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

Report on the audit of the financial statements

Qualified opinion

1. I have audited the financial statements of the Mafube Local Municipality set out on pages … to …, which comprise the statement of financial position as at 30 June 2021, 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 the notes to the financial statements, including a summary of significant accounting policies.

2. In my opinion, except for the effects and the possible effects of the matters described in the basis for qualified opinion section of this auditor's report, the financial statements present fairly, in all material respects, the financial position of the Mafube 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 Practices (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 qualified opinion

Receivables from exchange transactions

3. I was unable to obtain sufficient appropriate audit evidence for receivables from exchange transactions, as the municipality could not provide adequate, accurate, and complete underlying accounting records to support the receivables from exchange transactions amounts recorded in the financial statements. I was unable to confirm receivables from exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to receivables from exchange transactions stated at R76 734 197 (2020: R19 548 099) in note 9 to the financial statements.

Service charges

4. I was unable to obtain sufficient appropriate audit evidence for the sale of water included in service charges, as a number of consumers were not billed, meter readings were incorrectly captured on the billing system and some consumers were also inconsistently billed. I was unable to confirm the revenue for sale of water by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to revenue from sale of water stated at R36 174 566 (2020: R24 277 991) in note 19 to the financial statements.

Receivables from non-exchange transactions

5. During 2020, the municipality did not recognise receivables from non-exchange transactions in accordance with GRAP 104, *Financial instruments* as the municipality recorded consumer debtors – rates from which they could not generate economic benefits. Consequently, consumer debtors – rates and allowance for impairment consumer – rates were overstated by

R13 044 227 in note 10 and 12 to the financial statements. My audit opinion on the financial statements for the period ended 30 June 2020 was modified accordingly. My opinion on the current year financial statements was also modified because of the possible effect of this matter on the comparability of the receivables from non-exchange transactions for the current period.

Context for the opinion

6. 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 this auditor's report.

7. 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 codes) 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.

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

Material uncertainty relating to going concern

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

10. Note 48 to the financial statements indicates that the municipality experienced financial difficulties such as unfunded employee benefit obligations, high levels of distribution losses, and slow collection and low recoverability of outstanding consumer accounts. In addition, the municipality incurred a net loss of R67 337 157 for the year ended 30 June 2021 and, as of that date, the municipality's current liabilities exceeded its current assets by R677 189 800. These events or conditions, along with the other matters set forth in note 48, indicate that a material uncertainty that may cast significant doubt on the municipality's ability to continue as a going concern .

Emphasis of matters

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

Unauthorised expenditure

12. As disclosed in note 50 to the financial statements, the municipality incurred unauthorised expenditure of R401 843 178 (2020: R370 698 249), due to overspending of the budget.

Irregular expenditure

13. As disclosed in note 52 to the financial statements, the municipality incurred irregular expenditure of R82 157 895 (2020: R61 640 179), mainly due to non-compliance with supply chain management (SCM) requirements.

Fruitless and wasteful expenditure

14. As disclosed in note 51 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R51 540 236 (2020:3 684 661), due to interest on the late payment of suppliers.

Material losses

15. As disclosed in note 53 to the financial statements, material water distribution losses of R37 200 047 (2020: R25 076 608) were incurred by the municipality mainly due to burst water pipes, leakages, and unmetered sites.

Material uncertainty relating to claims against the municipality

16. With reference to note 42 to the financial statements, the municipality is the defendant in various claims against the municipality. 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.

Restatement of corresponding figures

17. As disclosed in note 45 to the financial statements, the corresponding figures for 30 June 2020 have been restated as a result of errors in the financial statements of the municipality at, and for the year ended, 30 June 2021.

Other matter

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

Unaudited disclosure notes

19. 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

20. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the SA 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.

21. 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

22. 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.

23. 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

24. In accordance with the Public Audit Act of 2004 (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected key performance area (KPA) presented in the annual performance report. I was engaged to perform procedures to identify findings but not to gather evidence to express assurance.

25. I was engaged to evaluate 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 service delivery	x –x

26. The material findings in respect of the usefulness and reliability of the selected KPA are as follows:

KPA 1 – basic service delivery

27. I was unable to audit the usefulness and reliability of the selected KPA as the annual performance report was presented without accurate and complete underlying (performance) records. This placed a limitation on the scope of my work as I was unable to obtain sufficient and appropriate audit evidence and to audit the reported performance information by alternative means.

Other matters

28. I draw attention to the matters below.

Achievement of planned targets

29. 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 paragraph 27 of this report.

Report on the audit of compliance with legislation

Introduction and scope

30. 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.

31. The material findings on compliance with specific matters in key legislations are as follows:

Annual financial statements and annual report

32. 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 non-current assets and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements and supporting documentation that could not be provided subsequently, resulted in the financial statements receiving a qualified audit opinion.

33. The financial statements were not submitted to the auditor-general, for auditing within two months after the end of the financial year, as required by section 126(1)(a) of the MFMA.

Expenditure management

34. Payments were made from the municipality's bank account without the approval of the accounting officer, the chief financial officer, or a properly authorised official, as required by section 11(1) of the MFMA.

35. Reasonable steps were not taken to ensure that the municipality implements and maintains an effective system of expenditure control, including procedures for the authorisation of funds, as required by section 65(2)(a) of the MFMA.

36. Reasonable steps were not taken to prevent irregular expenditure amounting to R82 157 895 as disclosed in note 52 to the financial statements, as required by section 62(1)(d) of the MFMA. The majority of the irregular expenditure was caused by non-compliance with the SCM regulations.

37. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R 51 540 236 as disclosed in note 51 to the 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 on the overdue accounts.

38. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R401 843 178, as disclosed in note 50 to the 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.

Procurement and contract management

39. 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). Similar non-compliance was also reported in the prior year.

40. Written quotations were accepted from prospective providers who were not on the list of accredited prospective providers and did not meet the listing requirements prescribed by the SCM policy, in contravention of SCM regulations 16(b) and 17(1)(b).

41. Quotations and some of the contracts were accepted from bidders whose tax matters had not been declared by the South African Revenue Service to be in order, in contravention of SCM regulation 43. Similar non-compliance was also reported in the prior year.

42. Sufficient appropriate audit evidence could not be obtained that contracts were awarded through a competitive bidding process that were adjudicated by the bid adjudication committee as required by SCM regulations 29(1) (a) and (b) and the 2017preferential procurement regulations. This non-compliance was identified in the procurement processes for the construction of a 3.1km MV feeder line Namahadi to Frankfort substation and electrification of 228 households in Matoding extension, Namahadi and Mafahlaneng in-fills.

43. Some of the contracts and quotations 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). This non-compliance was identified in the procurement processes for the construction of a 3,1 km MV feeder line Namahadi to Frankfort substation and electrification of 228 households in Matoding extension, Namahadi and Mafahlaneng in-fills. Similar non-compliance was also reported in the prior year.

44. The preference point system was not applied on some of the procurement of goods and services above R30 000 as required by section 2(1)(a) of the Preferential Procurement Policy Framework Act 5 of 2000 (PPPFA). Similar non-compliance was also reported in the prior year.

45. Sufficient appropriate audit evidence could not be obtained that contracts were awarded to suppliers based on preference points that were allocated and calculated in accordance with the requirements of section 2(1)(a) of the PPPFA and its regulations. This non-compliance was identified in the procurement processes for the upgrading of gravel roads to a paved road and installation of proper storm water channels phase 2.

46. The performance of 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.

Consequence management

47. 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.

48. Irregular 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.

49. 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.

Revenue management

50. An adequate management, accounting and information system which accounts for revenue was not in place, as required by section 64(2)(e) of the MFMA.

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

Other information

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

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

54. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the 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.

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, 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.

57. There was continued instability in the leadership at the municipality with the position of the municipal manager being vacant and the appointment of administrators under section 139 of the Constitution of the Republic of South Africa. This contributed to ineffective oversight over financial and performance reporting, compliance with laws and regulations, and ineffective internal controls.

58. Compliance with applicable legislation was not effectively monitored by management as instances of non-compliance reported in the previous year recurred. The oversight structures, including the administrators, did not improve the oversight and governance of the control environment which maintained the lack of implementation of consequences and accountability. It also resulted in officials not being held accountable for transgressions of laws and regulations and the significant number of non-compliance findings raised.

59. Effective internal control processes were not implemented by management to manage the daily and monthly processing and reconciling of transactions. Effective record keeping was not implemented to ensure that complete, relevant, and accurate information is accessible and available to support financial and performance reporting. This resulted in material limitation misstatements being identified in the financial statements and the annual performance report.

60. The internal audit division was not adequately resourced and functioning and did not effectively identify internal control deficiencies or recommend effective corrective action. This contributed to the material misstatements being identified in the financial statements and the annual performance report.

61. The audit committee did not provide adequate oversight to review and verify the information reported in the annual financial statements and annual performance report submitted for auditing. This resulted in the processing of material adjustments during the audit that could have been prevented.

Material irregularities

62. In accordance with the PAA and the Material Irregularity Regulations, I have a responsibility to report on material irregularities identified during the audit. The material irregularity identified is as follows:

Status of previously reported material irregularity

Full and proper records not kept (2017-18) – infrastructure assets and bulk purchases of water

63. In my 2019-20 auditor's report, I reported that the municipality did not take reasonable steps in the 2017-18 financial year to ensure that full and proper records were kept of infrastructure assets and bulk purchases of water, as required by section 62(1)(b) of the MFMA. The non-compliance contributed to a disclaimed audit opinion as I could not obtain sufficient appropriate audit evidence to support the amounts and disclosures in the financial statements.

64. The lack of full and proper records is likely to result in substantial harm to the municipality as it contributed to the material uncertainty regarding its ability to continue operations, as disclosed in note 42 to the 2017-18 financial statements and paragraph 33 in the 2017-18 audit report. This, in turn, is likely to have a negative impact on the municipality's ability to discharge its service delivery mandate.

65. The accounting officer was notified of this material irregularity on 11 June 2021. The following actions have been taken or is in progress to resolve the material irregularity:

- The municipality has been placed under provincial intervention in terms of section 139(5)(a) and (c) of the Constitution of the Republic of South Africa with the purpose to impose and ensure implementation of a recovery plan aimed at securing the municipality's ability to meet its obligations to provide basic services and to meet its financial commitments. An administrator was appointed on 10 June 2022.
- Two senior officials were subjected to a disciplinary process due to mal-administration issues identified during previous audits and have subsequently been dismissed.
- A funding plan for the 2021-2022 financial year, which includes activities relating to improved revenue enhancement and cost containment, was developed and approved by the council on 31 May 2021 and implementation is in progress.
- The municipality has addressed some of the shortcomings with regard to the availability of financial records, and the audit outcome for the 2018-19 financial year, as per audit report signed on 30 September 2021, improved from a disclaimer of opinion to a qualified opinion. The qualified opinion was maintained in the 2019-20 audit report, signed on 15 December 2021, and in this auditor's report for 2020-21. The actions taken to address the limitation of scope included the following:
  - the fixed asset register was updated through asset verifications and reconciled to the general ledger and financial statements. In 2020-21, the electricity fixed asset register was also updated and reconciled to the general ledger and financial statements.
  - the reconciliation of bulk water purchases as well as the invoices and statements were provided for audit purposes.

66. I will follow up on the implementation of the planned actions and actions in progress during my next audit.

Auditor - General

Bloemfontein

16 September 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 Mafube 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.