



CHRIS HANI DISTRICT MUNICIPALITY (Cons.)

Audit Report

For the year ended 30 June 2021



**AUDITOR - GENERAL
SOUTH AFRICA**

Auditing to build public confidence

Report of the auditor-general to the Eastern Cape Provincial Legislature and the council on the Chris Hani District Municipality

Report on the audit of the consolidated and separate financial statements

Disclaimer of opinion

1. I was engaged to audit the consolidated and separate financial statements of the Chris Hani District Municipality set out on pages ... to ..., which comprise the consolidated and separate statements of financial position as at 30 June 2021, the consolidated and separate financial statements performance, statement of changes in net assets and cash flow statement and statement of comparison of budget information with actual for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. I do not express an opinion on the consolidated and separate financial statements of the municipality because of the significance of the matters described in the basis for a disclaimer of opinion section of my report. I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

Basis for disclaimer of opinion

Property, plant and equipment

3. The municipality did not assess all assets for impairment in accordance with the Standards of Generally Recognised Accounting Practice (GRAP) 21, *Impairment of non-cash-generating assets*. Damaged and vandalised assets were included in the infrastructure assets without being impaired and the useful lives of fully depreciated movable assets have not been reassessed. The Agency did not account for its property, plant and equipment in accordance with GRAP 17, *Property plant and equipment*. I could not confirm the impairment by alternative means. Consequently, I was unable to determine the full extent of the overstatement of property, plant and equipment stated at R4,6 billion (2020: R4,3 billion), impairment loss stated at R8,2 million (2020: R73 768), and depreciation stated at R181,5 million (2020: R159,8 million) in the consolidated and separate financial statements.

Revenue from exchange transactions

4. The municipality did not recognise revenue from service charges in accordance with GRAP 9, *Revenue from exchange transactions* due to inadequate systems in place for revenue management. Revenue was billed using incorrect rates, incorrect consumption units were used, some customers were not billed throughout the year and sufficient appropriate audit evidence could not be obtained to verify the averages used for billing throughout the year. I could not confirm the amounts by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to service charges, stated at R370,6 million (2020: R300,5 million) in the consolidated and separate financial statements.

Receivables from exchange transactions

5. I was unable to obtain sufficient appropriate audit evidence for receivables from exchange transactions due to the limitations and disagreement of revenue from exchange transactions, which had an impact on the receivables from exchange transactions. I could not confirm the amounts by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to receivables from exchange transactions stated at R383,5 million (2020: R315,3 million) and the debt impairment expense stated at R304,2 million (2020: R278,9 million) in the financial statements, and interest revenue from debtors stated at R62,8 million (2020: R57,8 million) in note 24 to the consolidated and separate financial statements

Revenue from non-exchange transactions

6. The municipal entity did not recognise revenue from non-exchange transactions in accordance with GRAP 23, *Revenue from non-exchange transactions*. The municipal entity did not account for revenue and expenditure from conditional grants although conditions were met. As a result, revenue from non-exchange transactions were understated by R13.6 million and expenditure understated by R13,6 million.

VAT payable/receivable

7. I was unable to obtain sufficient appropriate audit evidence for VAT payable/receivable due to the limitations and disagreements of receivables from exchange transactions and revenue from exchange transactions, which have an impact on the calculation of VAT receivable. I could not confirm the amounts by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to VAT receivable and VAT payable, stated at R1,3 billion and R1,3 billion (2020: R1,1 billion and R1,0 billion) respectively in note 12 to the consolidated and separate financial statements

Unspent conditional grants and receipts

8. I was unable to obtain sufficient appropriate audit evidence for unspent conditional grants and receipts, as the municipality did not maintain accurate and complete records of amounts received from provincial and national government departments. I could not confirm the amounts by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to unspent conditional grants and receipts, stated at R83,2 million (2020: R77,2 million) in note 17 to the consolidated and separate financial statements.

General expenses

9. The municipality did not recognise general expenses in accordance with GRAP1, *Presentation of financial statements*. The municipality recorded general expenses inaccurately using amounts paid as compared to amount incurred and customers who do not qualify for indigent subsidies received subsidies. As a result, general expenses were overstated by R36,8 million (2020: R18,6 million), payables was overstated by R21,2 million (2020: R37,7 million) and receivables from exchange transactions was understated by R2,0 million (2020: R1,4 million).

