



SUPPLEMENTARY ITEM

A017/01/2021

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REPORT OF THE AUDITOR-GENERAL ON THE 2018/2019 ANNUAL FINANCIAL STATEMENTS

FILE NUMBER : 6/1/1-2018/2019

RESPONSIBLE DEPARTMENT : Finance

DELEGATED AUTHORITY : Non-delegated

1. STRATEGIC INTENT:

Financial Sustainability	
Sustainable Physical Infrastructure and Improve Customer Care Services	
Economic Growth and Development	
Institutional Transformation	
Spatial Integration and Safe Protected Environment	
Governance and Stakeholder Participation	✓

2. PURPOSE OF THE REPORT:

To table the report of the Auditor-General on its audit of the municipality's 2018/2019 Annual Financial Statements.

3. BACKGROUND:

Section 126(1)(a) of the Local Government: Municipal Finance Management Act, Act 56 of 2003, determines that the accounting officer of a municipality must prepare the annual financial statements of the municipality and submit the statements to the Auditor-General for auditing.

Section 126(3) determines that the Auditor-General must audit those financial statements and submit an audit report on those statements to the accounting officer of the municipality.

4. DISCUSSION:

The report of the Auditor-General on the municipality's 2018/2019 Annual Financial Statements has been received and is attached as **ANNEXURE 'A'**.

This report is to be considered with item A004/01/2020 on the 2018/2019 Audited Annual Report.

A representative from the Office of the Auditor-General will be present at the Council meeting to be held on the 28th of January 2021 to present the report in compliance with Section 130(2) of the MFMA.

5. IMPLICATIONS:

5.1. FINANCIAL

The municipality is liable for the auditing costs of the Office of the Auditor-General.

5.2. LEGAL

Sections 126 and 130(2) of the Local Government: Municipal Finance Management Act, Act 56 of 2003.

5.3. PERSONNEL

None.

5.4. COMMUNICATION

None.

6. RECOMMENDATION:

1. That it **BE ACKNOWLEDGED** that the report of the Auditor-General on the municipality's 2018/2019 Annual Financial Statements has been received and is attached as ANNEXURE 'A' to item A017/01/2021.
2. That it **BE ACKNOWLEDGED** that the Office of the Auditor-General gave a disclaimer opinion on the municipality's 2018/2019 Annual Financial Statements.

Report of the auditor-general to the Mpumalanga Provincial Legislature and the council on the Govan Mbeki Local Municipality

Report on the audit of the financial statements

Disclaimer of opinion

1. I was engaged to audit the financial statements of the Govan Mbeki Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2019, 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 financial statements, including a summary of significant accounting policies.
2. I do not express an opinion on the accompanying financial statements of the municipality. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs of my report, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

Basis for disclaimer of opinion

Cash and cash equivalents

3. I was unable to obtain sufficient appropriate audit evidence for cash and cash equivalents. This was due to the municipality not implementing sufficient controls to ensure that its main bank account in the general ledger is reconciled to the statement from the bank. I could not obtain the required evidence by alternative means. Consequently, I was unable to determine if any adjustments were required to cash and cash equivalents stated at R97,24 million (2017-18: bank overdraft of R78,62 million) in the statement of financial position and note 14 to the financial statements.

Service charge revenue

4. I was unable to obtain sufficient appropriate audit evidence for service charge revenue. This was due to inadequate controls over the billing of this revenue. I could not obtain the required evidence by alternative means. Consequently, I was unable to determine whether any adjustments were required to the service charge revenue stated at R1,1 billion (2017-18: R1,03 billion) in the statement of financial performance and note 24 to the financial statements.

