Report of the auditor-general to the Eastern Cape Provincial Legislature and council on Nelson Mandela Bay Metropolitan Municipality and its municipal entity

Report on the audit of the consolidated and separate financial statements

Qualified opinion

1. I have audited the consolidated and separate financial statements of the Nelson Mandela Bay Metropolitan Municipality and its municipal entity (group) 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 and statement of cash flows for the year then ended, as well as notes to the consolidated and separate financial statements, including a summary of significant accounting policies.

2. In my opinion, except for the effects of the matters described in the basis for qualified opinion section of my report, the consolidated and separate financial statements present fairly, in all material respects, the financial position of the group as at 30 June 2021, and its financial performance and cash flows for the year then ended in accordance with the Standards of Generally Recognised Accounting Practice (GRAP) and the requirements of the Municipal Finance Management Act 56 of 2003 (MFMA) and the Division of Revenue Act 4 of 2020 (Dora).

Basis for qualified opinion

Property, plant and equipment

3. The municipality did not adequately assess at each reporting date whether there were any indications that the expectations on the useful lives of property, plant and equipment had changed in accordance with GRAP 17, *Property, plant and equipment*. I was unable to determine the impact on property, plant and equipment stated at R17,7 billion (2020: R17,3 billion) in note 9 to the financial statements as well as depreciation stated at R937,8 million and R936,9 million (2020: R957,2 million and R858,3 million) in note 31.1 to the consolidated and separate financial statements, as it was impracticable to do so. There was also an impact on the surplus for the period and on the accumulated surplus which was impracticable to determine.

4. Included in property, plant and equipment are infrastructure assets of R12,9 billion disclosed in note 9 to the consolidated and separate financial statements. I was unable to obtain sufficient appropriate evidence that the municipality had appropriately accounted for and disclosed these assets due to the status of the accounting records. Certain infrastructure assets could not be supported by complete and accurate underlying records. I could not confirm infrastructure assets by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to infrastructure assets.

5. As a result of the misstatements on depreciation, I was unable to obtain sufficient appropriate audit evidence that the municipality correctly calculated unauthorised expenditure in the current year. I was unable to confirm the unauthorised expenditure by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the unauthorised expenditure stated at R849,5 million in note 44.1 to the consolidated and separate financial statements.

Trade receivables - exchange transactions

6. The municipality did not have adequate systems for recording and accounting for indigent debtors. Some indigent subsidies were provided to consumers that did not qualify for the indigent subsides and supporting evidence could not be provided for the indigent subsidies of some consumers. I was unable to determine the full extent of the misstatements to trade receivables from exchange transactions stated at R2,3 billion in note 15 to the consolidated and separate financial statements as well as the related service charges in note 21.1 to the consolidated and separate financial statements, as it was impractical to do so. There was also an impact on the surplus for the period and on the accumulated surplus which was impracticable to determine.

Context for the opinion

7. 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 consolidated and separate financial statements section of my report.

8. 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.

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

Emphasis of matters

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

Restatement of corresponding figures

11. As disclosed in note 40 to the consolidated and separate financial statements, the corresponding figures for 30 June 2020 have been restated as a result of errors identified in the consolidated and separate financial statements of the municipality at, and for the year ended, 30 June 2021.

Material losses and impairment

12. As disclosed in notes 15 and 16 to the consolidated and separate financial statements, material impairment allowances of R3,9 billion (2020: R2,6 billion) and R1,4 billion (2020: R1,1 billion) were made against trade receivables – exchange and non-exchange transactions respectively. The net movement in these impairment allowances together with the bad debt write-offs resulted in an impairment expense of R1,8 billion (2020: R1,1 billion).

13. As disclosed in note 35.9 to the consolidated and separate financial statements, material water losses of R217,1 million (2020: R180,7 million) were incurred, which represented 40% (2020: 43%) of the total water cost. The non-technical losses of 11% were as a result of unauthorised consumption due to theft or illegal use and all technical and administrative inaccuracies associated with customer metering.

14. As disclosed in note 35.10 to the consolidated and separate financial statements, material electricity losses of R651,6 million (2020: R558,6 million) were incurred, which represented 21,63% (2020: 20,3%) of the total electricity purchased. The non-technical losses of 15,6% were as a result of faulty meters, theft through illegal connections and meter tampering.

