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

Qualified Opinion

1. I have audited 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 2022, the consolidated and separate statement of financial performance, the statement of changes in net assets and cash flow statement and statement of comparison of budget information with actual information for the year then ended, as well as notes to the consolidated and separate financial statements, including a summary of significant accounting policies.

2. In my opinion, except for the effects and possible effects of the matters described in the basis for qualified opinion section of this auditor's report, the consolidated and separate financial statements present fairly, in all material respects, the financial position of the Chris Hani District Municipality as at 30 June 2022, and its financial performance and cash flows for the year then ended in accordance with the Standards of Generally Recognised Accounting Practice (GRAP) and the requirements of the Municipal Finance Management Act 56 of 2003 (MFMA) and the Division of Revenue Act 9 of 2021 (Dora).

Basis for qualified opinion

Receivables from exchange transactions

3. I was unable to obtain sufficient appropriate audit evidence for receivables from exchange transactions due to the limitations on the opening balance and allowance for impairment and differences between age analysis and financial statements, which had 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 R355,7 million (2021: R346,9 million) and the debt impairment expense stated at R335,3 million (2021: R383,5 million) in the financial statements, and interest revenue from debtors stated at R84,2 million (2021: R62,8 million) in note 24 to the consolidated and separate financial statements.

VAT payable

4. I was unable to obtain sufficient appropriate audit evidence for VAT payable due to the limitations and disagreements of receivables from exchange transactions and revenue from exchange transactions, which have an impact on the calculation of VAT payable. I could not confirm the VAT payable by alternative means. Consequently, I was unable to determine the

full extent of the misstatement of VAT payable stated at R121,1 million (2021: 9,5 million) in note 8 to the consolidated and separate financial statements.

Inventories

5. During 2021 and 2022 the municipality did not account for inventory in accordance with the GRAP 12, *Inventories*. Bulk water purchases and chemicals to purify the water were directly expensed and there was no closing balance for water inventory accounted on the annual financial statements. I could not confirm the balance of inventory by alternative means. Consequently, I was unable to determine the full extent of the understatement of inventories stated at R20,9 million (2021:R14 million), bulk purchases stated at R38,8 million (2021:R33,6 million) and chemicals stated at R7,4 million (2021:R13,9 million) in note 34 to the consolidated and separate financial statements.

Revenue from exchange transactions

6. The municipality did not recognise service charges revenue, as required by GRAP 9, *Revenue from exchange transactions*. Revenue was billed using incorrect rates, incorrect consumption units were used, and some customers were not billed throughout the year. Consequently, I was unable to determine the full extent of the misstatement of service charges stated at R369,1 million and receivables from exchange transations stated at R355,7 million in the consolidated and separate financial statements.

7. Furthermore, in my previous year's audit report, I modified my opinion on revenue from exchange transactions in the financial statements due to the poor state of accounting records as supporting documents to substantiate the estimates on revenue were not submitted. Management incorrectly used the current year credit control rates and debt collection policy to correct the prior year limitation. I could not confirm the amount by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to sale of water service charges, stated at R350,7 million in note 20 to the consolidated and separate financial statements.

Contracted services

8. The municipality did not recognise contracted services in accordance with GRAP 1, *Presentation of financial statements.* The municipality recorded expenses that relate to the prior year in the current financial year. As a result, contracted services were overstated by R30,9 million and the accumulated surplus was overstated by R30,9 million in the consolidated and separate financial statements.

General expenses

9. The municipality did not recognise general expenses in accordance with GRAP 1, *Presentation of financial statements*. The municipality recorded expenses inaccurately as the expenditure recorded did not agree to the consumption billed and the expenditure recorded was inclusive of VAT. As a result, general expenses were overstated by R17,6 million (2021: R20,9 million) and payables from exchange transactions were overstated by R17,6 million (2021: R20,9 million) in the consolidated and separate financial statements.

Irregular expenditure

10. The municipality did not include irregular expenditure in the notes to the financial statements, as required by section 125(2)(d) of the MFMA. This was due to payments made in contravention of the supply chain management requirements and municipal cost containment measures, which resulted in irregular expenditure of R103,1 million (2021: R47,2 million) in note 49 to the consolidated and separate financial statements.

Water distribution losses

11. During 2021 and 2022 the municipality did not account for water distribution losses in accordance with the GRAP 1, *Presentation of financial statements*. The municipality could not support rates used in the calculation of losses and revenue was not accounted for correctly which affected the losses. I could not confirm the water distribution losses by alternative means. Consequently, I was unable to determine the full extent of the water distribution losses stated at R93,1 million (2021: R75,3 million) in note 51 to the consolidated and separate financial statements.

Cash flow statement

12. The group did not correctly prepare and disclose the net cash flows from operating and investing activities as required by Standards of GRAP 2, *Cash flow statements*. This was due to errors identified in interest received and payments to suppliers and errors in calculating additions for property plant and equipment. I was not able to determine the full extent of the errors in the net cash flows from operating and investing activities, as it was impracticable to do so. Consequently, I was unable to determine whether any adjustments to cash flows from operating and investing activities as stated at R585,6 million (2021:R706,5 million) and R577,7 million, respectively, in the consolidated and separate financial statements were necessary.

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 consolidated and separate financial statements section of my 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.

Emphasis of matter

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

Restatements of corresponding figures

17. As disclosed in note 43 to the consolidated and separate financial statements, the corresponding figures for 30 June 2021 have been restated because of errors in the consolidated and separate financial statements of the municipality at, and for the year ended, 30 June 2022.

Impairment loss on property plant and equipment

18. As disclosed in notes 4 and 30 to the consolidated and separate financial statements, property plant and equipment of R4,9 billion (2021: R4,6 billion) was impaired.

Other matters

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 consolidated and separate financial statements. This disclosure requirement did not form part of the audit of the consolidated and separate financial statements and, accordingly, I do not express an opinion on it.

Responsibilities of the accounting officer for the consolidated and separate financial statements

21. The accounting officer is responsible for the preparation and fair presentation of the consolidated and separate financial statements in accordance with the GRAP and the requirements of the MFMA and Dora, and such internal controls as the accounting officer determine are necessary to enable the preparation of the consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.

22. 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

23. My objectives are to obtain reasonable assurance about whether the consolidated and separate 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 consolidated and separate financial statements.

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

Report on the audit of the annual performance 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 on the usefulness and reliability of the reported performance information against predetermined objectives for selected key performance areas (KPAs) presented in the annual performance report. I performed procedures to identify material findings, but not to gather evidence to express assurance.

26. 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 do not extend to any disclosures or assertions relating to the extent of achievements in the current year or 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.

27. 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 key performance area presented in the municipality's annual performance report for the year ended 30 June 2022.

Key performance area	Pages in the annual performance report
KPA – basic services and infrastructure development	x – x

28. 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.

29. The material finding on the usefulness of the performance information of the selected KPA is as follows:

SDI 14 – % wastewater quality compliance in accordance with regulation 991 and section 39 of the National Water Act 36 of 1998 as amended for compliance

30. The planned target for this indicator was not well defined and measurable as the method of calculation per the indicator description included in the annual performance report did not agree with the method of calculation performed by management to test the overall compliance percentage per sample taken.

Other matters

31. I draw attention to the matters below.

Achievement of planned targets

32. Refer to the annual performance report on page(s) x to x; x to x 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 29 of this report.

Adjustment of material misstatements

33. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were in the reported performance information of KPA – basic services and infrastructure development. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness of the reported performance information. Those that were not corrected are reported above.

Report on the audit of compliance with legislation

Introduction and scope

34. 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.

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

Annual financial statements, performance reports and annual reports

36. The annual financial statements submitted to be audited were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of non-current assets, liabilities, revenue and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.

Expenditure management

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

38. 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.

39. 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 qualification paragraph. The majority of the disclosed irregular expenditure was caused by the contracts that exceeded their duration and the scope of work that was exceeded without following proper processes of section 116 of the MFMA.

40. Reasonable steps were not taken to prevent fruitless and wasteful expenditure of R4,0 million as disclosed in note 48 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed fruitless and wasteful expenditure was caused by interest incurred on overdue accounts.

41. Reasonable steps were not taken to prevent unauthorised expenditure of R284,2 million as disclosed in note 47 to the consolidated and separate annual financial statements, in contravention of section 62(1)(d) of the MFMA.

Revenue management

42. An adequate management accounting and information system that accounts for debtors and revenue were not in place, as required by section 64(2)(e) of the MFMA.

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

44. Revenue due to the municipality was not calculated monthly, as required by section 64(2)(b) of the MFMA. The non-compliance resulted in a material irregularity as reported in the section on material irregularities

45. Accounts for service charges were not prepared monthly, as required by section 64(2)(c) of the MFMA.

Assets management

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

Consequence management

47. Some 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.

48. Some irregular 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.

Strategic planning and performance management

49. The performance management system and related controls were not adequately maintained as required by municipal planning and performance management regulation 7(1). Internal control deficiencies in the review and reconciliation of the quarterly reports used to prepare the annual performance report were not adequately performed and material misstatements on usefulness were identified.

Procurement and contract management

50. The performance of some contractors or providers was not monitored monthly, as required by section 116(2)(b) of the MFMA.

51. The contract performance and monitoring measures were not in place to ensure effective contract management, as required by section 116(2)(c)(ii) of the MFMA.

Other information

52. 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 those selected key performance areas presented in the annual performance report that have been specifically reported in this auditor's report.

53. My opinion on the financial statements and findings on the reported performance information and compliance with legislation does not cover the other information and I do not express an audit opinion or any form of assurance conclusion on it.

54. 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 key performance areas presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.

55. 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

56. 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 qualified opinion, the findings on the KPA – basic services and infrastructure development and the findings on compliance with legislation included in this report.

57. There was insufficient oversight to ensure consistent implementation and monitoring of controls over financial, performance information and compliance with legislation. This was due to a lack of capacity and accountability as well as inadequate communication between departments within the municipality.

58. The municipality did not have a proper system of records management for the financial environment as material misstatements were identified, resulting in a qualified audit opinion.

59. 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 respect of the management of the operations of the municipality.

60. The reporting with recommendations provided by the internal audit unit was not implemented timeously 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 were not adequate as they did not have a positive impact on the improvement of internal controls, as material findings were still identified through the audit process.

61. Although the municipality developed an audit action plan to address audit findings; however, this audit action plan was not implemented throughout the year, resulting in recurring material misstatements in the current year.

Material irregularities

62. In accordance with the PAA and the Material Irregularity Regulations, I have a responsibility to report on material irregularities identified during the audit and on the status of the material irregularities reported in the previous year's auditor's report.

Material irregularities identified during the audit

Payment for goods not received

63. The municipality paid an engineering company R20 million for an extension of time with cost for the project Cluster 9 Backlog Eradication: Tsomo Water Treatment and River Abstraction Works – Tender No. 33/2015/MD (TN) for which the municipality did not receive any value. The payment for the extension of time was made as a result of variation order number 3 dated

12 September 2019, which was for preliminary and general costs of R12,1 million and contract price adjustments of R5,2 million that were already included in the contract for the tender and no additional value was received for these. The VAT on these costs was R2,6 million and is included in the total payment of R20 million to the contractor for the extension of time to the contract. The municipality's process for ensuring that payments were made to the contractor for goods and services that are received was not effective, as it did not prevent the municipality from paying an additional amount of R20 million to the contractor for preliminary and general costs and contract price adjustments without receiving any value.

The municipality, therefore, did not comply with section 65(2)(a) of the MFMA, which requires that reasonable steps are taken to ensure that the municipality has and maintains an effective system of expenditure control including procedures for the approval, authorisation, withdrawal and payment of funds. The non-compliance resulted in a material financial loss of R20 million by 12 March 2021 for the Chris Hani District Municipality.

The accounting officer was notified of the material irregularity on 19 October 2021. The accounting officer responded by disagreeing that the municipality received value for money for the extension of time granted on the project as the project was already at 94% of completion at the time when the request for the extension was made. Therefore the Accounting officer has not taken any action in response to being notified of the material irregularity.

I referred the material irregularity to the Special Investigating Unit (SIU) on 6 July 2022 for investigation as provided for in section 5(1A) of the PAA.

Material irregularities in progress

64. I identified material irregularities during the audit and notified the accounting officer of these, as required by material irregularity regulation 3(2). By the date of this auditor's report, the responses of the accounting officer were not yet due. These material irregularities will be included in the next year's auditor's report.

Other reports

65. In addition to the investigations relating to material irregularities, 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.

66. The Hawks are investigating allegations of maladministration, corruption and tender irregularities in the procurement process of ventilated improved pit toilets.

67. At the date of this report, the investigation was still in progress.

Auditor-General

Auditor-General

East London

5 December 2022

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 key performance areas 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 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.
   - obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group to express an opinion on the consolidated financial statements. I am responsible for the direction, supervision and performance of the group audit. I remain solely responsible for my audit opinion

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 provide the accounting officer with a statement that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to bear on my independence and, where applicable, actions taken to eliminate threats or safeguards applied.