Consumer debtors

5. The municipality did not bill all consumers and did not record all amounts due to it as required by GRAP 104, *Financial instruments* and GRAP 9, *Revenue from exchange transactions*. As a result, consumer debtors as disclosed in the statement of financial position and note 12 is understated by R99,53 million, long term receivables as disclosed in the statement of financial position and note 8 is understated by R5,6 million, interest revenue as disclosed in the statement of financial performance and note 58 is overstated by R20,18 million (2017-18: R96,97 million understated), service charge revenue as disclosed in the statement of financial performance and note 24 is understated by R24,90 million, transfer and subsidies expense as disclosed in the statement of financial performance and note 29 is overstated by R3,44 million, and the accumulated surplus at the beginning of the year as disclosed in the statement of financial position and the statement of changes in net assets is understated by R96,97 million. There is also a consequential impact on the surplus for the year and the accumulated surplus at the end of the year.
6. Furthermore, I was unable to obtain sufficient appropriate audit evidence for consumer debtors. This was due to inadequate controls over the billing of service charge revenue and the collection of the amounts billed to consumers. I could not obtain the required evidence by alternative means. Consequently, I was unable to determine whether any further adjustments were required to the consumer debtors stated at R145 million (2017-18: R263,8 million) in the statement of financial position and note 12 to the financial statements.

Receivables from non- exchange transactions

7. The municipality did not bill rates to all property owners and did not record all amounts due to it as required by GRAP 104, *Financial instruments* and GRAP 23, *Revenue from non-exchange transactions*. As a result, receivables from non-exchange transactions as disclosed in the statement of financial position and note 11 is understated by R10,55 million, property rates revenue and debt impairment expense as disclosed in the statement of financial performance and notes 27 and 36 are understated by R5,04 million and R10,15 million, respectively, and the accumulated surplus at the beginning of the year as disclosed in the statement of financial position and the statement of changes in net assets is understated by R15,66 million. There is also a consequential impact on the surplus for the year and the accumulated surplus at the end of the year.
8. Furthermore, I was unable to obtain sufficient appropriate audit evidence for receivables from non-exchange transactions. This was due to inadequate controls over the billing of rates and the collection of the amounts billed to consumers. I could not obtain the required evidence by alternative means. Consequently, I was unable to determine whether any further adjustments were required to the receivables from non-exchange transactions stated at R59,65 million (2017-18: R56,4 million) in the statement of financial position and note 11 to the financial statements.

Debt impairment expense

9. I was unable to obtain sufficient appropriate audit evidence that the impairment of consumer debtors and receivables from non-exchange transactions was adequate. This was due to the municipality not adequately implementing its credit control policy. I could not obtain the required evidence by alternative means. Consequently, I could not determine whether any adjustments were required to the debt impairment expense disclosed at R632,64 million (2017-18: R207,93 million) in the statement of financial performance and note 36. I also could not determine whether any further adjustments were required to consumer debtors stated at R145 million (2017-18: R263,8 million) in the statement of financial position and note 12 and the receivables from non-exchange transactions stated at R59,65 million (2017-18: R56,4 million) in the statement of financial position and note 11.

Irregular expenditure

10. I was unable to obtain sufficient appropriate audit evidence for the restated opening balance of irregular expenditure. This was due to the municipality not performing investigations to determine the full extent of the irregular expenditure incurred in the previous year. Consequently, I could not determine whether any adjustments were required to the irregular expenditure disclosed at R658 million (2017-18: R406,85 million) in note 52 to the financial statements.

Corresponding figures

11. My previous report on the financial statements for the year ended 30 June 2018 contained modifications on various classes of transactions due to a lack of sufficient appropriate audit evidence and misstatements identified during that audit.
12. During the year under review, I was still not able to obtain sufficient appropriate audit evidence for some of the classes of transactions that are now recorded as corresponding figures. As a result, I am not able to determine whether any adjustments are required to the following corresponding figures:
 - Contracted services stated at R88,12 million.
 - General expenses stated at R117,15 million.
 - Transfers and subsidies expense stated at R2,99 million.
13. My report on the 2018-19 financial statements is modified due to the comparability of this information.

Other matters

14. I draw attention to the matters below.

Unaudited disclosure note

15. In terms of section 125(2)(e) of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (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 thereon.

