 million (2019: R109,2 million) were incurred, which represents 48,94% (2019: 48,57%) of the total electricity purchased. This is due to illegal connections and aging electricity infrastructure.

### **Events after the reporting date**

21. I draw attention to note 53 to the financial statements which deals with events after the reporting date and, specifically, the pending court order issued for the attachment of the municipality's assets for the payment of the Eskom debt. Management has described how they are dealing with this event and circumstances.

## **Other matter**

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

### **Unaudited disclosure notes**

23. 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**

24. 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 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.

25. 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

26. 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.
27. 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

28. 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 on the usefulness and reliability of the reported performance information against predetermined objectives for selected programme presented in the annual performance report. I performed procedures to identify material findings but not to gather evidence to express assurance.
29. My procedures address the usefulness and reliability of the reported performance information, which must be based on the municipality's approved performance planning documents. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures do not examine whether the actions taken by the municipality enabled service delivery. My procedures also do 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.
30. 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 municipality's annual performance report for the year ended 30 June 2020:

<b>Programme</b>	<b>Pages in the annual performance report</b>
Basic service delivery and infrastructure development	x – x

31. 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.

32. 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

33. Targets for the following performance indicators were not specific in clearly identifying the nature and required level of performance, as required by the Framework for Managing Programme Performance Information (FMPPI):

Indicator	Target
Refuse removal service provided to all serviced areas by 30 June 2020	Provide refuse removal services in all serviced areas by 30/06/20
Number of cleared illegal dumping sites	Reduction of illegal dumping sites

34. The measure taken to improve performance against the target for the below performance indicator was not reported in the annual performance report as required by section 46 of the Municipal Systems Act (MSA):

Indicator	Target	Achievement
Bladed gravel road (50 km) completed by 30 June 2020	50 km of bladed gravel roads completed by 30 June 2020	Not Achieved 46,2 km of bladed gravel roads (SADA, Mlungisi, Ezibeleni)

35. The reported measures taken to improve performance against the planned targets for the following performance indicators did not agree to supporting evidence provided. Based on the supporting evidence, the measures taken to improve performance are not valid and effective as there is lack of progress and improvement in the reported performance of the first two quarters of the 2020/21 quarterly performance reports:

Indicator	Target	Achievement	Remedial action
Construction of the Qwabi bridge at 95% by 30 June 2020	95% construction completed of the Qwabi bridge over the Kuzitungu River by 30 June 2020	Not achieved. 62% progress made. Work was done in the 2019-20 financial year. Contractor resumed work in March but had to stop due to the lockdown	A cession agreement was signed between the municipality and the service providers for the completion of the project
Construction of the Bucles Farm bridge at 95% by 30 June 2020	95% construction completed of the Baccles Farm bridge by 30 June 2020	Not achieved. No work was done in the 2019-20 financial year on the Baccles Farm bridge	A dispute is being concluded. The project will be fast-tracked in the next financial year. It is included in the 2020-21 SDBIP

Indicator	Target	Achievement	Remedial action
Electrification of 202 Airstrip Housing Development completed by 30 June 2020	Electrification of 202 Airstrip Housing Development in Moltano Phase 3 (ward 28) by 30 June 2020	Not achieved. There was no movement in the project during the period under review	The project will be fast-tracked in the next financial year. It is included in the 2020-21 SDBIP
Nomzamo T-switch and Central T-switch refurbished by 30 June 2020	100 % completion of Nomzamo T- switch and Central T-switch refurbishment by 30 June 2020	Not achieved. There was no movement in the project during the period under review	The project was advertised. Awaiting SCM committees. Project included in the 2020-21 SDBIP
Central substation 11 kv underground cable upgraded by 30 June 2020	100 % completion of Central substation 11 kv underground cable upgrade by 30/06/20	Not achieved. There was no movement in the project during the period under review	The project was advertised. Awaiting SCM committees. Project included in the 2020-21 SDBIP

36. The reported achievements for the following indicators were misstated as the evidence provided did not agree with the reported achievement, or supporting information was inadequate. The system and processes implemented by the municipality to ensure valid, accurate and complete reported performance information were not effective:

Indicator	Target	Achievement
Number of cleared illegal dumping sites	Reduction of illegal dumping sites	Not achieved. Illegal dumping was removed in the first 3 quarters
Bladed gravel road (50 km) completed by 30 June 2020	50 km of bladed gravel roads completed by 30 June 2020	Not achieved. 46,2 km of bladed gravel roads (SADA, Mlungisi, Ezibeleni)

## Other matters

37. I draw attention to the matters below.

### Achievement of planned targets

38. Refer to the annual performance report on pages ... to ... for information on the achievement of planned targets for the year and explanations provided for the under/over achievement of a significant 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 33 to 36 of this report.

### Adjustment of material misstatements

39. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were in the reported performance information of basic service

delivery and infrastructure development. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and 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

40. 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.
41. The material findings on compliance with specific matters in key legislation are as follows:

### Annual financial statements

42. The financial statements submitted for audit were not fairly presented in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of current assets and disclosure items identified by the auditors in the submitted financial statements were corrected and supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified opinion.

### Strategic planning and management

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

### Revenue management

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

### Expenditure management

45. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
46. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The expenditure disclosed does not reflect the full extent of the irregular expenditure incurred, as indicated in the basis for qualified opinion paragraph. The majority of the disclosed irregular expenditure was caused by non-compliance with supply chain management (SCM) legislation.
47. Reasonable steps were not taken to prevent fruitless and wasteful expenditure as required by section 62(1)(d) of the MFMA. The expenditure disclosed does not reflect the full extent of the



fruitless and wasteful expenditure incurred as indicated in the basis for the qualified opinion paragraph. The majority of the disclosed fruitless and wasteful expenditure was caused by interest incurred on overdue accounts.

48. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R480,5 million, as disclosed in note 45 to the annual financial statements, in contravention of 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by unbudgeted non-cash items and overspending of the allocated budget.
49. Reasonable steps were not taken to ensure that the municipality implements and maintains an effective system of expenditure control, including procedures for the approval, authorisation, withdrawal and payment of funds, as required by sections 65(2)(a) of the MFMA.

### **Asset management**

50. 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.
51. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

### **Consequence management**

52. Some losses resulting from irregular expenditure were not recovered from the liable person, as required by section 32(2) of the MFMA and municipal budget and reporting regulation 75(2).

### **Procurement and contract management**

53. Some goods and services with a transaction value below R200 000 were procured without obtaining the required price quotations, in contravention of SCM regulation 17(1)(a) and (c).
54. Some goods and services with a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). The accounting officer approved deviations even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1). Similar noncompliance was also reported in the prior year.
55. Some quotations were accepted from bidders whose tax matters had not been declared by the South African Revenue Service to be in order, in contravention of SCM regulation 43.

### **Other information**

56. 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.

57. 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.
58. 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.
59. 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

60. 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 audit opinion, the findings on the basic service delivery and infrastructure development programme and the findings on compliance with legislation included in this report.
61. Management did not adequately implement and monitor the internal controls of the municipality on a regular basis. This is evidenced by the significant errors in the annual financial statements (AFS) and annual performance report (APR) submitted for audit.
62. The municipality did not have adequate systems in place to monitor compliance with all applicable legislation and, as a result, non-compliance with legislation was not prevented. In addition, there was inadequate supervision, monitoring and consequence management within the municipality.
63. The weaknesses in the internal control environment can also be attributed to the lack of oversight by leadership and vacancies in key positions, combined with systemic weaknesses in information technology systems that were reported on repeatedly in prior years and not addressed.

### Other reports

64. 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.

## Ongoing investigation

65. During the previous financial year, an independent consultant was engaged to investigate allegations of irregularities and possible misappropriation of the municipality's assets. These proceedings were in progress at the date of this report.

*Auditor - General*

East London

30 March 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 programmes and on the municipality’s compliance with respect to the selected subject matters.

### **Financial statements**

2. In addition to my responsibility for the audit of the 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 relating to events or conditions that may cast significant doubt on the ability of the Enoch Mgijima 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.