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**A U D I T O R - G E N E R A L**  
**S O U T H A F R I C A**

# **OR Tambo District Municipality (Cons.)**

## **Audit Report**

For the year ended 30 June 2018

# Report of the auditor-general to the Eastern Cape Provisional Legislature and the council on OR Tambo District Municipality

## 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 OR Tambo District Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2018, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget information with actual information for the year then ended, as well as the notes to consolidated and separate 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 paragraphs, the consolidated and separate financial statements present fairly, in all material respects, the financial position of the OR Tambo District Municipality as at 30 June 2018 and financial performance and cash flows for the year then ended in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2013 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2017 (Act No. 3 of 2017) (Dora).

### Basis for qualified opinion

#### Commitments

3. The municipality did not correctly recognise its contractual commitments for the acquisition of property, plant and equipment as required by GRAP 17, *Property, plant and equipment (PPE)*. This was due to a lack of systems and processes in place at the municipality to ensure that commitments are correctly disclosed. Consequently, commitments disclosed in note 46 to the consolidated and separate financial statements are overstated by R579,3 million (2016-17: R936,1 million).

#### Property, plant and equipment

4. The municipality did not adequately assess the condition of the assets to determine whether there were any indications that its infrastructure assets may be impaired, as required by GRAP 17, *Property, plant and equipment* and GRAP 21, *impairment of non-cash generating assets*. I was unable to determine the impact of this lack of assessment as it was impractical for me to do so. Furthermore, an unreconciled difference of R96 million was identified between the opening balance in the fixed asset register and the opening balance of **PPE** for 2018, as well as the closing balance of **PPE** for 2017 disclosed in note 9 to the consolidated and separate financial statements. The municipality did not have adequate systems of internal control for reconciling transactions and events to the financial statements. As a result, I was unable to obtain the required evidence by alternative means. Consequently, I was unable to determine whether any adjustments were required to the **PPE** disclosed at R2,8 billion in the statement of financial position and note 9 to the financial statements.

5. The municipality did not recognise all items of **PPE** in accordance with GRAP 17, *Property plant and equipment*. Projects that were completed at year end were not transferred from work in progress to infrastructure. Consequently, infrastructure disclosed in note 9 to the consolidated and separate financial statements is understated by R312,8 million and work in progress disclosed in note 9 to the financial statements is overstated by the same amount.

### **Context for the opinion**

6. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the consolidated and separate financial statements section of this auditor's report.
- 7 I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* (IESBA code) and the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.
8. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

### **Emphasis of matters**

9. I draw attention to the matters below. My opinion is not modified in respect of these matters. **Irregular expenditure**
10. As disclosed in note 57 to the consolidated and separate financial statements, the municipality has accumulated irregular expenditure amounting to R2,9 billion, of which R833,7 million (2016-17: R2,5 billion) was written off during the 2017-18 financial year. Irregular expenditure incurred in the current year amounts to R982,9 million (2016-17: R1 billion). This resulted in a closing balance of R3,1 billion (2016-17: R2,9 billion) at the end of the 2017-18 financial year which has not been investigated by council.

### **Impairment loss**

- 11 As disclosed in note 4 to the consolidated and separate financial statements, material impairment allowances of R623,45 million (2017: R535,44 million) was made against receivables from exchange transactions. The net movement in these allowances together with bad debt write-offs resulted in an impairment expense of R88,7 million (2017: R146,9 million) as disclosed in the statement of financial performance and note 4 to the consolidated and separate financial statements.

### **Material losses**

12. As disclosed in note 60 to the consolidated and separate financial statements, material losses of R21,3 million (2017: R22, million) was incurred, which represents 47.28% (2016-17: 54.13%) of total bulk water purchases.

### **Restatement of corresponding figures**

13. As disclosed in notes 48-50 to the consolidated and separate financial statements, the corresponding figures for 30 June 2017 have been restated as a result of errors discovered during the financial year ended 30 June 2018.

