

Report of the auditor-general to the Free State Provincial Legislature and the council on the 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 xx to xx, which comprise the statement of financial position as at 30 June 2023, 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 2023, 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 5 of 2022 (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 responsibilities of the auditor-general 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 47 to the financial statements indicates that the municipality incurred a net loss of R29 648 855 during the year ended 30 June 2023 and, as of that date, the municipality's current liabilities exceeded its current assets by R352 034 086. The municipality has been deducting pension, medical aid, and pay as you earn from employees salaries, but has been unable to pay over R4 537 728 of these amounts deducted to the relevant third parties as disclosed in note 52. In addition, the municipality owed Eskom R182 438 800 (2022: 161 221 232) and the Department of Water and Sanitation R159 798 238 (2022: R137 339 493) as at 30 June 2023, which was long overdue. These events or conditions, along with other matters as set forth in note 47, 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.

Underspending of conditional grants

9. As disclosed in note 17 to the financial statements, the municipality materially underspent the conditional grants by R13 144 330 (2022: R10 867 438).

Material impairments

10. As disclosed in note 15 to the financial statements, material losses of R460 673 905 were incurred as a result of a write-off of irrecoverable trade debtors.

Restatement of corresponding figures

11. As disclosed in note 44 to the financial statements, the corresponding figures for 30 June 2022 were restated as a result of errors in the financial statements of the municipality at, and for the year ended, 30 June 2023.

Material losses

12. As disclosed in note 51 to the financial statements, material electricity losses of R5 869 563 (2022: R6 981 631) were incurred, due to technical losses on the breakdown of transformers, cables, overhead lines, faulty meters, theft and vandalism.

13. As disclosed in note 51 to the financial statements, material water losses of R6 670 895 (2022: R6 851 136) were incurred due to defective meters, losses on the water network (breakage in pipelines and pumps, leaking valves), evaporation, theft, vandalism and damages as a result of blind excavations.

Unauthorised expenditure

14. As disclosed in note 48 to the financial statements, unauthorised expenditure of R72 133 854 (2022: R92 504 657) was incurred, due to overspending of the budget and some conditional grants were not spent for its intended purposes.

Fruitless and wasteful expenditure

15. As disclosed in note 49 to the financial statements, fruitless and wasteful expenditure of R15 582 902 (2022: R11 318 083) was incurred, due to interest charged on late payments to suppliers.

Irregular expenditure

16. As disclosed in note 50 to the financial statements, irregular expenditure of R10 646 508 (2022: R14 284 537) was incurred, as adequate competitive bidding processes were not followed.

Other matter

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

Unaudited disclosure notes

18. In terms of section 125(2)(e) of the MFMA, the particulars of non-compliance with the MFMA should be disclosed in the financial statements. The disclosure requirements 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 financial statements

19. 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.

20. 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.

Responsibilities of the auditor-general for the audit of the financial statements

21. 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.

22. 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 annual performance report

23. In accordance with the Public Audit Act 25 of 2004 (PAA) and the general notice issued in terms thereof, I must audit and report on the usefulness and reliability of the reported performance information against predetermined objectives for the selected material performance indicators presented in the annual performance report. The accounting officer is responsible for the preparation of the annual performance report.

24. I selected the following material performance indicators related to the basic services and infrastructure development presented in the annual performance report for the year ended 30 June 2023. I selected those indicators that measure the municipality's performance on its primary mandated functions and that are of significant national, community or public interest.

- TS 1 - Number of Constructed sewer reticulation and house connection for 118 houses, toilets structure and outfall sewer in Zamani by 30 June 2023
- TS 2 - Number of KM roads and storm water constructed in Memel/Zamani by 30 June 2023
- TS 3 - Number of KM roads and storm water constructed in Thembalihle/Vrede by 30 June 2023
- TS 4 - Number of KM roads and storm water constructed in Warden/Ezenzeleni by 30 June 2023
- TS 5 - Number of Outfall Sewer refurbished by 30 June 2023 (Thembelihle/Vrede)
- TS 6 - Number of sewer line revamped in Warden/Ezenzeleni by 30 June 2023
- TS 7 - Number of Outfall Sewer refurbished by 30 June 2023 (Ext 4 Vrede/Thembelihle)
- TS 8 - Number of Sewer System in Warden Phase 1
- TS10 - Number of sites/Households electrified in Memel/ Zamani by 30 June 2023
- TS14 - Number of Household provided with electricity by June 2023

25. I evaluated the reported performance information for the selected material performance indicators against the criteria developed from the performance management and reporting framework, as defined in the general notice. When an annual performance report is prepared using these criteria, it provides useful and reliable information and insights to users on the municipality's planning and delivery on its mandate and objectives.

26. I performed procedures to test whether:

- the indicators used for planning and reporting on performance can be linked directly to the municipality's mandate and the achievement of its planned objectives
- the indicators are well defined to ensure that they are easy to understand and can be applied consistently, as well as verifiable so that I can confirm the methods and processes to be used for measuring achievements
- the targets can be linked directly to the achievement of the indicators and are specific, time bound and measurable to ensure that it is easy to understand what should be delivered and by when, the required level of performance as well as how performance will be evaluated
- the indicators and targets reported on in the annual performance report are the same as those committed to in the approved initial or revised planning documents
- the reported performance information is presented in the annual performance report in the prescribed manner

- there is adequate supporting evidence for the achievements reported and for the measures taken to improve performance.

27. I performed the procedures to report material findings only; and not to express an assurance opinion or conclusion.

28. I did not identify any material findings on the reported performance information for the selected indicators.

Other matter

29. I draw attention to the matters below.

Achievement of planned targets

30. The annual performance report includes information on reported achievements against planned targets and provides measures taken to improve performance.

Material misstatements

31. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were in the reported performance information for basic services and infrastructure development. Management subsequently corrected all the misstatements, and I did not include any material findings in this report.

Report on compliance with legislation

32. In accordance with the PAA and the general notice issued in terms thereof, I must audit and report on compliance with applicable legislation relating to financial matters, financial management and other related matters. The accounting officer is responsible for the municipality's compliance with legislation.

33. I performed procedures to test compliance with selected requirements in key legislation in accordance with the findings engagement methodology of the Auditor-General of South Africa (AGSA). This engagement is not an assurance engagement. Accordingly, I do not express an assurance opinion or conclusion.

34. Through an established AGSA process, I selected requirements in key legislation for compliance testing that are relevant to the financial and performance management of the municipality, clear to allow consistent measurement and evaluation, while also sufficiently detailed and readily available to report in an understandable manner. The selected legislative requirements are included in the annexure to this auditor's report.

35. The material findings on compliance with the selected legislative requirements, presented per compliance theme, are as follows:

Annual financial statements

36. 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, liabilities 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.

37. The oversight report adopted by the council on the 2021-22 annual report was not made public, as required by section 129(3) of the MFMA.

Procurement and contract management

38. Some of the goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of SCM regulation 17(1)(a) and (c). A similar non-compliance was also reported in the prior year.
39. Sufficient appropriate audit evidence could not be obtained that contracts were extended or modified with the approval of a properly delegated official as required by SCM regulation 5. A similar non-compliance was also reported in the prior year.

Consequence management

40. 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.
41. 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.
42. 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

43. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
44. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R72 133 853 as disclosed in note 48 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by overspending of the budget and some conditional grants were not used for its intended purposes.
45. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R15 582 902, as disclosed in note 49 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 and penalties charged due to late payments to the suppliers.
46. Reasonable steps were not taken to prevent irregular expenditure amounting to R10 646 508, as disclosed in note 50 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 with SCM legislation during the bidding processes followed.

Conditional grants

47. The municipal infrastructure grant and water services infrastructure grant were not spent for its intended purposes in accordance with the applicable grant framework, as required by section 16(1) of the Dora.
48. Performance in respect of programmes funded by the municipal infrastructure grant, extended public works programme grant, financial management grant and water services infrastructure grant was not evaluated within two months after the end of the financial year, as required by section 12(5) of the Dora.

Strategic planning and performance

49. No key performance indicators were set in respect of the provision of basic water, sanitation, electricity and solid waste removal services, as required by section 43(2) of the Municipal System Act 32 of 2000 and municipal planning and performance management regulation 10(a).
50. The performance management system and related controls were inadequate as it did not describe how the performance review and reporting processes should be conducted and managed, as required by municipal planning and performance management regulation 7(1).

Asset management

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

Other information in the annual report

52. The accounting officer is responsible for the other information included in the annual report. The other information referred to does not include the financial statements, the auditor's report and the selected material performance indicators presented in the annual performance report that have been specifically reported on in this auditor's report.
53. My opinion on the financial statements, the report on the audit of the annual performance report and the report on compliance with legislation does not cover the other information included in the annual report and I do not express an audit opinion or any form of assurance conclusion on it.
54. My responsibility is to read this other information and, in doing so, consider whether it is materially inconsistent with the financial statements and the selected material indicators 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 financial statements, annual performance report and compliance with applicable legislation; however, my objective was not to express any form of assurance on it.
57. The matters reported below are limited to the significant internal control deficiencies that resulted in opinion and the material findings on compliance with legislation included in this report.
58. The accounting officer and municipal council did not effectively oversee financial and performance reporting and compliance as well as related internal controls which resulted in the numerous misstatements.
59. The accounting officer and municipal council did not adequately monitor the action plan to address prior year findings resulting in recurring material misstatements and material non-compliance.
60. Management and the accounting officer did not adequately review and monitor compliance with applicable legislations which resulted in material non-compliance findings.
61. Management did not implement adequate controls over the daily and monthly processing and reconciling of transactions and as a result there were material misstatements in the annual financial statements and annual performance report.
62. Leadership did not implement effective human resource management to ensure that adequate and sufficiently skilled resources are in place and that performance is monitored, as a result repetitive material findings were identified without sufficient consequences.

Auditor-General

Bloemfontein

30 November 2023



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

Annexure to the auditor's report

1. The annexure includes the following:
 - The auditor-general's responsibility for the audit
 - The selected legislative requirements for compliance testing

Auditor-general's responsibility for the audit

Professional judgement and professional scepticism

2. 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 the selected material performance indicators and on the municipality's compliance with selected requirements in key legislation

Financial statements

3. 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
 - conclude on the appropriateness of the 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 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

4. 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.
5. I also provide the accounting officer with a statement that I have complied with relevant ethical requirements regarding independence and 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.

Compliance with legislation – selected legislative requirements

The selected legislative requirements are as follows:

Legislation	Sections or regulations
Municipal Finance Management Act 56 of 2003	Section 1 - Paragraphs (a), (b) & (d) of the definition: irregular expenditure, Section 1 - Definition: service delivery and budget implementation plan, Sections 11(1), 13(2), 14(1), 14(2)(a), 14(2)(b), 15, 24(2)(c)(iv), 29(1), Sections 29(2)(b), 32(2), 32(2)(a), 32(2)(a)(i), 32(2)(a)(ii), 32(2)(b), Sections 32(6)(a), 32(7), 53(1)(c)(ii), 54(1)(c), 62(1)(d), 62(1)(f)(i), Sections 62(1)(f)(ii), 62(1)(f)(iii), 63(1)(a), 63(2)(a), 63(2)(c), 64(2)(b), Sections 64(2)(c), 64(2)(e), 64(2)(f), 64(2)(g), 65(2)(a), 65(2)(b), 65(2)(e), Sections 72(1)(a)(ii), 112(1)(j), 116(2)(b), 116(2)(c)(ii), 117, 122(1), Sections 122(2), 126(1)(a), 126(1)(b), 127(2), 127(5)(a)(i), 127(5)(a)(ii), Sections 129(1), 129(3), 133(1)(a), 133(1)(c)(i), 133(1)(c)(ii), 170, Sections 171(4)(a), 171(4)(b)
MFMA: Municipal Budget and Reporting Regulations, 2009	Regulations 71(1), 71(2), 72
MFMA: Municipal Investment Regulations, 2005	Regulations 5(4), 6(8)(a), 6(8)(b), 10(1)
MFMA: Municipal Regulations on Financial Misconduct Procedures and Criminal Proceedings, 2014	Regulations 5(4), 6(8)(a), 6(8)(b), 10(1)
MFMA: Municipal Supply Chain Management Regulations, 2017	Regulations 5, 12(1)(c), 12(3), 13(b), 13(c), 13(c)(i), 16(a), 17(1)(a), Regulations 17(1)(b), 17(1)(c), 19(a), 21(b), 22(1)(b)(i), 22(2), 27(2)(a), Regulations 27(2)(e), 28(1)(a)(i), 28(1)(a)(ii), 29(1)(a), 29(1)(b), Regulations 29(5)(a)(ii), 29(5)(b)(ii), 32, 36(1), 36(1)(a), 38(1)(c), Regulations 38(1)(d)(ii), 38(1)(e), 38(1)(g)(i), 38(1)(g)(ii), 38(1)(g)(iii), 43, Regulations 44, 46(2)(e), 46(2)(f)
Municipal Systems Act 32 of 2000	Sections 25(1), 26(a), 26(c), 26(h), 26(i), 29(1)(b)(ii), 29(3)(b), 34(a), 34(b), Sections 38(a), 41(1)(a), 41(1)(b), 41(1)(c)(ii), 42, 43(2), 56(a), 57(2)(a), Sections 57(4B), 57(6)(a), 66(1)(a), 66(1)(b), 67(1)(d), 74(1), 93J (1), 96(b)
MSA: Municipal Planning and Performance Management Regulations, 2001	Regulations 2(1)(e), 2(3)(a), 3(3), 3(4)(b), 3(6)(a), 7(1), 8, 9(1)(a), 10(a), Regulations 12(1), 15(1)(a)(i), 15(1)(a)(ii)
MSA: Municipal Performance Regulations for Municipal Managers and Managers directly Accountable to Municipal Managers, 2006	Regulations 2(3)(a), 4(4)(b), 8(1), 8(2), 8(3)
MSA: Regulations on Appointment and Conditions of Employment of Senior Managers, 2014	Regulations 17(2), 36(1)(a)
VSA: Disciplinary Regulations for Senior Managers, 2011	Regulations 5(2), 5(3), 5(6), 8(4)
Annual Division of Revenue Act	Section 11(6)(b), 12(5), 16(1); 16(3)
Construction Industry Development Board Act 38 of 2000	Regulations 17, 25(7A)
Municipal Property Rates Act 6 of 2004	Section 3(1)
Preferential Procurement Policy Framework Act 5 of 2000	Sections 2(1)(a), 2(1)(f)
Preferential Procurement Regulations, 2017	Regulations 4(1), 4(2), 5(1), 5(3), 5(6), 5(7), 6(1), 6(2), 6(3), 6(6), 6(8), Regulations 7(1), 7(2), 7(3), 7(6), 7(8), 8(2), 8(5) 9(1), 10(1), 10(2), Regulations 11(1), 11(2)
Preferential Procurement Regulations, 2022	Regulations 4(1), 4(2), 4(3), 4(4), 5(1), 5(2), 5(3), 5(4)
Prevention and Combating of Corrupt Activities Act 12 of 2004	Section 34(1)

