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

Report on the audit of the financial statements

Qualified opinion

1. I have audited the financial statements of the Emalahleni Local Municipality set out on pages … to …, which comprise the statement of financial position as at 30 June 2022, the statement of financial performance, the statement of changes in net assets, the 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, except for 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 Emalahleni Local Municipality as at 30 June 2022, and financial performance and cash flows for the year then ended in accordance with the Standards of Generally Recognised Accounting Practice (GRAP), the requirements of the Municipal Finance Management Act 56 of 2003 (MFMA) and the Division of Revenue Act 9 of 2021 (Dora).

Basis for qualified opinion

Consumer debtors

3. The municipality did not properly account for consumer debtors as required by GRAP 104, *Financial instruments* in the prior year. The impairment method on consumer debtors was incorrectly applied in calculating the impairment provision. I was unable to quantify the full extent of the misstatements to the corresponding figures for the allowance for impairment stated at R4,17 billion and consumer debtors stated at R786,45 million in note 15 to the financial statements, as it was impracticable to do so.

4. The consumer debtors were also included under risk management in note 56 to the financial statements. I was unable to quantify the impact of these misstatements on the corresponding figures for contribution to the debt impairment provision stated at R631,74 million in note 43 to the financial statements; as well as on the prior year adjustments to consumer debtors and debt impairment stated at R1,85 billion and R383,24 million, respectively, in note 55 to the financial statements, as it was impracticable to do so. My opinion on the current year's financial statements was modified because of the effects of this matter on the comparability of the allowance for impairment, consumer debtors and debt impairment provision for the current period.

Receivables from non-exchange transactions

5. The municipality did not properly account for receivables from non-exchange transactions in terms of GRAP 108, *Statutory receivables* in the prior year. The impairment method on

consumer debtors rates was incorrectly applied in calculating the impairment provision. I was unable to quantify the full extent of the misstatements to the corresponding figures for the allowance for impairment stated at R783,16 million and receivables from non-exchange transactions stated at R43,30 million in note 13 to the financial statements, as it was impracticable to do so.

6. The receivables from non-exchange transactions were also included under risk management in note 56 to the financial statements. I was unable to quantify the impact of these misstatements on the corresponding figures for contribution to the debt impairment provision stated at R631,74 million in note 43 to the financial statements; as well as on the prior year adjustments to consumer debtors and debt impairment stated at R1,85 billion and R383,24 million, respectively, in note 55 to the financial statements, as it was impracticable to do so. My opinion on the current year's financial statements was modified because of the effects of this matter on the comparability of the allowance for impairment, receivables from non-exchange transactions and debt impairment provision for the current period.

Net cash flows from operating activities

7. During 2021, the municipality did not correctly prepare and disclose the net cash flows from operating activities as required by GRAP 2, *Cash flow statements*. This was due to multiple errors in determining cash flows from operating activities. I was unable to determine the full extent of the errors in the net cash flows from operating activities stated at R289,91 million in the cash flow statement as well as note 47 to the financial statements, as it was impracticable to do so. I was also unable to determine the full extent of these errors on the prior year adjustments to the net cash flow from operating activities in note 56 to the financial statements, as it was impracticable to do so. My audit opinion on the financial statements for the period ended 2021 was modified accordingly. My opinion on the current year’s financial statements was also modified because of the possible effect of this matter on the comparability of the net cash flows from operating activities for the current period.

Net cash flows from investing activities

8. The municipality did not correctly prepare and disclose the net cash flows from investing activities as required by GRAP 2, *Cash flow statements* in the prior year. This was due to multiple errors in determining cash flows from investing activities. I was unable to determine the full extent of the errors in the net cash flows from investing activities stated at negative R284,60 million in the cash flow statement for the prior year, as it was impracticable to do so. I was also unable to determine the full extent of these errors on the prior year adjustments to the net cash flow from operating activities in note 56 to the financial statements, as it was impracticable to do so. My opinion on the current year's financial statements was modified because of the effect of this matter on the comparability of the net cash flows from investing activities for the current period.