### **Other matter**

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

### **Unaudited disclosure notes**

15. In terms of section 125(2)(e) of the **MFMA**, the entity is required to disclose particulars of noncompliance with this legislation. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

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

16. The accounting officer is responsible for the preparation and fair presentation of the consolidated and separate financial statements in accordance with the SA Standards of CRAP 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.
17. 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 consolidated and separate financial statements**

18. 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.
19. 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.

## Introduction and scope

20. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
21. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to 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.
22. 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 development priorities presented in the annual performance report of the municipality for the year ended 30 June 2018:

Development priorities	Pages in the annual performance report
KPA 1: Basic service delivery and infrastructure	x — x
KPA 4: Local economic development	x — x

23. 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.
- 24 I did not raise any findings on the usefulness and reliability of *KPA4: Local economic development* or on the usefulness of *KPA1: Basic service delivery and infrastructure*. The material findings in respect of reliability of the selected development priorities are as follows:

### KPA 1: Basic service delivery and infrastructure

#### Various indicators

25. I was unable to obtain sufficient appropriate audit evidence for the reported achievements of three of the 80 indicators relating to this programme. This was due to limitations placed on the scope of my work. I was unable to confirm the reported achievements by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievements in the annual performance report of the indicators listed below.

Indicator number	Indicator description	Planned achievement	Reported achievement
1_17_6_P039	Percentage completion of Thornhill	93%	95%
1_17_6_P039	Percentage completion of Libode and Ngqeleni Corridor Bulk Water Supply Scheme (WSS)	45%	45%
1_17_1_P034	Number of indigent households supplied with tanks and gutter for rainwater harvesting	250	50

26. The reported achievement in the annual performance report did not agree to the supporting evidence provided for the indicators listed below. The supporting evidence provided indicated that the achievements of these indicators were as follows:

Indicator number	Indicator description	Reported performance	Audited value
1_17_11_P105	Percentage completion of KSD PIP: Rosedale	93%	76%
1_17_13_P107	Percentage completion of KSD PIP: Libode	96%	92%
1_17_12_P106	Percentage completion of KSD PIP: Mcianduli Corridor	96%	95%
1_18_9_P113	Percentage completion of Northern outfall sewers (bulk waterborne sanitation infrastructure to cover Mthatha West)	98%	15%
1_17_3_P036	Number of indigent households receiving free basic water and sanitation services	153 000	187 000

#### Other matter

27. I draw attention to the matter below.

#### Adjustment of material misstatements

28. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were in the reported performance information of *KPA1: Basic service delivery and infrastructure*. As management subsequently corrected only some of the misstatements, I raised material findings on the reliability of the reported performance information. Those that were not corrected are reported above.

## Achievement of planned targets

29. Refer to the annual performance report on pages x to x; for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings expressed on the reliability of the reported performance information in paragraphs 24 to 26 of this report.

## Responsibilities of the accounting officer for the reported performance information

30. The accounting officer is responsible for the preparation of the annual performance report in accordance with the prescribed performance management and reporting framework, as set out in annexure D to this report, and for such internal control as the accounting officer determines is necessary to enable the preparation of performance information that is free from material misstatement in terms of its usefulness and reliability.

## Auditor-general's responsibilities for the reasonable assurance engagement on the reported performance information

31. My objectives are to obtain reasonable assurance about whether **the** reported performance information for the selected development priorities presented in the annual performance report is free from material misstatement, and to issue a management report that includes my opinion. Reasonable assurance is a high level of assurance but is not a guarantee that the assurance engagement conducted in accordance with the relevant assurance standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if they could reasonably be expected to influence the relevant decisions of users taken on the basis of the reported performance information.

## Report on the audit of compliance with legislation

### Introduction and scope

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

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

### Annual financial statements, performance and annual report

34. The consolidated and separate 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 current assets, expenditure and disclosure items identified by the auditors in the submitted consolidated and separate financial statements were subsequently corrected, but the uncorrected material misstatements resulted in the consolidated and separate financial statements receiving a qualified audit opinion.