Irregular expenditure

10. The municipality did not have adequate systems to identify and disclose all irregular expenditure during the year, as required by section 125(2)(d)(i) of the MFMA. The irregular expenditure for the year under review and the previous year, disclosed in note 38 to the consolidated and separate financial statements is understated. As a result, irregular expenditure is understated by R77,7 million.

Cash flow statement

11. I was unable to obtain sufficient appropriate audit evidence for other prior year movements and prior year adjustments included in net cash flows from operating activities, due to the poor state of accounting records, as supporting documents to substantiate the reversals and movements were not submitted. The municipality also incorrectly included Interest from debtors as part of payments to suppliers. I could not confirm these movements by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to net cash flows from operating activities, stated at R659,9 million (2020: R21,5 million).
12. Furthermore, in my previous year's audit report, I modified my opinion on prior year other movements included in cash flows from investing activities and movement in other financial liabilities included in cash flow from financing activities, due to the poor state of accounting records, as supporting documents to substantiate the reversals and movements were not submitted. I could not confirm these movements by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to net cash flows from investing activities corresponding figure stated at R309,9 million, and cash flow from financing activities corresponding figure stated at R0 in the cash flow statement.

Commitments

13. The municipality did not recognise commitments in accordance with GRAP 17, *Property, plant and equipment*. The municipality did not recognise all capital commitments as required by GRAP 17. As a result, commitments was understated by R278,3 million (2020: R14,9 million).

Corresponding figures

Revenue from non-exchange transactions

14. The municipality did not recognise revenue from non-exchange transactions in accordance with GRAP 23, *Revenue from non-exchange transactions*. The municipality double-counted the VAT portion to be recognised as government grants and subsidies from expenditure on conditional grants. As a result, revenue from non-exchange transactions were overstated by R48,7 million and unspent conditional grants understated by R48,7 million.

Payables from exchange transactions

15. The municipality did not recognise trade payables in accordance with GRAP1, *Presentation of financial statements*, due to an inadequate credit management system in place, as trade payables included amounts for goods and services that had not been received at year-end and the creditors listing did not agree with the consolidated and separate statements.. As a

result, payables from exchange transactions as well as expenditure were both overstated by R37,7 million.

Water distribution losses

16. I was unable to obtain sufficient appropriate audit evidence for water distribution losses due to the limitations of revenue from service charges, which had an impact on the calculation of water distribution losses. I could not confirm the amounts by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to water distribution losses, stated at R6,9 million (2020: R182,1 million) in note 56 to the consolidated and separate statements..

Aggregation of immaterial uncorrected misstatements

17. Total current assets were materially misstated by R18,7 million due to the cumulative effect of individually immaterial uncorrected misstatements in the following items:
- Inventory, stated at R17,1 million, was overstated by R11,2 million.
 - Cash and cash equivalents, stated at R42,2 million, was understated by R7,7 million.

Emphasis of matter

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

Restatement of corresponding figures

19. As disclosed in note 43 to the consolidated and separate statements., the corresponding figures for 30 June 2020 were restated because of errors in the consolidated and separate financial statements of the municipality at, and for the year ended, 30 June 2021.

Other matter

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

Unaudited disclosure notes

21. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the consolidated and separate statements and, accordingly, I do not express an opinion on it.

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

22. The accounting officer is responsible for the preparation and fair presentation of the consolidated and separate statements in accordance with the GRAP and the requirements of the Municipal Finance Management Act 56 of 2003 (MFMA) and the Division of Revenue Act 4 of 2020 (Dora), and for such internal control as the accounting officer determines is

necessary to enable the preparation of consolidated and separate statements that are free from material misstatement, whether due to fraud or error.

23. In preparing the consolidated and separate 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

24. 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 separate financial statements.

Report on the audit of the annual performance report

Introduction and scope

25. 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 programmes presented in the annual performance report. I performed procedures to identify material findings but not to gather evidence to express assurance.
26. 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.
27. 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 programme 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 2 – basic service delivery and infrastructure development	x – x

28. 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.
29. The material findings on the usefulness of the performance information of the selected programmes are as follows:

KPA 2 – basic service delivery and infrastructure development

Various indicators

30. For the following indicators, measures taken to improve performance could not be corroborated:

Indicator code	Remedial action
SDI 1 – number of households served with quality basic water	Measures taken to improve performance were not disclosed in the APR
SDI 6 – number of households served with safe basic sanitation	Committees to process bid SMME to commence work in the 2021-22 financial year.

Other matter

31. I draw attention to the matter below.

Achievement of planned targets

32. 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 finding on the usefulness of the reported performance information in paragraph 29 of this report.

