

# Report of the auditor-general to the Free State Legislature and the council on Phumelela Local Municipality

## Report on the audit of the financial statements

### Opinion

1. I have audited the financial statements of the Phumelela Local Municipality set out on pages .... to ....., which comprise the statement of financial position as at 30 June 2021, the statement of 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, 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 Phumelela Local Municipality as at 30 June 2021, and its financial performance and cash flows for the year then ended in accordance with the South African 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 10 of 2020 (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 matter below. My opinion is not modified in respect of this matter.
7. Note 45 to the financial statements indicates that, as of 30 June 2021, the municipality's current liabilities exceeded its current assets by R301 242 599. In addition, the municipality owed Eskom R147 497 312 (2020: R139 225 406) and the water board R125 682 386 (2020: R107 138 388) as at 30 June 2021, both of which were long overdue. These events or conditions, along with other matters as set forth in note 45, 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.

### **Irregular expenditure**

9. As disclosed in note 48 to the financial statements, the municipality incurred irregular expenditure of R8 471 110 (2020: R13 201 813), due to non-compliance with the supply chain management (SCM) requirements.

### **Unauthorised expenditure**

10. As disclosed in note 46 to the financial statements, unauthorised expenditure of R95 611 689 (2020: R108 371 149) was incurred, due to overspending of the budget.

### **Restatement of corresponding figures**

11. As disclosed in note 43 the financial statements, the corresponding figures for 30 June 2020 were adjusted as a result of errors in the financial statements of the municipality at, and for the year ended, 30 June 2021.

### **Material losses**

12. As disclosed in note 49 to the financial statements, material water distribution losses of R6 730 725 (2020: R9 712 850) and electricity distribution losses of R3 257 975 (2020: R2 353 045) were incurred by the municipality mainly due to leakages, burst water pipes, line losses, tampering and theft.

### **Material impairment**

13. As disclosed in note 12 to the financial statements, receivables from exchange transactions and receivables from non-exchange transactions were impaired by R369 253 092 (2020: R320 118 768).

### **Material uncertainty relating to claims against the municipality**

14. With reference to note 41 to the financial statements, the municipality is the defendant in various claims. The municipality is opposing these claims. The ultimate outcome of these matters could not be determined and no provision for any liabilities that may result were made in the financial statements.

### **Other matter**

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

### **Unaudited disclosure notes**

16. 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 thereon.

## **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 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.
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 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.
20. 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**

21. 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.
22. 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.
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 KPA presented in the municipality's annual performance report for the year ended 30 June 2021:

KPA	Pages in the annual performance report
KPA 1 – basic services and infrastructure development	x – x

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. I did not identify material findings on the usefulness and reliability of the reported performance information for KPA 1 – basic services and infrastructure development.

#### **Other matter**

26. I draw attention to the matter below.

#### **Achievement of planned targets**

27. Refer to the annual performance report on pages ... to ... for information on the achievement of planned targets for the year.

#### **Adjustment of material misstatements**

28. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were in the reported performance information of KPA 1: basic services and infrastructure development. As management subsequently corrected the misstatements, I did not raise any material findings on the usefulness and reliability of the reported performance information.

### **Report on the audit of compliance with legislation**

#### **Introduction and scope**

29. 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.
30. The material findings on compliance with specific matters in key legislation are as follows:

#### **Annual financial statements**

31. 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

current assets, non-current assets, current liabilities, non-current liabilities expenditure and disclosure items identified by the auditors in the submitted financial statement were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion.

### **Utilisation of conditional grants**

32. Performance in respect of programmes funded by the municipal infrastructure grant, regional bulk infrastructure grant, water services infrastructure grant, financial management grant, and integrated national electrification grant was not evaluated within two months after the end of the financial year, as required by section 12(5) of the Dora.

### **Consequence management**

33. 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.
34. 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.
35. 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**

36. Reasonable steps were not taken to prevent irregular expenditure amounting to R8 741 110 as disclosed in note 48 to the annual financial statements, as required by section 62(1)(d) of the MFMA. The majority of the irregular expenditure was caused by non-compliance to SCM requirements.
37. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R270 749, as disclosed in note 47 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the fruitless and wasteful expenditure was caused by interests and penalties paid with regard to taxes payable.
38. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R95 611 689, as disclosed in note 46 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by the municipality exceeding its budget.

### **Procurement and contract management**

39. 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).

## Strategic planning and performance management

40. No key performance indicators were set in respect of the provision of solid waste removal services, as required by section 43(2) of the Municipal Systems Act 32 of 2000 and municipal planning and performance management regulation 10(a).

## Other information

41. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements, the auditor's report and those selected KPA presented in the annual performance report that have been specifically reported in this auditor's report.
42. 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.
43. 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.
44. 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

45. 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 compliance with legislation included in this report.
46. Management did not implement adequate controls to ensure compliance with laws and regulations. As a result, material non-compliance matters were reported.
47. Management did not implement effective human resource management measures to ensure that vacancies were filled, and sufficiently skilled resources were in place to ensure effective controls over daily and monthly processing and reconciling of transactions was implemented. This resulted in material misstatements in the financial statements and performance reports that had to be corrected.

48. The leadership did not take effective steps to ensure that there were consequences for poor performance and transgressions, and did not ensure that all unauthorised and irregular expenditure incurred was investigated during the financial year.

*Auditor - General*

Bloemfontein

30 November 2021



AUDITOR - GENERAL  
SOUTH AFRICA

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## **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 Phumelela 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 applicable, actions taken to eliminate threats or safeguards applied.