### Strategic planning and performance management

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



### **Expenditure management**

36. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
37. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. Most of the disclosed irregular expenditure was caused by non-compliance with supply chain management (SCM) policies.
38. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R21,6 million as disclosed in note 56 to the consolidated and separate financial statements, in contravention of section 62(1)(d) of the MFMA. Most of the disclosed fruitless and wasteful expenditure was caused by interest on overdue accounts.

### **Consequence management**

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

### **Asset management**

40. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.

### **Procurement and contract management**

41. Some of the goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of SCM regulation 17(a) and (c). Similar non-compliance was reported in the prior year.
42. Some of the contracts were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, in contravention of SCM regulation 43. Similar non-compliance was reported in the prior year.
43. Some of the 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 SCM regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations.
44. Some of the contracts were awarded through competitive bidding processes that were not adjudicated by the bid adjudication committee. Similar non-compliance was reported in the prior year.
45. Some of the invitations for competitive bidding were not advertised for a required minimum period of days, in contravention of SCM regulation 22(1) and 22(2).
46. Some of the contracts and quotations were awarded to bidders based on pre-qualification criteria that were not stipulated in the original invitation for bidding and quotations, in contravention of the 2017 preferential procurement regulation 4(1) and 4(2).
47. Some of the construction contracts were awarded to contractors that did not qualify for the contract in accordance with section 18(1) of the CIDB Act and CIDB regulations 17 and 25(7A).

48. Some of the bid documentation for procurement of commodities designated for local content and production, did not stipulated the minimum threshold for local production and content as required by the 2017 preferential procurement regulation 8(2). Similar non-compliance was also reported in the prior year.
49. Some of the commodities designated for local content and production, were procured from suppliers who **did not** submit a declaration on local production and content as required by the 2017 preferential procurement regulation. Similar non-compliance was also reported in the prior year.
50. Some of the commodities designated for local content and production, were procured from suppliers who did not meet the prescribed minimum threshold for local production and content, as required by the 2017 preferential procurement regulation 8(5). Similar non-compliance was also reported in the prior year.
51. Some of the contracts were extended or modified without the approval of a properly delegated official, in contravention of SCM regulation 5.
52. The performance of some of the contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA. Similar non-compliance was also reported in the prior year.

#### Other information

53. 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 those selected development priorities presented in the annual performance report that have been specifically reported in this auditor's report.
54. 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 thereon.
55. 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 priorities presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
56. I did not receive the other information prior to the date of this auditor's report. When I do receive and read this information, if I conclude that there is a material misstatement therein, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to retract this auditor's report and re-issue an amended report as appropriate. However, if it is corrected this will not be necessary.

#### Internal control deficiencies

57. 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 annual performance report and the findings on compliance with legislation included in this report.

Leadership has not established a compliance and performance culture within the municipality. This is further substantiated by the fact that no officials have been held accountable for past unauthorised, irregular and fruitless wasteful expenditure incurred. Leadership's inability to address and prioritise this critical area had a direct bearing on the number of compliance findings reported. Weekly and monthly reconciliations were not prepared for all financial items during the year. This is due to a lack of capacity to execute basic accounting functions. Internal controls were not in place as a limited number of key officials within the finance unit were responsible for performing multiple incompatible functions. Leadership was slow to respond to the recommendations made by the governance structures and external audit relating to the improvement of controls required for good governance and improved financial and performance reporting.

*Auditor-General*

East London

30 November 2018



AUDITOR-GENERAL  
SOUTH AFRICA

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## 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 development priorities 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 related to events or conditions that may cast significant doubt on the O.R Tambo District ability 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 the opinion on the 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 continuing as a going concern
  - evaluate the overall presentation, structure and content of the consolidated and separate financial statements, including the disclosures, and whether the consolidated and separate financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

### Communication with those charged with governance

- 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.
- I also confirm to the accounting officer 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, related safeguards.**