Withdrawal from the engagement

16. Due to the limitations imposed on the scope of the audit by management, I have disclaimed my opinion on the financial statements. However, were it not for the legislated requirement to perform the audit of the municipality, I would have withdrawn from the engagement in terms of the International Standards on Auditing (ISAs).

Responsibilities of the accounting officer for the financial statements

17. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the MFMA and the Division of Revenue Act of South Africa, 2018 (Act No. 1 of 2018) (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.
18. 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

19. My responsibility is to conduct an audit of the financial statements in accordance with the 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.
20. I am independent of the municipality in accordance with sections 290 and 291 of the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* and parts 1 and 3 of the *International 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.

Report on the audit of the annual performance report

Introduction and scope

21. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected priorities presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
22. 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.
23. 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 priority presented in the annual performance report of the municipality for the year ended 30 June 2019:

Priority	Pages in the annual performance report
KPA 2: sustainable physical infrastructure and improve customer care	xx – xx

24. 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.
25. The material findings in respect of the usefulness and reliability of the selected priority are as follows:

KPA 2: sustainable physical infrastructure and improve customer care

Various indicators

26. The reported achievement in the annual performance report for the indicators listed below did not agree to the supporting evidence provided. The supporting evidence provided indicated that the achievement of these indicators was as follows:

Indicator description	Reported achievement	Audited value
Percentage (%) reduction of water losses by 30 June 2019	3,7% reduction achieved on water losses recorded	2,5% reduction achieved on water losses recorded
Percentage completion of upgrading of the inlet works and mechanical equipment of Emzinoni WWTW by 30 September 2018	78% completion of upgrading of the inlet works and mechanical equipment of Emzinoni WWTW	50% completion of upgrading of the inlet works and mechanical equipment of Emzinoni WWTW

Number of indigent households provided with access to basic services at 30 June 2019

27. The reported achievement of 12 253 households receiving access to free basic services by 30 June 2019 is not reliable, as the municipality did not have an adequate performance management system to maintain records to ensure reliable reporting of actual achievements. As a result, I was unable to obtain sufficient appropriate evidence in some instances. In other cases, the supporting evidence provided did not agree to the reported achievement. Based on the supporting evidence that was provided, the reported achievement was 11 028 households, but I was unable to further confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any further adjustments were required to the reported achievement.

Various indicators

28. I was unable to obtain sufficient appropriate evidence for the reported achievements of three indicators included for this priority. This was due to the municipality not keeping appropriate records to support the reported achievements. 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 for the indicators listed below.

Indicator description	Reported achievement
m2 of roads maintained by 30 June 2019	10011.17m2 of roads maintained

Indicator description	Reported achievement
KMs of Gravel Roads maintained 30 June 2019	311.62 km of Gravel Roads Maintained
Number of households receiving a weekly refuse removal service (A household is defined as a residential and non-residential unit billed for the service by way of the financial system) by 30 June 2019	60 639 households receiving a weekly refuse removal service by 30 June 2019

Other matter

29. I draw attention to the matter below.

Achievement of planned targets

30. Refer to the annual performance report on pages xx to xx 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 26 to 28 of this report.

Report on the audit of compliance with legislation

Introduction and scope

31. 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.

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

Annual financial statements

33. The annual financial statements were not submitted to the auditor-general for auditing within two months after the end of the financial year, as required by section 126(1)(a) of the MFMA.

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 the supporting records could not be provided subsequently, which resulted in the financial statements receiving a disclaimer of opinion.

