Report of the auditor-general to the Eastern Cape Provincial Legislature and the council of Amahlathi Local Municipality

Report on the audit of the financial statements

Opinion

1. I have audited the financial statements of the Amahlathi Local Municipality set out on pages … to …, which comprise the statement of financial position as at 30 June 2022, statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as notes to the financial statements, including a summary of significant accounting policies.

2. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Amahlathi Local 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 (Standards of 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 opinion

3. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of my report.

4. 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.

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

Material uncertainty relating to going concern

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

7. I draw attention to note 44 to the financial statements, which indicates that the municipality's inability to pay creditors on due dates, negative key financial ratios and net current liability were realised. These events or conditions, along with other matters as set out in note 44, indicate that a material uncertainty exists that may cast significant doubt on the municipality's ability to continue as a going concern.

Emphasis of matters

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

Restatement of corresponding figures

9. As disclosed in note 42 to the financial statements, the corresponding figures for 30 June 2021 were restated as a result of errors in the financial statements of the municipality at, and for the year ended, 30 June 2022.

Material impairment of consumer debtors

10. As disclosed in note 31 to the financial statements, material impairments of consumer debtors of R7,5 million (2021: R26,5 million) were incurred.

Material electrical distribution losses

11. As disclosed in note 49 to the financial statements, material electricity losses of R15,3 million (2021: R11,7 million) were incurred, which represented 34,5% (2021: 34,2%) of total electricity purchased. The losses are attributed to normal losses and illegal connections.

Other matter

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

Unaudited disclosure note

13. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA in the financial statements. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion on it.

Responsibilities of the accounting officer for the financial statements

14. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the Standards of GRAP and the requirements of the MFMA and 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.

15. 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

16. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an

auditor's report that includes my opinion. Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

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

Report on the audit of the annual performance report

Introduction and scope

18. 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 area (KPA) presented in the annual performance report. I performed procedures to identify material findings but not to gather evidence to express assurance.

19. 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.

20. 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 KPA 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 1 – Service delivery and infrastructure development	x – x

21. 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.

22. The material findings on the usefulness and reliability of the performance information of the selected KPA are as follows:

KPA 1 – service delivery and infrastructure development

% of km of roads paved (key performance indicator (KPI) 7)

23. The measures taken to improve performance against target of 100% of 1,7 km of roads paved were not reported in the annual performance report.

No. of km of gravel roads maintained (blading) (KPI 1)

24. The achievement of 47,1 km of roads bladed was reported against the target 20 km of roads bladed in the annual performance report. However, the supporting evidence provided did not agree with the reported achievement and indicated an achievement of 9,643 km of roads bladed.

No. of km of municipal roads re-gravelled (KPI 2)

25. The achievement of 0,8 km of roads re-gravelled was reported against the target 4 km of roads re-gravelled in the annual performance report. However, the supporting evidence provided did not agree with the reported achievement and indicated an achievement of 0,3 km of roads re-gravelled.

No. of km of roads constructed (gravelled) (KPI 5)

26. The achievement of 21,17 km of roads constructed (gravelled) was reported against the target of 5 km of roads constructed (gravelled) in the annual performance report. However, the supporting evidence provided did not agree with the reported achievement and indicated an achievement of 4,18 km of roads constructed (gravelled).

No. of households and businesses with basic waste collection (KPI 16)

27. The achievement of 8 200 households and businesses with basic waste collected was reported against the target 6 000 of households and businesses with basic waste collected in the annual performance report. However, the supporting evidence provided did not agree with the reported achievement and indicated an achievement of 4 967 households and businesses with basic waste collected.

Various indicators – limitation misstatement on reliability

28. I was unable to obtain sufficient appropriate audit evidence that systems and processes were established to enable consistent measurement and reliable reporting of performance against the predetermined indicator definitions. This was due to a lack of measurement definitions and processes. I was unable to validate the existence of systems and processes by alternative means.

Indicator number	Indicator description	Target
KPI 6	% of km of roads surfaced	100%
KPI 7	% of km of roads paved	64%
KPI 10	% of cemeteries fenced	100%
KPI 24	% of inspected damaged road markings and signs maintained	100%

% of faulty reported meters repaired per inspection report (KPI 8)

29. The achievement of 88,84% of faulty reported meters repaired per inspection report was reported against target 80% of faulty reported meters repaired as per inspection report in the annual performance report. However, I was unable to obtain sufficient appropriate audit evidence due to the lack of accurate and complete records. I was also unable to confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any further adjustments were required to the reported achievement.

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 usefulness and reliability of the reported performance information in paragraphs 23 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 KPA 1: service delivery and infrastructure development. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are reported above.

Report on the audit of compliance with legislation

Introduction and scope

33. 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.

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

Annual financial statements, annual performance report and annual report

35. The financial statements submitted for auditing were not fully prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of non-current assets, current assets, current liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statement were subsequently corrected and the supporting records were provided subsequently, resulting in the financial statements receiving an unqualified audit opinion.

Strategic planning and performance management

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

37. Performance targets set for each of the KPIs for the financial year were not well defined with measurable outputs, as required by section 41(1)(b) of the MSA and municipal planning and performance management regulation 12(1).

Expenditure management

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

39. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R2,1 million, as disclosed in note 47 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA.

40. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R15,3 million, as disclosed in note 46 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA.

Procurement and contract management

41. Some of the contracts were awarded to providers whose tax matters had not been declared by the South African Revenue Service (Sars) to be in order, in contravention of SCM regulation 43.

Consequence management

42. Unauthorised expenditure incurred by the municipality was not investigated to determine if any person was liable for the expenditure, as required by section 32(2)(a) of the MFMA.

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

44. Some of the irregular expenditure incurred by the municipality were not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.

