Report of the auditor-general to the Eastern Cape Provincial Legislature and the Council on the OR Tambo 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 OR Tambo District Municipality, set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2021, the consolidated and separate statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget with actual amounts 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 consolidated and separate financial position of the OR Tambo District Municipality as at 30 June 2021, and consolidated and separate financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts, for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practise (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act 56 of 2003 (MFMA) and the Division of Revenue Act 4 of 2020 (Dora).

Basis for qualified opinion

Irregular expenditure

3. The municipality did not fully record irregular expenditure in the notes to the financial statements, as required by section 125 (2)(d)(1) of the MFMA. This was because expenditure incurred in contravention of the supply chain management (SCM) requirements was not detected and appropriately disclosed in the consolidated and separate financial statements. Consequently, I was unable to determine the full extent of the irregular expenditure, stated at R1,7 billion (2019-20: R2 billion) in note 54 to the consolidated and separate financial statements as it was impracticable to do so.

Property, plant and equipment

4. The municipality did not recognise all items of property, plant, and equipment in accordance with GRAP 17, *Property, plant, and equipment*. Some infrastructure work in progress (WIP) was incorrectly recognised as completed infrastructure assets. Some infrastructure WIP was recorded at incorrect amounts and certain of these assets were transferred to the completed infrastructure assets at incorrect amounts. Furthermore, there were instances where infrastructure WIP was not recognised in the consolidated and separate financial statements.

Consequently, infrastructure WIP disclosed in note 8 to the consolidated and separate financial statements was understated and infrastructure assets was overstated by R189,9 million, (2019-20: R193,6 million).

5. I was unable to identify the completed infrastructure assets that belong to the municipality. Furthermore, certain damaged assets were identified in the property, plant and equipment that were not assessed for impairment. I was unable to verify these by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to infrastructure assets stated at R5,2 billion (2019-20: R5,1 billion) in note 8 to the consolidated and separate financial statements.

6. In addition to the individually material uncorrected misstatements on property, plant and equipment, the following was materially misstated by R18,3 million, due to the cumulative effect of individually immaterial uncorrected misstatements:

- Other property plant and equipment stated at R96,6 million as disclosed in note 8 to the consolidated and separate financial statements was overstated by R12,5 million.
- Machinery, IT equipment, transport assets and furniture and fixtures, totalling to R67,7 million as disclosed in note 8 to the consolidated and separate financial statements was overstated by R5,8 million.

Prepayments

7. The municipality did not have an adequate system in place to account for prepayments made. As a result, the municipality has not recorded all of its prepayments and some prepayments have been recorded at incorrect amounts. I was unable to confirm the prepayments by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the prepayments, stated at R66,4 million (2019-20: R126,9 million) in the consolidated and separate financial statements.

Employee related cost

8. The municipality did not implement an effective system of internal controls to account for payments made to its employees. The municipality incorrectly paid the covid-19 danger allowance to its employees who worked during the national lockdown using the leave encashment formula instead of using the approved standby allowance formula. This has led to an overstatement of employee cost by R42 million in the consolidated and separate financial statements. Furthermore, some payments were made to employees that could not be verified. This has led to an overstatement of employee costs by an undeterminable amount, as it was impractical to determine the full extent of the overstatement.

Fruitless and wasteful expenditure

9. The municipality did not fully record fruitless and wasteful expenditure in the notes to the financial statements, as required by section 125(2)(d)(1) of the MFMA, in that they did not disclose the fruitless and wasteful expenditure in respect of overpayments to employees in relation to the COVID 19 danger allowance. Consequently, I was unable to determine the full extent of the fruitless and wasteful expenditure, stated at R35,6 million in note 53 to the consolidated and separate financial statements as it was impracticable to do so.

Capital commitments

10. The municipality did not record all its capital commitments for the year under review and some commitments were recorded at incorrect amounts. This was due to a lack of adequate systems and processes at the municipality to ensure that capital commitments were correctly recorded. Consequently, capital commitments disclosed in note 44 to the consolidated and separate financial statements was understated by R136,5 million (2019-20: R67,8 million).

Context for the opinion

11. 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.

12. 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.

13. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

Emphasis of matters

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

Unspent conditional grants and receipts

15. As disclosed in note 16 to the consolidated and separate financial statements, the municipality has unspent conditional grants and receipts of a total amount of R245,9 million (2019-20: R447,8 million).

Corresponding figures

16. As disclosed in note 46 to the consolidated and separate financial statements, the corresponding figures for 30 June 2020 were restated as a result of errors in the consolidated and separate financial statements of the municipality at, and for the year ended, 30 June 2021.

Events after reporting date

17. As disclosed in note 50 to the consolidated and separate financial statements, the following events took place after year-end:

    - The municipality was put under administration in line with section 139(1)(c) of the South African constitution on 20 August 2021 and that invocation was set aside in court on 26 August 2021.

    - The National Treasury withheld equitable share and all other grants.

    - A number of municipal vehicles were attached by the sheriff of the court in January 2022 as a result of a failure to honour a court order for the municipality to pay former expanded public works programme (EPWP) employees.

Material allowance for impairment

18. As disclosed in note 3 to the consolidated and separate financial statements, a material impairment allowance of R41,1 million (2019-20: R96,4 million) was made against receivables from exchange transactions. The net movement in this impairment allowance, together with bad debts written off resulted in an impairment expense of 21,5 million (2019-20: R11,5 million). The provision for impairment on receivables exists predominantly due to the possibility that these debts will not be recovered.

Responsibilities of the accounting officer for the financial statements

19. The accounting officer is responsible for the preparation and fair presentation of the consolidated and separate financial statements in accordance with the Generally Recognised Accounting Practice (South Africa) and the requirements of the Municipal Finance Management Act 56 of 2003 (MFMA) 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.

20. 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 separate financial statements

21. 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.

22. 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

23. In accordance with the Public Audit Act 25 of 2004 (PAA (Public Audit Act)) 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 area presented in the annual performance report. I performed procedures to identify material findings but not to gather evidence to express assurance.

24. 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.

25. 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 2021:

Key performance area	Pages in the annual performance report
Key performance area 1 (KPA 1) – basic service delivery and infrastructure	x – x

26. 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.

27. The material findings on the reliability of the performance information of the selected key performance area are as follows:

KPA 1 – Basic service delivery and infrastructure

Various indicators

28. The achievements reported in the annual performance report materially differed from the supporting evidence provided for the indicators listed below:

Indicator description	Reported achievement
Number of households with access to basic level of sanitation services	11 964
Number of stand-alone schemes maintained/refurbished	43
Number of Ventilated Improved Pit (VIP) toilets provided	11 964

Various indicators

29. I was unable to obtain sufficient appropriate audit evidence for the reported achievements of three of the 13 indicators relating to this key performance area. This was due to the lack of accurate and complete records. 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
Number of water tanks provided to communities	90
Purified mega litres of water carted and delivered to communities	147,8
Number of households with access to basic level of water services	2 868

Other matters

30. I draw attention to the matters below.

Achievement of planned targets

31. Refer to the annual performance report on pages … to … for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the reliability of the reported performance information in paragraphs 27 to 29 of this report.

Adjustment of material misstatements

32. 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. As management subsequently corrected only some of the misstatements, I raised material findings on the reported performance information. Those that were not corrected are reported above.

Report on the audit of compliance with legislation

Introduction and scope

33. In accordance with the PAA (Public Audit Act) 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.

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

Strategic planning and performance management

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

Annual financial statements

36. 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 revenue from non-exchange transactions and expenditure 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 qualified audit opinion.

Asset management

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

Expenditure management

38. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R1,2 million, as disclosed in note 52 to the consolidated and separate financial statements, in contravention of section 62(1)(d) 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 irregular expenditure incurred as indicated in the basis for the qualified opinion. Most of the disclosed expenditure was caused by the non-compliance with supply chain management (SCM) regulations.

40. 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 qualification paragraph.

Procurement and contract management

41. Some of the goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).

42. Some of the contracts were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c). Similar non-compliance was also reported in the prior year.

43. The performance of some of the contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA. Similar non-compliance was also reported in the prior year.

44. Sufficient appropriate audit evidence could not be obtained that contract performance and monitoring measures were in place to ensure effective contract management as required by section 116(2)(c)(ii) of the MFMA.

45. Persons in the service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest, in contravention of SCM regulation 46(2)(e).

Other information

46. 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 development priorities presented in the annual performance report that have been specifically reported in this auditor's report

47. My opinion on the consolidated and separate 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.

48. 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 development priorities presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.

49. 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

50. 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 annual performance report and the findings on compliance with legislation included in this report.

51. Leadership did not implement the necessary discipline required to enable effective oversight that promotes the achievement of credible reporting in the financial management, annual performance report and compliance with laws and regulations. The leadership did not appropriately monitor the implementation of corrective actions to address internal control deviations and compliance requirements.

52. Management did not implement daily and monthly controls in order to ensure the financial statements and annual performance reports are supported by valid, accurate and complete underlying records. Furthermore, management continued to display a lack of commitment to addressing the previous year's findings. This was evident in the audit action plan designed to address such issues not being implemented, which resulted in repeat audit findings on the annual financial statements, annual performance report and compliance with applicable laws and regulations.

Material irregularities

53. In accordance with the PAA (Public Audit Act) and the Material Irregularity Regulations, I have a responsibility to report on material irregularities identified during the audit.

Material Irregularity identified during the audit

Prepayments made to an implementing agent for water projects

54. The municipality made payments to its implementing agent for water projects, for goods and services not yet received. This resulted in non-compliance with section 65(2)(a) of the Municipal Finance Management Act 56 of 2003 (MFMA), which requires that the municipality should have and maintain an effective system of expenditure control, including procedures for the approval, authorisation, withdrawal and payment of funds. The non-compliance with legislation resulted in a likely material financial loss because the amount could still be recovered from the implementing agent.

55. The accounting officer was notified of the material irregularity on 7 April 2021 and invited to make written submission on the actions taken or to be taken to address the matter.

- On 30 July 2020, the council instituted a forensic investigation into the matter which was concluded on 17 December 2020.

- The report of the forensic investigator recommended that the municipality should institute corrective actions against the officials within the municipality who facilitated all undue payments without following the due diligence process and/or correct protocols. The municipality is still currently instituting the disciplinary processes against the implicated officials.

- The service level agreement to be signed between the municipality and the implementing agent must state unequivocally that all payments for all invoices from the implementing agent must be based on work done which clearly demonstrate value for money. There should be regular sittings of engagement meetings for improved performance monitoring.

- The municipality had also reported the matter to the Directorate for Priority Crime Investigation (DPCI), these matters were still in progress at the time of this report.

56. On conclusion of the disciplinary processes and the investigation by the DPCI, the accounting officer is planning to take appropriate steps against the identified responsible officials.

57. I will follow up on the implementation of the planned actions during my next audit.

Auditor-General.

East London

28 February 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 development priorities and on the municipality's compliance with respect to the selected subject matters.

Financial statements

2. In addition to my responsibility for the audit of the 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 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 consolidated and separate 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 O.R. Tambo District Municipality and its subsidiary 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 consolidated and separate financial statements, including the disclosures, and determine whether the consolidated and separate 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 to communicate with them 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.