Procurement and contract management

35. Sufficient appropriate audit evidence could not be obtained that all quotations were awarded in accordance with the legislative requirements, as the municipality's record-keeping systems did not allow for the easy retrieval of documentation. A similar limitation was also reported in the prior year.
36. Some of the 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(a) and (c). Similar non-compliance was also reported in the prior year.
37. Some of the 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) and the Preferential Procurement Regulations. Similar non-compliance was also reported in the prior year.
38. Some of the construction contracts were awarded to contractors that did not qualify for the contract in accordance with Construction Industry Development Board regulations 17 and 25(7A). Similar non-compliance was also reported in the prior year. This non-compliance was identified in the procurement processes for the conversion of water-borne toilets in Emzinoni and the rehabilitation of Victor Khayiyane Road in Emzononi and Albert Luthuli Drive.
39. Some of the bid documentation for the procurement of commodities designated for local content and production did not stipulate the minimum threshold for local production and content, as required by preferential procurement regulation 8(2). Similar non-compliance was also reported in the prior year.

Asset management

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

Consequence management

41. Unauthorised expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a) of the MFMA.
42. Irregular expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.
43. Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.

Expenditure management

44. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

45. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The full extent of the irregular expenditure incurred could not be quantified as indicated in the basis for disclaimer of opinion paragraph. Irregular expenditure amounting to R27,6 million was incurred on sanitation infrastructure projects in Emzinoni and Kinross and two road projects (Albert Luthuli and Victor Khayiyane).
46. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R177,69 million, as disclosed in note 51 to the financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed fruitless and wasteful expenditure was due to interest incurred on late payments to suppliers and the impairment of assets under construction where the construction sites were abandoned by contractors who were replaced, and the work redone.
47. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R897 million, as disclosed in note 49 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 approved budget.

Revenue management

48. An adequate management, accounting and information system was not in place to account for revenue, as required by section 64(2)(e) of the MFMA.
49. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.
50. Revenue due to the municipality was not calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.
51. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.
52. Accounts for municipal tax and service charges were not prepared on a monthly basis, as required by section 64(2)(c) of the MFMA.

Strategic and performance management

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

Conditional grants

54. I was unable to obtain sufficient appropriate evidence that the energy efficiency and demand management grant was spent for its intended purposes in accordance with the applicable grant framework, as required by section 17(1) of Dora.

Other information

55. 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. The other information does not include the financial statements, the auditor's report and those selected priorities presented in the annual performance report that have been specifically reported in this auditor's report.
56. The disclaimer of 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.
57. 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 priorities presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
58. As a result of the disclaimer of opinion expressed on the financial statements, I do not conclude on material misstatements of the other information relating to the financial statements. If, based on the work I have performed relating to the audit of performance information and compliance with legislation, I conclude that there is a material misstatement of this other information, I am required to report that fact.
59. 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 are misstatements contained 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 issue an amended report as appropriate. If the other information 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 disclaimer of opinion on the financial statements, findings on the annual performance report and findings on compliance with legislation included in this report:
- Management did not demonstrate effective leadership that was based on a culture of honesty and integrity as well as low levels of tolerance for poor performance and transgressions of laws and regulations. The action plans put in place to address internal and external audit findings did not adequately address the root causes of the findings raised and were not adequately monitored and

implemented. This resulted in many repeat findings on the financial statements, annual performance report and compliance with laws and regulations.

- The controls over daily, weekly and monthly processing and reconciling activities were not adequately monitored. As a result, misstatements in the financial statements and annual performance report, and non-compliance with laws and regulations, were detected.
- Management did not adequately identify and respond to the risks relating to financial and performance reporting and compliance with laws and regulations. Furthermore, management was slow to respond to the recommendations of the internal audit function and the audit committee, limiting their impact on the audit outcome.

Other reports

61. 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 the disclaimer of opinion on the financial statements or my findings on the reported performance information or compliance with legislation.
62. A report on alleged fraud committed by the chief financial officer was received from the integrity management unit of the Office of the Premier and was tabled in council. This report related to transactions that took place in the previous financial year.
63. The integrity management unit situated in the Office of the Premier is investigating allegations of maladministration and corruption in the SCM processes of the municipality. The investigation was in progress at the date of this report.

Auditor - General

Mbombela

2 December 2020



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence