# Report of the auditor-general to the Mpumalanga Provincial Legislature and the council on the Lekwa Local Municipality

## Report on the audit of the financial statements

### Disclaimer of opinion

1. I was engaged to audit the financial statements of the Lekwa 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 the 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. I do not express an opinion on the financial statements of the municipality. Because of the significance of the matters described in the basis for disclaimer of opinion section of this auditor's report, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

### Basis for disclaimer of opinion

#### Cash and cash equivalents

3. I was unable to obtain sufficient appropriate audit evidence for bank balances, due to the inadequate state of the accounting records. The municipality did not have adequate systems of internal control for reconciling all bank transactions and could not provide reconciliations between the bank accounts and the accounting records. I could not confirm bank balances by alternative means. The cash and cash equivalents included in risk management in note 38 to the financial statements also included this amount.

4. Consequently, I was unable to determine whether any adjustment was necessary to the bank overdraft/cash and cash equivalents of R139,45 million (2019-20: R43,11 million) and risk management, as disclosed in notes 8 and 38 to the financial statements, respectively. Since the cash and cash equivalents balance and bank overdraft are included in the determination of net cash flows from operating activities reported in the statement of cash flows, I was unable to determine whether any adjustments were necessary in the cash flows from operating activities stated at R37,58 million in the financial statements.

#### Property, plant and equipment

5. Contrary to the requirements of the Standards of Generally Recognised Accounting Practice (GRAP) 17, *Property, plant and equipment*, the municipality included land that it did not have control over in its fixed asset register. Consequently, property, plant and equipment was overstated by R25,79 million (2019-20:R25,79 million). Furthermore, some properties identified from the valuation roll could not be traced to the asset register as internal controls

had not been established to maintain an adequate asset register. I was not able to determine the full extent of the misstatement to property, plant and equipment, as it was impracticable to do so.

6. I was unable to obtain sufficient appropriate audit evidence for the unreconciled difference of R46,58 million between the asset register and the financial statements due to the lack of adequate accounting records. I was unable to confirm the reconciling difference by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to property, plant and equipment, stated at R1,14 billion (2019-20: R1,18 billion) and the depreciation expense of R94,93 million (2019-20: R87,25 million), as disclosed in notes 10 and 27 to the financial statements, respectively.

### Investment property

7. Contrary to the requirements of GRAP 16, *investment property*, the municipality did not recognise all its investment properties in the assets register. Some properties identified from the valuation roll could not be traced to the investment property asset register. Consequently, I was unable to determine the full extent of the misstatement to investment property, stated at R1,37 million in note 9 to the financial statements, as it was impracticable to do so.

### Inventory: land for sale – RDP

8. The municipality did not recognise all its inventory in the financial statements in accordance with GRAP 12*, Inventories*. Some land for sale – RDP could not be traced to the valuation roll, while some of the land for sale – RDP were recognised at amounts above their net realisable values. Consequently, inventory and expenditure are overstated and understated by R33,67 million, respectively.

9. Furthermore, I could not trace land selected from the valuation roll to the assets register of land for sale – RDP. Consequently, I was unable to determine the full extent of the misstatement to inventories, stated at R67,18 million in note 3 to the financial statements, as it was impracticable to do so.

### Value-added tax (VAT)

10. I was unable to obtain sufficient appropriate audit evidence for the unreconciled difference between VAT receivables and the VAT 201 returns, as internal controls had not been established to maintain financial records. I was unable to confirm the VAT receivables by alternative means.

11. Consequently, I was unable to determine whether any adjustment was necessary to the VAT receivables, stated at R74 million (2019-20: R62 million) in note 4 to the financial statements.

### Receivables from exchange transactions

12. I was unable to obtain sufficient appropriate audit evidence for the unreconcilable difference between the debtors listing and consumer debtors due to the poor status of the accounting records and the non-submission of information in support of these differences. I could not confirm consumer debtors by alternative means. The receivables from exchange transactions

included in risk management in note 38 and allowance for impairment stated in note 6 to the financial statements were also impacted by the difference

13. Consequently, I was unable to determine whether any adjustment was necessary to the receivables from exchange transactions and risk management, stated at R155 million (2019-20: R168 million) in notes 5, 6 and 38 to the financial statements. Additionally, there was a consequential impact on the debt impairment, stated at R210 million (2019-20: R189 million) in note 30 to the financial statements.

### Receivables from non-exchange transactions

14. The municipality did not record all the revenue in accordance with GRAP 23, *Revenue from non-exchange transactions*. The municipality did not record all the traffic fines issued in the accounting records. As a result, receivables and revenue from non-exchange transactions were understated. The receivables from non-exchange transactions included in risk management in note 38 to the financial statements also included this amount and was also understated. Consequently, I was unable to determine the full extent of the misstatement to receivables from non-exchange transactions, stated at R37,68 million; revenue from non-exchange transactions, stated at R1,11 million; and risk management – receivables from non-exchange transactions, stated at R 37,68 million, as disclosed in notes 7, 19 and 38 to the financial statements, respectively, as it was impracticable to do so.

15. In terms of GRAP 104, *Financial instruments*, an entity is required to assess individually significant financial assets for impairment where there are indicators of impairment, and to collectively assess significant financial assets with groups of assets with similar credit-risk characteristics. Contrary to this requirement, the municipality did not wholly assess individual debtors' payment history in calculating the allowance for impairment for property rates.

16. Consequently, I was unable to determine the full extent of the misstatement to receivables from non-exchange transactions, stated at R37,68 million, and allowance for debt impairment, stated at R1,23 billion, as disclosed in notes 7 and 6 to the financial statements, respectively, as it was impracticable to do so.

### Provisions

17. I was unable to obtain sufficient appropriate audit evidence for the adjustments made to the opening balance of the provisions amounting of R157 million (2019-20: R251 million), as I was not provided with supporting evidence. I could not confirm the provisions balance by alternative means.

18. Consequently, I was unable to determine whether any adjustment was necessary to the provisions, stated at R518 million (2019-20: R 504 million) in note 15 to the financial statements.

### Payables from exchange transactions

19. I was unable to obtain sufficient appropriate audit evidence for prior year payments received in advance and salary accruals included in payables from exchange transactions due to a lack of proper record keeping and reconciliations of control accounts by the municipality. I was unable to confirm these payables from exchange transactions by alternative means

20. I was unable to obtain sufficient appropriate audit evidence for the debtors with credit balance for R13 431 100, as disclosed in the financial statements, as I was not provided with supporting evidence. I could not confirm this by alternative means.

21. Consequently, I was unable to determine whether any further adjustments were necessary to payables from exchange transactions, stated at R1,93 billion (2019-20: R1,83 billion) in note 12 to the financial statements.

### Service charges

22. Included in service charges is sale of electricity, sale of water, sewerage and sanitation charges, and refuse removal. The municipality processed the correction of prior year period errors as part of current year, contrary to GRAP 3, *Accounting policies, estimates and errors*. The prior year correction of billing errors for refuse removal, sewerage and sanitation was processed against the current year revenue instead of the corresponding figures, resulting in an overstatement of R43,19 million on current year service charges and receivables from exchange transactions. Additionally, there was an impact on surplus for the period and on the accumulated surplus.

23. Furthermore, not all service charges were billed for the full 12 months against some of the properties, resulting in service charges and receivables from exchange transactions being understated. I could not determine the full extent of the understatement of service charges and receivables from exchange transactions as it was impracticable to do so.

24. I was unable to obtain sufficient appropriate audit evidence for estimate billing on sale of electricity and water as I was not provided with the methods and assumptions used to determine this. I could not confirm the estimate billing by alternative means. The water and electricity losses stated in note 31 to the financial statements were also affected by this. Consequently, I was unable to determine whether any adjustment was necessary to service charges, stated at R481,06 million (2019-20: R441,27 million) in note 18; receivables from exchange transactions, stated at R155,10 million in notes 5 and 6; and electricity and water losses, stated at R124,40 million and R 77,97 million, respectively, in note 31 to the financial statements. This also had an impact on the surplus for the period and on the accumulated surplus.

### Property rates

25. The municipality did not record all the revenue in accordance with GRAP 23, *Revenue from non-exchange transactions* .The municipality did not charge property rates on some properties for the full 12 months, resulting in property rates revenue and receivables from non-exchange transactions being understated. I could not determine the full extent of the understatement of revenue from property rates and receivables from non-exchange transactions by alternative means. Consequently, I was unable to determine the full extent of the understatement to property rates, stated at R156,42 million in note 22 to the financial statements, as it was impracticable to do so.

## Bulk purchases

26. The municipality did not recognise some expenditures in accordance to GRAP 1, *Presentation of financial statements*. Some of the invoices of bulk purchases relating to goods received in the prior year were recorded as transactions that occurred in the current year, resulting in both expenditure and payables from exchange transaction being overstated by R47 million. This also had an impact on the surplus for the period and on the accumulated surplus.

## Contracted services

27. The municipality did not recognise some expenditures in accordance with GRAP 1, *Presentation of financial statements* .Some of the invoices of contracted services relating to services that were received in the current year were recorded as the ensuing financial year's transactions, resulting in expenditure and payables from exchange transactions being understated by R38 million. This also had an impact on the surplus for the period and on the accumulated surplus.

## Operational costs

28. The municipality did not recognise some expenditures in accordance with GRAP 1, *Presentation of financial statements* .Some of the invoices for services rendered for operational cost during the year were not recorded in the general ledger, resulting in both the expenditure and payable from exchanges transaction being understated. I could not determine the full extent of the understatement of operational costs, stated at R41,95 million in note 34, and payables from exchange transactions, stated R1,93 billion in note 12 to the financial statements, as it was impracticable to do so.

## Commitments

29. I was unable to obtain sufficient appropriate audit evidence for commitments as the municipality did not have adequate systems to maintain records for commitments. I was unable to confirm these amounts disclosed by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to commitments, stated at R6,24 million (2019-20: R8,36 million) in note 43 to the financial statements.

## Fruitless and wasteful expenditure

30. The municipality did not recognise fruitless and wasteful expenditure, as required by section 125(2)(d) of the Municipal Financial Management Act 56 of 2003 (MFMA).The penalties and interest for late submission of returns to the South African Revenue Service (Sars) were not all recorded in the fruitless and wasteful expenditure register, as internal controls had not been established to recognise and record all fruitless and wasteful expenditure incurred. I could not confirm whether all fruitless and wasteful expenditure had been recognised by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to fruitless and wasteful expenditure of R461,92 million, as disclosed in note 42 to the financial statements.

### Irregular expenditure

31. The municipality did not have adequate system to detect,record and appropriately disclose all irregular expenditure incurred, as required by section 125(2)(d) of the Municipal Financial Management Act 56 of 2003 (MFMA). I was unable to determine the full extent of the understatement of irregular expenditure stated at R 502,17 million (2019-20: R 461,42 million) in note 44 to the financial statements, as it was impracticable to do so.

### Net cash flows from operating and investing activities

32. The municipality did not correctly prepare and disclose the net cash flows from operating and investing activities, as required by GRAP 2, *Cash flow statements*. This was due to multiple errors in determining cash flows from operating and investing activities. I was unable to determine the full extent of the errors in the net cash flows from operating and investing activities as it was impracticable to do so. Consequently, I was unable to determine whether any adjustments were necessary to cash flows from operating and investing activities, stated at R37,58 million and R46,47 million, respectively, in the financial statements.

### Prior period error

33. I was unable to obtain sufficient appropriate audit evidence for the adjustments disclosed to VAT receivable; property, plant and equipment; provision of water; trade payables; and bulk purchases, which were stated in note 48 to the financial statements. I was unable to confirm these adjustments by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the prior year adjustments as well as the prior period error note in the financial statements.

## Material uncertainty relating to going concern

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

35. I draw attention to note 39 to the financial statements, which indicates that the municipality incurred an accumulated deficit of R1,17 billion during the year ended 30 June 2021. As of that date, the municipality's liabilities exceeded its assets by R1,17 billion. Management indicated a financial recovery plan is currently being implemented, and is being monitored by oversight committees and stakeholders with the aim of improving the financial sustainability.

## Other matter paragraph

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

### Unaudited disclosure notes

37. 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.

### Withdrawal from the audit engagement

38. Due to the limitation imposed on the scope of the audit by management, I have disclaimed my opinion on the financial statements. However, were it not for the legislated requirement to perform the audit of the municipality, I would have withdrawn from the engagement in terms of the International Standards of Auditing (ISAs).

## Responsibilities of the accounting officer for the financial statements

39. 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 Division of Revenue Act 4 of 2020 (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.

40. 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

41. My responsibility is to conduct an audit of the financial statements in accordance with the International Standards on Auditing and to issue an auditor's report. However, because of the matters described in the basis for disclaimer of opinion section of this auditor's report, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

42. 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 the other ethical requirements that relevant to my audit of the financial statements in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.

# Report on the audit of the annual performance report

## Introduction and scope

43. 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 areas

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

44. 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.

45. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected key performance area presented in the municipality's annual performance report for the year ended 30 June 2021:

| Key performance area (KPA) | Pages in the annual performance report |
|---|---|
| *KPA 1 – service delivery and infrastructure development* | x – x |

46. 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.

47. The material findings on the usefulness and reliability of the performance information of the selected key performance areas are as follows:

### KPA 1 – service delivery and infrastructure development

#### Various indicators

48. The reported achievements were inconsistent with the planned and reported indicator and target.

| Planned indicator | Planned target | Reported achievement |
|---|---|---|
| % progress on refurbishment and/or upgrade of critical components of Standerton Water Treatment Plant | % progress on refurbishment and/or upgrade of critical components of Standerton Water Treatment Plant | 61%<br>(The project is 61% complete) (Not Achieved) |
| % progress on refurbishment and/or upgrade of critical components of Morgenzon Water Treatment Plant | % progress on refurbishment and/or upgrade of critical components of Morgenzon Water Treatment Plant | Project practically complete (99,75%) with snag list issued (Achieved) |

## Various indicators

49. The reported targets do not agree with the planned targets for the following indicators as per the approved service delivery, budget and implementation plan. These changes were made without the necessary approval. Furthermore, the reported achievement was inconsistent with the planned and reported indicator and target.

| Key performance indicator (KPI) planned and reported | Planned target | Reported target | Reported achievement |
|---|---|---|---|
| Refurbishment of sewer pump stations | Refurbishment of sewer pump stations | 855 968,25 | (Preliminary design approval not 100% completed – Not Achieved) |

## Various Indicators

50. I was unable to obtain sufficient appropriate audit evidence that clearly defined the predetermined source information, evidence and method of collection, or that related systems and processes were established to enable consistent measurement and reliable reporting of the actual achievement for the indicator. This was due to insufficient measurement definitions and processes. I was unable to test whether the indicator was well-defined and verifiable by alternative means. As a result, I was unable to audit the reliability of the following reported achievement against planned targets in the annual performance report.

| KPI | Planned target | Reported achievement |
|---|---|---|
| Refurbishment of sewer pump stations | 855 968,25 | (Preliminary design approval not 100% completed – Not Achieved) |
| % progress on refurbishment and/or upgrade of critical components of Standerton Water Treatment Plant | % progress on refurbishment and/or upgrade of critical components of Standerton Water Treatment Plant | 61%<br>(The project is 61% complete) (Not Achieved) |
| % progress on refurbishment and/or upgrade of critical components of Morgenzon Water Treatment Plant | % progress on refurbishment and/or upgrade of critical components of Morgenzon Water Treatment Plant | Project practically complete (99,75%) with snag list issued. (Achieved) |
| % progress on installation of telemetry system to monitor reservoir water levels | 0%<br>(Project not implemented) (Not Achieved) | 0%<br>(Project not implemented) (Not Achieved) |
| % progress on number of bulk water meters Installed | 0% | 0% |

| KPI | Planned target | Reported achievement |
|---|---|---|
| | (Project not implemented)<br>(Not Achieved) | (Project not implemented)<br>(Not Achieved) |

### Other matters

51. I draw attention to the matters below.

#### Achievement of planned targets

52. 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 48 to 50 of this report.

## Report on the audit of compliance with legislation

### Introduction and scope

53. 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.

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

#### Financial statements, performance reports and annual reports

55. 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 disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a disclaimer audit opinion.

#### Strategic planning and performance management

56. A performance management system was not adopted, as required by municipal planning and performance management regulation 8.

57. 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 and managed, as required by municipal planning and performance management regulation 7(1). This resulted in indicators not being well defined and consistent between planning and reporting documents, and inadequate reviews of reported achievements in the annual performance report.

### Expenditure management

58. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1) (d) of the MFMA. The full extent of the irregular expenditure could not be quantified as indicated in the basis for qualification paragraph. The majority of the disclosed irregular expenditure was caused by non-compliance with supply chain management (SCM) regulation 19(a)

59. Reasonable steps were not taken to prevent fruitless and wasteful expenditure, as required by section 62(1) (d) of the MFMA. The expenditure disclosed does not reflect the full extent of the fruitless and wasteful expenditure incurred as indicated in the basis for qualification paragraph. The majority of the disclosed fruitless and wasteful expenditure was caused by late submission and payment of VAT and pay-as-you-earn (PAYE) returns'

60. Reasonable steps were not taken to prevent unauthorised expenditure of R233,47 million, as disclosed in note 41 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 within various votes.

61. An adequate management, accounting and information system that recognised expenditure when it was incurred and accounted for creditors was not in place, as required by section 65(2)(b) of the MFMA.

### Revenue management

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

### Asset management

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

### Consequence management

64. 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.

65. 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.

66. 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.

### Procurement and contract management

67. Quotations were accepted from 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).

68. Invitations to tender for procurement of commodities designated for local content and production did not stipulate the minimum threshold for local production and content, as required by the 2017 preferential procurement regulation 8(2).

69. 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.

70. Sufficient appropriate audit evidence could not be obtained that the performance of contractors or providers was monitored on a monthly basis, as required by section 116(2) of the MFMA.

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

### Conditional grants

72. The municipal infrastructure grant was not spent for its intended purposes in accordance with the applicable grant framework, as required by section 17(1) of Dora.

## Internal control deficiencies

73. 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 disclaimer of opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

74. Management did not exercise oversight responsibility regarding financial and performance reporting and compliance and related internal controls.

75. Management did not ensure that controls were implemented over daily and monthly processing and reconciling of transactions.

76. Management did not prepare regular, accurate and complete financial and performance reports that were supported and evidenced by reliable information.

77. Management did not review and monitor compliance with applicable laws and regulations.

## Material irregularities

78. 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

79. The material irregularities identified are as follows:

## Material irregularities in progress

80. I identified a material irregularity during the audit and notified the accounting officer, as required by material irregularity regulation 3(2). By the date of this auditor's report, I had not yet completed the process of evaluating the response from the accounting officer. This material irregularity will be included in the next year's auditor's report.

## Other reports

81. 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.

82. An independent consultant investigated allegations of possible maladministration at the municipality, at the request of the member of the executive council for cooperative governance and traditional affairs, in terms of section 106(1)(B) of the Municipal Systems Act 32 of 2000. The investigation was concluded and the recommendations of the investigation had been partially implemented at the time of this report.

Auditor - General

Mbombela

31 January 2022

AUDITOR-GENERAL
SOUTH AFRICA

*Auditing to build public confidence*