Underspending on conditional grants

15. As disclosed in note 22.16 to the consolidated and separate financial statements, the urban settlement development grant had an unspent portion amounting to R175,1 million. The grant is used to improve urban land production for the benefit of poor households as well as improving spatial integration and densities.

Other matter

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

Unaudited disclosure note

17. In terms of section 125(2)(e) of the MFMA, the municipality and its municipal entity are required to disclose particulars of non-compliance with the MFMA in the consolidated and separate financial statements. This disclosure requirement did not form part of the audit of the consolidated and separate financial statements and, accordingly, I do not express an opinion on it.

Responsibilities of the accounting officer for the consolidated and separate financial statements

18. The accounting officer is responsible for the preparation and fair presentation of the consolidated and separate financial statements in accordance with the 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 consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.

19. In preparing the consolidated and separate financial statements, the accounting officer is responsible for assessing the group'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 group or to cease operations, or has no realistic alternative but to do so.

Auditor-general's responsibilities for the audit of the consolidated and separate financial statements

20. My objectives are to obtain reasonable assurance about whether the consolidated and separate 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 consolidated and separate financial statements.

21. A further description of my responsibilities for the audit of the consolidated and separate financial statements is included in the annexure to this auditor's report.

Report on the audit of the annual performance report

Introduction and scope

22. 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.

23. 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.

24. 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 - Basic service delivery	x – x

25. 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.

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

KPA 1 - Basic service delivery

Various indicators

27. Adequate systems and processes were not established to enable consistent measurement and reliable reporting of performance against the predetermined indicator definitions. As a result, I was unable to obtain sufficient appropriate audit evidence for the achievements reported in the annual performance report. I was unable to confirm these achievements by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievements for the indicators listed below.

Indicator number	Indicator description	Planned target	Reported achievement
KPI 24	Percentage of complaints/callouts responded to within 24 hours (sanitation/wastewater)	100%	23.78%
KPI 25	Percentage of complaints/ callouts responded to within 24 hours (water)	100%	23.56%

Other matter

28. I draw attention to the matter 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 and management's explanations provided for the under/over achievement 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.

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 legislation are as follows:

Annual financial statements

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

Strategic planning and performance management

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

Asset management

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

Expenditure management

35. Reasonable steps were not taken to prevent irregular expenditure amounting to R1,4 billion as disclosed in note 44.2 to the annual financial statements of the municipality, as required by section 62(1)(d) of the MFMA. The majority of the irregular expenditure was caused by non-compliance with supply chain management (SCM) legislation.

36. Reasonable steps were not taken to prevent unauthorised expenditure, as required by section 62(1)(d) of the MFMA. The full extent of the unauthorised expenditure could not be quantified as indicated in the basis for qualification paragraph. The majority of the disclosed unauthorised expenditure was caused by overspending of the total amount appropriated for certain votes in the approved budget.

Consequence management

37. Irregular expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(b) of the MFMA.

38. Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(b) of the MFMA.

Procurement and contract management

39. Some of the goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1). Similar non-compliance was also reported in the prior year.

40. 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. Similar limitation was also reported in the prior year.

41. Persons in service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest, in contravention of the code of conduct for councillors issued in terms of the Municipal Systems Act 32 of 2000 (MSA) and the code of conduct for staff members issued in terms of the MSA.

Other information

42. 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 consolidated and separate financial statements, the auditor's report and the selected key performance area presented in the annual performance report that have been specifically reported in this auditor's report.

43. My opinion on the consolidated and separate 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.

44. 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 consolidated and separate financial statements and the selected key performance area presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.

45. I have nothing to report in this regard.

Internal control deficiencies

46. I considered internal control relevant to my audit of the consolidated and separate 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 performance report and the findings on compliance with legislation included in this report.

47. There was instability at the leadership and management level of the municipality. In addition, leadership did not stabilise the internal control environment through their oversight role to enable effective reporting on the municipality's financial and performance results, and to ensure compliance with legislative requirements.

48. Management did not consistently implement daily, weekly and monthly financial and performance management disciplines. In addition, key risks relating to financial and performance reporting as well as supply chain management were not actively managed during the year under review.

49. Management's review and monitoring processes for compliance were not effective to ensure compliance with legislative requirements.

Material irregularities

50. 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.

Status of previously reported material irregularities

Payment for services not received: Stormwater drain cleaning: Supplier 1

51. The municipality paid R10,1 million on 19 December 2018 for the provision of stormwater drain cleaning services which were not rendered to the municipality. This resulted in non-compliance with section 65(2)(a) of the MFMA which requires that the municipality have and maintain an effective system of expenditure control relating to the approval, authorisation, and payment of funds. The non-compliance with legislation is likely to result in a material financial loss if the municipality does not recover the money paid to the service provider.

52. The accounting officer was notified of the material irregularity on 13 December 2019 and invited to make a written submission on the actions taken or to be taken to address the matter.

53. An investigation into the matter by the provincial Hawks unit commenced in January 2020 and the municipality is co-operating with the investigation. The municipality has appointed a forensic investigator to assist in quantifying the value of the financial loss incurred and to compile further evidence for the submission to the Hawks unit. On conclusion of the investigation, the municipality intends to pursue the recovery of losses incurred and consequence management against the identified responsible official(s). I will follow up on the investigation and the implementation of the planned actions during my next audit.

Payment for services not received: Stormwater drain cleaning: Supplier 2

54. The municipality paid R10,1 million on 19 December 2018 for the provision of stormwater drain cleaning services which were not rendered to the municipality. This resulted in non-compliance with section 65(2)(a) of the MFMA which requires that the municipality have and maintain an effective system of expenditure control relating to the approval, authorisation, and payment of funds. The non-compliance with legislation is likely to result in a material financial loss if the municipality does not recover the money paid to the service provider.

55. The accounting officer was notified of the material irregularity on 13 December 2019 and invited to make a written submission on the actions taken or to be taken to address the matter.

56. An investigation into the matter by the provincial Hawks unit commenced in January 2020 and the municipality is co-operating with the investigation. The municipality has appointed a forensic investigator to assist in quantifying the value of the financial loss incurred and to compile further evidence for the submission to the Hawks unit. On conclusion of the investigation, the municipality intends to pursue the recovery of losses incurred and consequence management against the identified responsible official(s). I will follow up on the investigation and the implementation of the planned actions during my next audit.

Interest not charged on debtors

57. The municipality did not charge interest on arrears. Debtors who had entered into long-term arrangement agreements with the municipality were not charged interest in the 2018-19 financial year. This resulted in non-compliance with section 64(2)(g) of the MFMA which requires that the municipality charge interest on arrears, except where the council had granted exemptions. The municipality is likely to suffer a material financial loss if interest is not charged on the outstanding accounts and the debt is not recovered.

58. The accounting officer was notified of the material irregularity on 9 December 2019 and invited to make a written submission on the actions taken or to be taken to address the matter.

59. The following actions have been taken to resolve the material irregularity:

- A preliminary investigation completed in February 2020 by the billing coordination division in consultation with the debtor management division, determined that the accounting system was not charging interest on the capital portion that is subject to the arrangement. The outcome of the investigation also indicated that the material irregularity is a result of a system deficiency.

- The accounting system was programmed in February 2020 to raise interest every month. The raising of interest on arrangement debt is now an inherent part of the municipality's accounting system. The municipality has been raising interest on all its interest- bearing long-term arrangements with effect from February 2020.

- The accounting officer prepared and tabled a detailed item to the budget and treasury standing committee in June 2021 and to council for consideration and approval. The accounting officer proposed that interest on arrangements should not be raised retrospectively for the period where the interest on arrangements had not been raised.

60. The material irregularity is resolved.

Revenue for water and sanitation services not calculated on a monthly basis

61. The municipality did not charge for service charges for the year ended 30 June 2019. It was found that 1237 properties were not billed for the sale of water, sanitation and sewerage services provided by the municipality. This resulted in non-compliance with section 64(2)(b) of the MFMA which requires revenue due to the municipality to be calculated on a monthly basis. The municipality is likely to suffer a material financial loss if service charges are not being billed.

62. The accounting officer was notified of the material irregularity on 13 December 2019 and invited to make a written submission on the actions taken or to be taken to address the matter.

63. The following action has been taken to resolve the material irregularity:

- The service level agreement (SLA) between Budget and Treasury, Infrastructure and Engineering and Human Settlements Directorates was signed on 7 July 2021. The SLA outlines the value chain process between Human Settlements, Infrastructure and Engineering Directorate and Budget and Treasury Directorate in respect of the installation of new water meters, as well as linking them to the billing system.

64. The accounting officer further plans to ensure that the following actions are implemented to resolve the material irregularity:

- Monthly reporting to identify properties without water related services on the billing system.
- The monthly report will be sent to the Infrastructure and Engineering Directorate for investigation.
- Monthly meeting to be held between Revenue Management Customer Care Sub-directorate, Infrastructure, and Engineering Directorate.

65. The implementation of the above planned actions will be further followed up during the next audit.

Revenue for water and sanitation services not calculated on a monthly basis

66. The municipality did not charge for service charges for the year ended 30 June 2020. It was found that 7255 properties were not billed for the sale of water, sanitation and sewerage services provided by the municipality. This resulted in non-compliance with section 64(2)(b) of the MFMA which requires revenue due to the municipality to be calculated on a monthly basis. The municipality is likely to suffer a material financial loss if service services are not being billed.

67. The accounting officer was notified of the material irregularity on 1 September 2021 and invited to make a written submission on the actions taken or to be taken to address the matter.

68. The following actions have been taken to resolve the material irregularity:

- The SLA between Budget and Treasury, Infrastructure and Engineering and Human Settlements Directorates was signed on 7 July 2021. The SLA outlines the value chain process between Human Settlements, Infrastructure and Engineering Directorate and Budget and Treasury Directorate in respect of the installation of new water meters, as well as linking them to the billing system.

69. The accounting officer further plans to ensure that the following actions are implemented to resolve the material irregularity:

- Monthly reporting to identify properties without water-related services on the billing system.
- The monthly report will be sent to the Infrastructure and Engineering Directorate for investigation.
- Infrastructure and Engineering Directorate is in the process of reviewing their internal business processes relating to the transfer of meter installation information to the billing system.
- Internal Audit and Risk Assurance to include as part of their audit readiness assessment for 2021-22, the review of the internal controls that have been implemented through the SLA and subsequent standard operating procedures between Budget and Treasury, Infrastructure and Engineering and the Human Settlements Directorates.
- Infrastructure and Engineering Directorate is in the process of procuring additional resources to enable the physical verification of water meters on properties and to enable an improved turnaround time.

70. The implementation of the above planned actions will be further followed up during the next audit.

Other reports

71. In addition to the investigations relating to material irregularities, 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 consolidated and separate financial statements, reported performance information, compliance with applicable legislation and other related matters. These reports did not form part of my opinion on the consolidated and separate financial statements or my findings on the reported performance information or compliance with legislation.

72. In the current year, the Special Investigations Unit conducted an investigation into the construction of toilets meant for informal settlements, in response to the covid-19 pandemic and the provision of facemasks. Not all SCM processes had been followed in the appointment of the service providers. Disciplinary proceedings against the implicated officials are in progress based on the preliminary findings of the investigation.

Auditor-General

East London

28 February 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 consolidated and separate 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.

Financial statements

2. In addition to my responsibility for the audit of the consolidated and separate financial statements as described in this auditor's report, I also:

   - identify and assess the risks of material misstatement of the consolidated and separate 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 consolidated and separate 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 Nelson Mandela Bay Metropolitan 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 consolidated and separate financial statements about the material uncertainty or, if such disclosures are inadequate, to modify my opinion on the consolidated and separate 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 consolidated and separate financial statements, including the disclosures, and determine whether the consolidated and separate financial statements represent the underlying transactions and events in a manner that achieves fair presentation
   - obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group to express an opinion on the consolidated financial statements. I am responsible for the direction, supervision and performance of the group audit. I remain solely responsible for my audit opinion.

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.