Irregular expenditure

9. The municipality did not have adequate systems to identify and disclose all irregular expenditure incurred during the year, as required by section 125(2)(d) of the MFMA. I was unable to quantify the understatement, as it was impracticable to do so. Consequently, I was

unable to determine whether any adjustments were necessary to irregular expenditure stated at R806,22 million (2020-21: R618,42 million), disclosed in note 60 to the financial statements.

Segment reporting

10. The municipality did not include disclosures on segments in the financial statements, as required by GRAP 18, *Segment reporting*. Information to enable users of its financial statements to evaluate the nature and financial effects of the activities in which it engages and the economic environments in which it operates was not disclosed.

Context for the opinion

11. 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.

12. 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.

13. 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

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

15. Note 57 to the financial statements indicates that the municipality incurred a deficit of R1,06 billion (2020-21: R1,06 billion) during the year ended 30 June 2022 and that, as of that date, the municipality's current liabilities exceeded its current assets by R5,94 billion (2020-21: R4,91 billion). As stated in note 57, these events or conditions, along with other matters as set forth in note 57, indicate that a material uncertainty exists that may cast significant doubt on the municipality's ability to continue as a going concern.

Emphasis of matter

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

Material losses – electricity

17. As disclosed in note 45 to the financial statements, material electricity losses of R751,12 million (2020-21: R390,21 million) were incurred, which represents 38% (2020-21: 29%) of total electricity units purchased. These losses arose from ageing and deteriorating infrastructure as well as illegal connections.

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 on it.

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 GRAP and the requirements of the MFMA and Dora, and for such internal controls as the accounting officer determines are 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 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.

25. 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.

26. 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 2022:

Key performance area	Pages in the annual performance report
Key performance area 1 – infrastructure and basic service delivery	x – x

27. 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.

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

Key performance area 1 – infrastructure and basic service delivery

Various indicators

29. The source information, evidence and method of calculation for measuring the various planned indicators were not clearly defined, and related systems and processes were not adequate to enable consistent measurement and reliable reporting of performance against the predetermined indicator definitions. As a result, limitations were placed on the scope of my work and I was unable to audit the reliability of the achievement of targets reported against the planned targets in the annual performance report for the following indicators:

KPI no.	Indicator description	Planned target	Reported achievement
22	Upgrading of Klipspruit WWTW at 60% (Construction of a reactor commences) 60% (Construction of inner reactor wall footings)	Upgrading of Klipspruit WWTW at 60% (Construction of a reactor commences) 60% (Construction of inner reactor wall footings)	Upgrading of Klipspruit WWTW at 67% (Construction of a reactor commenced) 67% (Construction of inner reactor wall footings)

KPI no.	Indicator description	Planned target	Reported achievement
23	Percentage progress with the sewer reticulation Empumelelweni extensions	100% completion of sewer reticulation at Empumelelweni extensions	100% of sewer reticulation at Empumelelweni extensions completed
24	Percentage progress with treatment works for the upgrading of Ferrobank WWTW	3% progress with treatment works for the upgrading of Ferrobank WWTW	0% progress with treatment works for the upgrading of Ferrobank WWTW
25	Percentage progress with reticulation of water services Empumelelweni and KwaGuqa extension 10	90% progress on reticulation of water services Empumelelweni and KwaGuqa extension 1010 at 90%	Reticulation of water services Empumelelweni and KwaGuqa extension 10 at 91,13%
27	Percentage progress on construction of paved roads and stormwater in Thubelihle	Construction of paved roads and stormwater in Thubelihle at 85%	Construction of paved roads and stormwater in Thubelihle at 98,2%
28	Percentage progress with electrification of additional households living in formal areas provided with electricity connections	Percentage progress with electrification of additional households living in formal areas provided with electricity connections	Progress with electrification of additional households living in formal areas at 80%
39	Number of additional households receiving curbside refuse collection/ removal services	4 000 additional households receiving refuse curbside collection/refuse removal services	144 additional households receiving refuse curbside collection/refuse removal services
56	Percentage on construction of engineering services: Klarinet and Siyanqoba Phase 2 link and bulk water supply lines	Construction of engineering services: Klarinet and Siyanqoba Phase 2 link and bulk water supply lines at 70% (Construction of a 2, 175 km long bulk water pipeline fittings at 70%)	Construction of engineering services: Klarinet and Siyanqoba Phase 2 link and bulk water supply lines at 87,86% (Construction of a 2 175 km long bulk water pipeline fittings at 87,86%)

Other matters

30. I draw attention to the matters below.

Achievement of planned targets

31. Refer to the annual performance report on pages … to … for information on the achievement of planned targets for the year and management's explanations provided for the under/overachievement of targets. 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.

Adjustment of material misstatements

32. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were in the reported performance information of infrastructure and basic service delivery. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are reported above.

Report on the audit of compliance with legislation

Introduction and scope

33. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the municipality's compliance with specific matters in key legislation. I performed procedures to identify findings, but not to gather evidence to express assurance.

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

Annual financial statements

35. 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 expenditure, revenue and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.

Procurement and contract management

36. Some contracts were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding, in contravention of supply chain management (SCM) regulations 21(b) and 28(1)(a)(i) and the preferential procurement regulations.

37. Some tenders that failed to achieve the minimum qualifying score for functionality criteria were not disqualified as unacceptable tender in accordance with 2017 preferential procurement regulation 5(6).

Expenditure management

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

39. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The expenditure disclosed does not reflect the full extent of the irregular expenditure incurred as indicated in the basis for qualification paragraph. The majority of the disclosed irregular expenditure was caused by non-compliance with SCM regulations.

40. Reasonable steps were not taken to prevent unauthorised expenditure of R909,86 million, as disclosed in note 58 to the financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by overspending in relation to the approved budget.

Revenue management

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

Consequence management

42. 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.

Strategic planning and performance

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

Other information

44. 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 key performance areas presented in the annual performance report that have been specifically reported in this auditor's report.

45. 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.

46. 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 key performance areas presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.

47. If, based on the work I have performed, I conclude that there is a material misstatement in this other information, I am required to report that fact. I have nothing to report in this regard.

Internal control deficiencies

48. 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.

49. Leadership did not exercise adequate oversight of operations by taking appropriate action to ensure that internal control deficiencies were addressed on time.

50. Senior management did not implement adequate recording, reviewing and reporting processes and controls to ensure credible, complete and accurate financial and performance reporting.

51. Non-compliance with legislation could have been prevented had compliance been properly reviewed and monitored by senior management. This resulted in the compliance matters reported above as well as unauthorised, irregular and fruitless and wasteful expenditure.

Material irregularities

52. In accordance with the PAA and the Material Irregularity Regulations, I have a responsibility to report on material irregularities identified during the audit.

Material irregularities identified during the audit

Unfair disqualification of bidder – updating and maintaining of immovable asset register

53. A service provider was appointed on 13 January 2020 for a period of 36 months to update and maintain the municipality's fixed asset register, as the municipality did not have the capacity to fully perform this function. The total contract value was R14,88 million. The pre-qualification criteria applied in evaluating the contract were incorrectly applied, resulting in an unfair disqualification of a prospective bidder who bid an amount of R8,11 million which was R6,76 million lower than the bidder that was awarded the contract. This resulted in non-compliance with the 2017 preferential procurement regulation 4(2).

54. The non-compliance was likely to result in a material financial loss due to the appointment of a bidder whose bid amount exceeded the amount of the unfairly disqualified bidder.

55. The accounting officer was notified of this material irregularity on 8 December 2021 and was invited to make a written submission on the actions taken and that will be taken to address the matter. The accounting officer did not take appropriate action to resolve the material irregularity.

56. I referred the material irregularity to the Public Protector of South Africa on 21 November 2022 for investigation as provided for in section 5(1A) of the PAA.

Eskom not paid within 30 days of receiving the invoice or relevant statement

57. The municipality failed to ensure that the payments due to Eskom was made within 30 days of receiving the relevant invoice or statement, in contravention of section 65(2)(e) of the MFMA. The municipality incurred interest as a result of the late payments of R313,89 million in the 2019-20 financial year, which was disclosed as fruitless and wasteful expenditure in note 60 of

the 2019-20 annual financial statements. The non-compliance was likely to result in a material financial loss when the interest expense is paid.

58. The accounting officer was notified of this material irregularity on 15 April 2021 and was invited to make a written submission on the actions taken and that will be taken to address the matter. The accounting officer responded on 14 May 2021 with the actions taken to resolve the material irregularity. My assessment is that the actions taken are not appropriate to resolve the material irregularity.

59. I recommend that the accounting officer should take the following actions to address the material irregularity, which should be implemented by 31 May 2023 with progress reports every two months.

60. Appropriate action should be taken to implement the financial recovery plan of the municipality to address the financial problems that are preventing the municipality from paying Eskom within 30 days, as required by section 65(2)(e) of the MFMA. The strategies to be implemented should include measures to:

- Implement revenue enhancement interventions to increase the collection of revenue.
- Efficiently manage the available resources of the municipality to optimise and reduce costs by eliminating wastage while obtaining value in respect of all costs incurred.
- Reduce electricity distribution losses.
- Negotiate a reasonable payment arrangement with Eskom and properly budget for the amounts to be paid.

Department of Water and Sanitation not paid within 30 days of receiving the invoice or relevant statement

61. The municipality failed to ensure that the payments due to the Department of Water and Sanitation were made within 30 days of receiving the relevant invoice or statement, in contravention of section 65(2)(e) of the MFMA. The municipality incurred interest as a result of the late payments of R9,97 million in the 2019-20 financial year, which was disclosed as fruitless and wasteful expenditure in note 60 of the 2019-20 annual financial statements.

62. The non-compliance was likely to result in a material financial loss when the interest expense is paid.

63. The accounting officer was notified of this material irregularity on 4 June 2021 and was invited to make a written submission on the actions taken and that will be taken to address the matter. The accounting officer responded on 29 June 2021 with the actions taken to resolve the material irregularity. My assessment is that the actions taken are not appropriate to resolve the material irregularity.

64. I recommend that the accounting officer should take the following actions to address the material irregularity, which should be implemented by 31 May 2023 with progress reports every two months.

65. Appropriate action should be taken to implement the financial recovery plan of the municipality to address the financial problems that are preventing the municipality from paying the

Department of Water and Sanitation within 30 days, as required by section 65(2)(e) of the MFMA. The strategies to be implemented should include measures to:

- Implement revenue enhancement interventions to increase the collection of revenue.
- Efficiently manage the available resources of the municipality to optimise and reduce costs by eliminating wastage whilst obtaining value in respect of all costs incurred.
- Reduce water distribution losses.
- Negotiate a reasonable payment arrangement with the Department of Water and Sanitation and properly budget for the amounts to be paid.

Other reports

66. I draw attention to the following engagements conducted by various parties which had, or could have, an impact on the matters reported in the municipality's financial statements, reported performance information, compliance with applicable legislation and other related matters. These reports did not form part of my opinion on the financial statements or my findings on the reported performance information or compliance with legislation.

67. Two investigations by the Directorate for Priority Crime Investigation were ongoing at the time of the audit. These investigations relate to the possible misappropriation of the municipality's assets and had not been concluded at the date of this auditor's report.

Auditor - General

Mbombela

30 November 2022

AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence

Annexure – Auditor-general's responsibility for the audit

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements and the procedures performed on reported performance information for selected key performance areas and on the municipality's compliance with respect to the selected subject matters.

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 eMalahleni 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 communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and, where applicable, actions taken to eliminate threats or safeguards applied.