



Auditing to build public confidence

**AUDITOR - GENERAL
SOUTH AFRICA**



CHRIS HANI DISTRICT MUNICIPALITY

Audit Report

For the year ended 30 June 2020



**AUDITOR - GENERAL
SOUTH AFRICA**

Auditing to build public confidence

Report of the auditor-general to the Eastern Cape Provincial Legislature and the council on the Chris Hani District Municipality

Report on the audit of the consolidated and separate financial statements

Disclaimer of opinion

1. I was engaged to audit the consolidated and separate financial statements of the Chris Hani District Municipality set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2020, the consolidated and separate 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 consolidated and separate financial statements, including a summary of significant accounting policies.
2. I do not express an opinion on the consolidated and separate financial statements of the municipality because of the significance of the matters described in the basis for a disclaimer of opinion section of my report. I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these consolidated and separate financial statements.

Basis for disclaimer of opinion

Property, plant and equipment

3. The municipality and the entity did not assess all assets for impairment in accordance with the South African Standards of Generally Recognised Accounting Practice (GRAP) 21, *Impairment-of-Non-cash-generating-assets*. Damaged and vandalised assets were included in the infrastructure assets without being impaired, the useful lives of fully depreciated movable assets have not been reassessed and the municipal entity did not recognise all transferred assets in their register. I could not confirm the impairment and assessment by alternative means. Consequently, I was unable to determine the full extent of the overstatement of property, plant and equipment stated at R4,3 billion (2019: R4,1 billion), impairment loss stated at R73 678 (2019: R1 260), depreciation stated at R159,4 million (2019: R153,7 million) and R157,8 million (2019: R152,1 million) in the consolidated and separate financial statements, respectively.

Revenue from exchange transactions

4. The municipality did not recognise revenue from service charges in accordance with GRAP 9, *Revenue from exchange transactions* due to inadequate systems in place for revenue management, as revenue was billed using incorrect rates, incorrect consumption units were used, some customers were not billed throughout the year and sufficient appropriate audit evidence could not be obtained to verify the averages used for billing throughout the year. I could not confirm the amounts by alternative means. Consequently, I was unable to determine

whether any further adjustments were necessary to service charges, stated at R300,5 million (2019: R305,5 million) in the consolidated and separate financial statements.

Receivables from exchange transactions

5. I was unable to obtain sufficient appropriate audit evidence for receivables from exchange transactions due to the limitations and disagreement in respect of revenue from exchange transactions, which have an impact on the receivables from exchange transactions. I could not confirm the amounts by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to receivables from exchange transactions stated at R317,7 million (2019: R240,1 million) and R315,3 million (2019: R238,2 million), the debt impairment expense stated at R278,9 million (2019: R173,4 million) and interest revenue from debtors stated at R57,8 million (2019: R38,5 million) in note 22 to the consolidated and separate financial statements, respectively.

VAT receivable

6. I was unable to obtain sufficient appropriate audit evidence for VAT receivable due to the limitations and disagreements in respect of receivables from exchange transactions, revenue from exchange transactions and payables from exchange transactions, which have an impact on the calculation of VAT receivable. I could not confirm the amounts by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to VAT receivable, stated at R58,1 million (2019: R77,6 million) and R57,9 million (2019: R77,2 million) in the consolidated and separate financial statements, respectively.

Revenue from non-exchange transactions

7. The municipality did not recognise revenue from non-exchange transactions in accordance with GRAP 23, *Revenue from non-exchange transactions*. The municipality double counted the VAT portion to be recognised as government grants and subsidies from expenditure on conditional grants. As a result, revenue from non-exchange transactions are overstated by R47,6 million and unspent conditional grants understated by R47,6 million.

Unspent conditional grants and receipts

8. I was unable to obtain sufficient appropriate audit evidence for unspent conditional grants and receipts, as the municipality did not maintain accurate and complete records of amounts received from provincial and national government departments. I could not confirm the amounts by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to unspent conditional grants and receipts, stated at R85,2 million (2019: R301,5 million) and R78,6 million (2019: R300,5 million) in the consolidated and separate financial statements, respectively.

Payables from exchange transactions

9. The municipality did not recognise trade payables in accordance with GRAP1, *Presentation of financial statements*, due to an inadequate credit management system in place, as trade payables included amounts for goods and services that had not been received at year-end and the creditors listing did not agree with the financial statements. As a result, payables from

exchange transactions as well as and expenditure are both overstated by R28,9 million (2019: R85,4 million).

10. Furthermore, in my previous year's audit report, I modified my opinion on payables from exchange transactions in note 16 to the consolidated and separate financial statements due to the poor state of accounting records as supporting documents to substantiate the reversals and removals of retentions were not submitted. Management did not correct the matters giving rise to the modification. I could not confirm the amount by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to the retentions corresponding figure, stated at R34,8 million in note 16 to the consolidated and separate financial statements.

General expenses

11. The municipality did not recognise general expenses in accordance with GRAP1, Presentation of financial statements. The municipality recorded general expenses in the incorrect accounting period, customers who do not qualify for indigent subsidies received subsidies and capital expenditure are incorrectly recognised as general expenses. As a result, general expenses are overstated by R18,6 million, payables is overstated by R15,8 million, receivables from exchange transactions is understated by R1,4 million and property plant and equipment is understated by R1,4 million.

Irregular expenditure

12. I was unable to obtain sufficient appropriate audit evidence for irregular expenditure due to the non-submission of information to confirm the transgression that resulted in irregular expenditure. I could not confirm the transgressions and irregular expenditure by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to irregular expenditure, stated at R417,4 million (2019: R1,5 billion) in note 45 to the consolidated and separate financial statements.

Water distribution losses

13. I was unable to obtain sufficient appropriate audit evidence for water distribution losses due to the limitations in respect of revenue from service charges, which have an impact on the calculation of water distribution losses. I could not confirm the amounts by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to water distribution losses, stated at R182,1 million (2019: R8,4 million) in note 48 to the consolidated and separate financial statements.

Cash flow statement

14. I was unable to obtain sufficient appropriate audit evidence for prior year other movements included in cash flows from investing activities and movement in other financial liabilities included in cash flow from financing activities, due to the poor state of accounting records, as supporting documents to substantiate the reversals and movements were not submitted. I could not confirm these movements by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to net cash flows from investing activities stated at R601,4 million (2019: R517,8 million) and R601,2 million (2019:R517,7 million), and

cash flow from financing activities stated at R61,8 million in the cash flow statement of the consolidated and separate financial statements, respectively.

Aggregation of immaterial uncorrected misstatements

15. Total current assets were materially misstated by R21,6 million due to the cumulative effect of individually immaterial uncorrected misstatements in the following items:
 - Inventory stated at R17,1 million was overstated by R11,2 million.
 - Cash and cash equivalents stated at R42,2 million was understated by R7,7 million.
16. Total expenditure was materially misstated by R19,5 million due to the cumulative effect of individually immaterial uncorrected misstatements in the following items:
 - Employee cost stated at R368,9 million was overstated by R11,7 million.
 - Contracted services stated at R209,5 million was overstated by R7,5 million.

Corresponding figures

Commitments

17. I was unable to obtain sufficient appropriate audit evidence for commitments, as the municipality did not have adequate systems in place to support adjustments processed to commitments. I could not confirm the adjustment by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to commitments, stated at R872,7 million in note 35 to the consolidated and separate financial statements.

Contracted services

18. The municipality did not recognise repairs and maintenance in accordance with GRAP1, *Presentation of financial statements*. Capital expenditure was incorrectly recognised as repairs and maintenance. As a result, repairs and maintenance is overstated by R28 million and capital expenditure understated by R28 million.

Cash and cash equivalent

19. The municipality did not account for cash and cash equivalent as required by GRAP 104, *Financial instruments*. The cash and cash equivalent disclosed in the financial statements did not agree with the bank confirmation. This was because management did not clear unreconciled differences. As a result, cash and cash equivalent are understated by R14,1 million and payables from exchange transactions are understated by R14,1 million.

Emphasis of matter

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

Restatement of corresponding figures

21. As disclosed in note 38 to the consolidated and separate financial statements, the corresponding figures for 30 June 2019 have been restated because of errors in the financial statements of the municipality at, and for the year ended, 30 June 2020.

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 this legislation. 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 consolidated and separate financial statements

24. The accounting officer is responsible for the preparation and fair presentation of the consolidated and separate financial statements 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 2018 (Dora) and for such internal control as the accounting officer determines is necessary to enable the preparation of consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.
25. In preparing the consolidated and separate 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 consolidated and separate financial statements

26. My responsibility is to conduct an audit of the consolidated and separate financial statements in accordance with the International Standards on Auditing (ISAs) and to issue an auditor's report. However, because of the matters described in the basis for disclaimer of opinion section of this auditor's report, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.
27. 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 the other ethical requirements that relevant to my audit of the consolidated and separate financial statements in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.

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 programmes 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:

Key performance area (KPA)	Pages in the annual performance report
KPA 2 – 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 finding in respect of the usefulness of the selected key performance area is as follows:

KPA 2 – basic service delivery and infrastructure development

Various indicators

33. For the following indicators, measures taken to improve performance could not be corroborated:

Indicator code	Remedial action
SDI 1 Number of households served with quality basic water	2) Hewu Phase 7 extension of time was granted to the contractor and the project will be completed in Q1 of the next financial year
	Cluster 2 RS2 extension of time was granted to the contractor and the project will be completed in Q2 of the next financial year
SDI 2 Number of water reticulation projects completed	2) Hewu Phase 7 extension of time was granted to the contractor and the project will be completed in Q1 of the next financial year
	Cluster 2 RS2 extension of time was granted to the contractor and the project will be completed in Q2 of the next financial year
SDI 5 Number of water treatment works completed	The contractor will completed the project in Q2 of the next financial year
SDI 12 Number of waste water projects completed	Extension of time was granted to the contractor and the project will be completed in Q1 of the next financial year

Other matters

34. I draw attention to the matter below.

Achievement of planned targets

35. 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 usefulness of the reported performance information in paragraph 34 of this report.

Report on the audit of compliance with legislation

Introduction and scope

36. 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.

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

Annual financial statements, performance reports and annual reports

38. 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 expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a disclaimer audit opinion.
39. The consolidated financial statement submitted for audit was not submitted within five months after the financial year end. This resulted in a contravention of section 126(1)(b) of the MFMA.

Expenditure management

40. 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 disclaimer paragraph. The majority of the disclosed irregular expenditure was caused by the lack of documentation to support the non-compliance emanating from multi-year projects, and deviations not in line with regulation 36.
41. Reasonable steps were not taken to prevent fruitless and wasteful expenditure of R730 219, as disclosed in note 44 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 an amount paid into the incorrect bank account of a supplier.
42. Reasonable steps were not taken to prevent unauthorised expenditure of R135,9 million, as disclosed in note 43 to the financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by overspending incurred by the municipality in its different votes.
43. An adequate management, accounting and information system that recognised expenditure when it was incurred and accounted for creditors was not in place, as required by section 65(2)(b) of the MFMA.

Revenue management

44. An adequate management accounting and information system that accounts for debtors and revenue was not in place, as required by section 64(2)(e) of the MFMA.
45. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

Asset management

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

Consequence management

48. 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.
49. 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 and municipal budget and reporting regulation 75(1).

Conditional grants

50. I was unable to obtain sufficient appropriate audit evidence that the water services infrastructure grants (WSIG) was spent for its intended purposes in accordance with the applicable grant framework, as required by section 17(1) of Dora.
51. Performance in respect of programmes funded by the municipal infrastructure grant, regional bulk infrastructure grants and WSIG was not evaluated within two months after the end of the financial year, as required by section 12(5) of Dora.

Procurement and contract management

52. Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of supply chain management (SCM) regulation 36(1). Similar non-compliance was also reported in the prior year.

Other information

53. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report, which includes the audit committee's report. The other information does not include the consolidated and separate financial statements, the auditor's report and the selected programme presented in the annual performance report that has been specifically reported in this auditor's report.
54. 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.
55. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated and separate financial statements and the selected programmes presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
56. 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 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

57. I considered internal control relevant to my audit of the consolidated and separate financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance on it. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the disclaimer of opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.
58. There was insufficient oversight to ensure consistent implementation and monitoring of controls over financial and performance information, and compliance with legislation. This was mainly due to a lack of capacity and accountability as well as inadequate communication between departments within the municipality.
59. Consequence management was not implemented against officials who were responsible for incurring irregular and fruitless and wasteful expenditure.
60. The municipality did not have a proper system of records management for the financial environment as a whole as material misstatements were identified, resulting in a disclaimer of opinion. In addition, inadequate integration between the budget and treasury office and other departments within the municipality contributed to material misstatements identified during the audit process.
61. The municipality did not have adequate systems to monitor compliance with all applicable legislation and, as a result, non-compliance with legislation was not prevented. There was inadequate supervision, monitoring and consequence management in managing the operations of the municipality.
62. The recommendations by the internal audit unit were not implemented promptly and adequately by management to address or reduce findings raised through the external audit process. In addition, although the audit committee reviews the municipality's performance management system on a quarterly basis, the reviews did not have a positive impact on the improvement in internal controls, as material findings were still identified through the audit process.
63. Although the municipality developed an audit action plan to address audit findings, it was not implemented throughout the year. This resulted in recurring material misstatements in the current year.

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. This report did not form part of my opinion on the financial statements or my findings on the reported performance information or compliance with legislation.
65. Since 2019, an external service provider has been investigating allegations of misconduct on the part of a municipal management official. The investigation has since concluded.

Auditor General
East London

31 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 consolidated and separate 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 consolidated and separate financial statements as described in this auditor’s report, I also:
 - identify and assess the risks of material misstatement of the consolidated and separate financial statements, whether due to fraud or error; design and perform audit procedures responsive to those risks; and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations or the override of internal control
 - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 Chris Hani District 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 consolidated and separate financial statements. My conclusions are based on the information available to me at the date of this auditor’s report. However, future events or conditions may cause a 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.