45. Fruitless and wasteful expenditure were certified by the council as irrecoverable without having conducted an investigation to determine the recoverability of the expenditure, in contravention of section 32(2)(b) of the MFMA.

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 financial statements, the auditor's report and those selected KPAs presented in the annual performance report that have been specifically reported in this auditor's report.

47. 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.

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 financial statements and the selected KPA presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work performed, I conclude there is a material misstatement, I am required to report that fact. I have nothing to report in this regard.

Internal control deficiencies

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

50. Leadership of the municipality did not adequately discharge its oversight responsibilities with regard to the implementation and monitoring of internal controls to ensure sound performance reporting and compliance with legislation.

51. In addition, management did not always implement daily and monthly financial controls to ensure that the financial statements are supported by accurate and complete underlying records. This resulted in material misstatements in the financial statements that were subsequently corrected, material findings on annual performance report and findings on the audit of compliance with laws and regulations.

Material irregularities

52. 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

53. The material irregularities identified are as follows:

Interest paid to Eskom due to late payment of invoices

54. The municipality paid interest to Eskom on invoices that were not paid within 30 days. The payments not made within 30 days constitute non-compliance with section 65(2)(e) of the MFMA, which requires the accounting officer to take all reasonable steps to ensure that all money owing by the municipality are paid within 30 days of receiving the relevant invoice or statement, unless prescribed otherwise for certain categories of expenditure.

55. The non-compliance resulted in a material financial loss of R5 million in the form of interest, which is included as fruitless and wasteful expenditure in note 47 to the financial statements.

56. The accounting officer was notified of the material irregularity on 18 November 2021 and was invited to make a written submission on the actions taken and those that will be taken to address the matter. The accounting officer responded by providing evidence of investigation concluded on 15 December 2021. The investigation concluded that there were insufficient funds to make the payment on time and no persons were identified to be responsible. The investigation further found that there was no breakdown in controls and that the unavailability of funds was the main root cause.

57. The following actions have been taken to respond to the material irregularity:

- Steps have been taken to reduce the procurement of less critical services or goods through development and implementation of cost containment policy.
- The debt incentive scheme has been implemented.
- The municipality applied for exemption in the salary increase for 2021-22.

58. The following actions are planned to be taken to respond the material irregularity:

- The municipality has engaged the High Court to set it aside, the council decision for standardisation of salaries and impact of this decision will have to be adjusted retrospectively. Quarterly progress reports on the court litigation must be process to be provided.
- The council will initiate and lead a process of organisational re-alignment to achieve a balance between human capital and the size of the municipality by 30 June 2023.
- The council will initiate and lead a legal process of recovering some of the capital laid out in procuring the fleet. Quarterly progress report on the litigation process must be provided as evidence.
- The municipality will propose new payment arrangement with Eskom by 30 November 2022.
- The municipality has implemented the following policies: the financial recovery plan, revenue enhancement strategy and cost containment policy in order to mitigate its financial crisis.

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

Interest and penalties charged by SARS due to late payments

60. The municipality did not pay employees' tax that was deducted from employees over to the South African Revenue Services (SARS) within seven days after the end of the month during which the amount was deducted. This was in contravention of section 2(1) of the Fourth Schedule of the Income Tax Act and section 210 of Tax Administration Act. The municipality was required to pay penalties to SARS due to non-compliance with the Income Tax Act.

61. The non-compliance resulted in a material financial loss of R3,8 million in the form of interest, which is included as fruitless and wasteful expenditure in note 47 to the financial statements.

62. The accounting officer was notified of the material irregularity on 26 November 2021 and was invited to make a written submission on the actions taken and those that will be taken to address the matter. The accounting officer responded by providing evidence of investigation concluded on 22 January 2022. The investigation concluded that there were insufficient funds to make the payment on time and no persons were identified to be responsible. The investigation also found that there was no breakdown in controls and that the unavailability of funds was the main root cause.

63. The following actions have been taken to respond to the material irregularity:

- Application to SARS to waive the interest on 10 May 2022.
- The municipality applied for exemption in the salary increase for 2021-22.
- Steps have been taken to reduce the procurement of less critical services or goods through development and implementation of the cost containment policy.
- Implementation of the debt incentive scheme.

64. The following actions are planned to be taken to respond to the material irregularity:

- The municipality has engaged the high Court to set it aside, the council decision for standardisation of salaries and impact of this decision will have to be adjusted retrospectively
- The council will initiate and lead a process of organisational re-alignment to achieve a balance between human capital and the size of the municipality by 30 June 2023.
- The council will initiate and lead a legal process of recovering some of the capital laid out in procuring the fleet. Quarterly progress report on the litigation process must be provided as evidence.
- The municipality has implemented the following policies: the financial recovery plan, revenue enhancement strategy and cost containment policy in order to mitigate its financial crisis.

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

Other reports

66. 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.

67. The president of South Africa promulgated that an investigation be conducted by the Special Investigating Unit (SIU) based on the allegation of possible procurement irregularities. This investigation has been finalised at the date of this report.

Auditor General

East London

30 November 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 financial statements and the procedures performed on reported performance information for selected KPA and on the municipality's compliance with respect to the selected subject matters.

Financial statements

2. In addition to my responsibility for the audit of the financial statements as described in this auditor's report, I also:

   - identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error; design and perform audit procedures responsive to those risks; and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations or the override of internal control
   - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control
   - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer
   - conclude on the appropriateness of the accounting officer's use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists relating to events or conditions that may cast significant doubt on the ability of the Amahlathi Local Municipality to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify my opinion on the financial statements. My conclusions are based on the information available to me at the date of this auditor's report. However, future events or conditions may cause a municipality to cease operating as a going concern
   - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and determine whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Communication with those charged with governance

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

4. I also 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