Adjustment of material misstatements

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

Report on the audit of compliance with legislation

Introduction and scope

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

Annual financial statements, performance reports and annual reports

36. 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 identified by the auditors in the submitted financial statements were not adequately corrected and the supporting records could not be provided subsequently, which resulted in the financial statements receiving a disclaimer of audit opinion.

Expenditure management

37. 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 disclaimer paragraph. The majority of the disclosed irregular expenditure was caused by the extension of contracts without following necessary supply chain management (SCM) regulations, procurement not being in line with SCM regulations 12(3), 32 and 36, and preferential procurement regulation 8(5).
38. Reasonable steps were not taken to prevent fruitless and wasteful expenditure of R456 109 (2020: R683 798) disclosed in note 47 to the financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed fruitless and wasteful expenditure was caused by interest charged by creditors due to the municipality not paying invoices on due dates.
39. Reasonable steps were not taken to prevent unauthorised expenditure of R392,4 million (2020: R135,6 million) disclosed in note 36 to the financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by overspending incurred by the municipality in its different votes.
40. An adequate management, accounting and information system that recognised expenditure when it was incurred, accounted for creditors and accounted for payments made was not in place, as required by section 65(2)(b) of the MFMA.

Revenue management

41. An adequate management accounting and information system that accounts for debtors and revenue was not in place, as required by section 64(2)(e) of the MFMA.
42. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

Asset management

- 43. An adequate management, accounting and information system that accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
- 44. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

Consequence management

- 45. Some unauthorised expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(a) of the MFMA.
- 46. Some 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.

Conditional grants

- 47. Portions of funds received from the municipal infrastructure grant and regional bulk infrastructure grant were transferred to the Chris Hani Development Agency (CHDA) based on a payment schedule that was not approved by the National Treasury, as required by section 17(3) of Dora.

Procurement and contract management

- 48. Some 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 preferential procurement regulation 8(5).
- 49. Some 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 preferential procurement regulation 8(5).
- 50. Goods or services procured under contracts secured by other organs of state were not procured in accordance with SCM regulation 32, as the municipality procured beyond the scope of the original contract.

Other information

- 51. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report, which includes the audit committee's report. The other information does not include the consolidated and separate financial statements, the auditor's report and those selected programmes presented in the annual performance report that have been specifically reported in this auditor's report.
- 52. 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.

53. 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 programmes presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
54. 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

55. 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 disclaimer of opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.
56. There was insufficient oversight to ensure consistent implementation and monitoring of controls over financial and performance information, and compliance with legislation. This was mainly due to a lack of capacity and accountability as well as inadequate communication between departments within the municipality.
57. Consequence management was not implemented against officials who were responsible for incurring irregular, and fruitless and wasteful, and unauthorised expenditure.
58. The municipality did not have a proper system of records management for the financial environment as a whole, as material misstatements were identified, resulting in a disclaimer of opinion. In addition, inadequate integration between the budget and treasury office and other departments within the municipality contributed to material misstatements identified during the audit process, especially within SCM and engineering.
59. The municipality did not have adequate systems to monitor compliance with all applicable legislation and, as a result, non-compliance with legislation was not prevented. There was inadequate supervision, monitoring and consequence management in managing the operations of the municipality.
60. The report with recommendations provided by the internal audit unit was not implemented promptly and adequately by management to address or reduce findings raised through the external audit process. In addition, although the audit committee reviews the municipality's performance management system quarterly, the reviews did not have a positive impact on improving internal controls, as material findings were still identified through the audit process.

61. Although the municipality developed an audit action plan to address audit findings, it was not implemented throughout the year because the previous year's audit report was completed late due to covid-19 restrictions. This resulted in recurring material misstatements in the current year.
62. The municipality is year-end driven and the review of monthly financial reports was not adequate. Material differences in underlying records were identified in numerous line items of the financial statements during the audit process, and resulted in a disclaimer of audit opinion. These differences should have been identified and corrected before the start of the audit process.

Material irregularities

63. In accordance with the PAA and the Material Irregularity Regulations, I have a responsibility to report on material irregularities identified during the audit and on the status of the material irregularities reported in the previous year's auditor's report.

Material irregularity in progress:

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

Other reports

65. 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 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.
66. The Directorate for Priority Crime Investigation (Hawks) are investigating allegations of maladministration, corruption and tender irregularities in the procurement process of ventilated improved pit toilets.
67. At the date of this report, the investigation was still in progress.

Auditor-General

East London

31 January 2022



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence