

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

## **Report on the consolidated and separate financial statements**

### **Introduction**

1. I audited the consolidated and separate financial statements of the Chris Hani District Municipality set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2016, the consolidated and separate statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### **Accounting officer's responsibility for the consolidated and separate financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of the consolidated and separate financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2015 (Act No. 1 of 2015) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of the consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-general's responsibility**

3. My responsibility is to express an opinion on the consolidated and separate financial statements based on my audit. I conducted my audit in accordance with the International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the consolidated and separate financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated and separate financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated and separate financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated and

separate financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated and separate financial statements.

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

## **Basis for qualified opinion**

### Receivables from exchange transactions

6. The municipality did not bill all consumers for all 12 months in the financial year under review. As a result, receivables from exchange transactions as disclosed in note 12 to the consolidated and separate financial statements was understated by R40,98 million and revenue from exchange transactions was understated by the same amount. In addition, sufficient appropriate audit evidence was not available to support receivables from exchange transactions as a result of the status of the accounting records. I was unable to confirm the amount by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to receivables from exchange transactions and allowance for impairment of R975,21 million (2014-15: R677,66 million) and R863,86 million (2014-15: R341,46 million), respectively, as disclosed in note 12 to the consolidated and separate financial statements.
7. GRAP 104: *Financial instruments*, requires that an analysis by class of the age of financial assets that are past due but not impaired be recorded in the notes to the financial statements. Although the municipality did make the necessary disclosure in note 12 to the consolidated and separate financial statements, sufficient appropriate audit evidence was not available to support the amounts recorded per analysis by class of age as a result of inadequate recording of amounts in the age -analysis. I was unable to confirm the amount by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the amounts recorded in note 12 to the consolidated and separate financial statements.

### Revenue from exchange transactions

8. The municipality did not apply the correct tariffs as per the approved tariff policy and did not bill all consumers for water consumed during the financial year under review. As a result, service charges as disclosed in the statement of financial performance and note 21 to the consolidated and separate financial statements was overstated by R116,67 million and receivables from exchange transactions was overstated by the same amount. In addition, sufficient appropriate audit evidence was not available for service charges due to the absence of underlying accounting records. I was unable to confirm the amount by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to service charges of R335,76 million (2014-15: R185,22 million) as disclosed in the statement of financial performance and note 21 to the consolidated and separate financial statements.

## Commitments

9. GRAP 17, *Property, plant and equipment* requires disclosure of contractual commitments for the acquisition of property, plant and equipment. The municipality did not fully comply with this requirement as the manual commitments register prepared was found to have numerous deficiencies, in that commitments were included in the commitments register at the incorrect amounts, and not all commitments of the municipality were identified and included in the register. Consequently, the net overstatement of commitments as disclosed in note 39 to the consolidated financial statements was R338, 32 million.
10. Further, not all contracts supporting the original capital commitment raised could be provided to substantiate the disclosed amount for commitments. Due to the non-availability of sufficient appropriate audit evidence I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any adjustments were required to commitments of R1,07 billion as disclosed in note 39 to the consolidated financial statements.

## Irregular expenditure

11. 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)(i) of the MFMA. The irregular expenditure disclosed in disclosure note 51 to the consolidated financial statements was understated in respect of R202,58 million incurred during the year that was identified during the audit process. Due to the lack of systems and lack of sufficient appropriate audit evidence for all awards, it was impracticable to determine the full extent of the understatement of irregular expenditure disclosed at R1,20 billion (2015: R1,11 billion) disclosed in note 51 to the consolidated financial statements. Consequently, I was unable to determine whether any further adjustments were necessary to the irregular expenditure disclosure note.

## Water distribution losses

12. Section 125(2)(d)(i) of the MFMA states that the notes to the annual financial statements of a municipality must disclose particulars of any material losses. Water distribution losses of R40,91 million were disclosed in note 55 to the consolidated financial statements. I was unable to obtain audit assurance that distribution losses that should have been recorded, were recorded and that distribution losses were recorded at an appropriate amount. This was as a result of the municipality not being able to provide sufficient appropriate audit evidence to support these amounts. I was unable to perform alternative procedures due to a lack of controls over the recording of these losses. Consequently, I was unable to determine whether any adjustments were necessary to the water distribution losses disclosure note.



## **Qualified opinion**

13. 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 Chris Hani District Municipality as at 30 June 2016 and its financial performance and cash flows for the year then ended, in accordance with the SA standards of GRAP and the requirements of the MFMA and DoRA.

## **Emphasis of matters**

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

### Restatement of corresponding figures

15. As disclosed in note 46 to the consolidated financial statements, the corresponding figures for 30 June 2015 have been restated as a result of errors discovered during the year ended 30 June 2016 in the financial statements of the municipality at, and for the year ended, 30 June 2015.

### Unauthorised expenditure

16. As disclosed in note 49 to the consolidated financial statements, the municipality incurred unauthorised expenditure of R183,44 million (2014-15: R218,55 million) during the year. This was as a result of the overspending of the total amount appropriated for the budget and treasury office, technical services and roadworks votes in the municipality's approved budget.

### Fruitless and wasteful expenditure

17. As disclosed in note 50 to the consolidated financial statements, the municipality incurred fruitless and wasteful expenditure of R887 224 (2014-15: R1,07 million) during the year. This was due to interest on late payments of R736 542 and payments in respect of advertisement costs incurred in respect of cancelled tenders of R150 682.

## **Additional 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 entity is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the separate financial statements and, accordingly, I do not express an opinion thereon.

## Report on other legal and regulatory requirements

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 raise findings on the reported performance information against predetermined objectives of the selected Key Performance Area (KPA) 1: Basic service delivery and infrastructure development presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

### **Predetermined objectives**

21. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information of the selected KPA 1: Basic service delivery and infrastructure development presented on pages x to x in the annual performance report of the municipality for the year ended 30 June 2016.
22. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned KPA. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's Framework for managing programme performance information (FMPPI).
23. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
24. The material findings in respect of the selected KPA are as follows:

#### Usefulness of reported performance information

### **Measurability of indicators and targets**

25. The FMPPI requires that performance indicators should be clearly defined so that data can be collected consistently and is easy to understand and use. A total of 46% of indicators were not well defined.
26. The FMPPI requires that performance targets should be specific in clearly identifying the nature and required level of performance. A total of 50% of targets were not specific.
27. The FMPPI requires that performance targets should specify the period or deadline for delivery. A total of 21% of targets were not time bound.

## **Reliability of reported performance information**

28. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to insufficient appropriate supporting documentation.

## **Additional matters**

29. I draw attention to the following matters:

### **Achievement of planned targets**

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

### **Adjustment of material misstatements**

31. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of KPA 1: Service delivery and infrastructure development. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information.

## **Compliance with legislation**

32. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

## **Strategic planning and performance**

33. The performance management system and related controls were not maintained as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting and improvement and how it is conducted, organised and managed, as required by section 38 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) and regulation 7 of the Municipal planning and performance management regulations (GNR 796 of 24 August 2001).

## **Annual financial statements and performance report**

34. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of current assets, non-current assets, liabilities, irregular expenditure and unauthorised expenditure identified by the auditors in the submitted financial statements were subsequently corrected. However, the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.
35. The annual performance report for the year under review did not include measures taken to improve performance as required by section 46(1)(c) of the Municipal Systems Act.

## **Expenditure management**

36. Reasonable steps were not taken to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
37. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

## **Revenue management**

38. A tariff policy was not implemented for the levying of fees for provision of municipal services, as required by section 74(1) of the Municipal Systems Act and section 62(1)(f)(i) of the MFMA.
39. A credit control and debt collection policy was not implemented, as required by section 96(b) of the Municipal Systems Act and section 62(1)(f)(iii) of the MFMA.
40. An adequate management, accounting and information system which accounts for revenue and debtors was not in place, as required by section 64(2)(e) of the MFMA.
41. An effective system of internal control over debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.
42. Revenue due to the municipality was not calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.
43. Accounts for charges for municipal services were not prepared on a monthly basis, as required by section 64(2)(c) of the MFMA.
44. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

## **Human resource management**

45. The municipality did not adopt appropriate systems and procedures to monitor, measure and evaluate performance of all staff in contravention of section 67(d) of the Municipal Systems Act.



## **Liability management**

46. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the MFMA.

## **Asset management**

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

## **Consequence management**

48. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person was liable for the expenditure, as required by sections 32(2)(a) and (b) of the MFMA.

## **Procurement and contract management**

49. I could not obtain sufficient appropriate audit evidence that all contracts and quotations were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as proper record management was not in place.
50. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of Supply Chain Management (SCM) regulation 17(a) and (c).
51. I could not obtain sufficient appropriate audit evidence that bids were evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services and at least one supply chain management practitioner of the municipality as required by SCM regulation 28(2).
52. I could not obtain sufficient appropriate audit evidence that contracts were awarded to bidders based on points given for criteria that were stipulated in the original invitation for bidding and quotations, as required by SCM regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations.
53. I could not obtain sufficient appropriate audit evidence that bid adjudication committees were always composed in accordance with SCM regulation 29(2).
54. Awards were made to bidders other than those recommended by the bid evaluation committee without ratification by the accounting officer, as required by SCM regulation 29(5)(b).
55. The preference point system was not applied in all procurement of goods and services above R30 000, as required by section 2(a) of the Preferential Procurement Policy Framework Act (PPPFA) and SCM regulation 28(1)(a).
56. Contracts were awarded to bidders based on preference points that were not calculated in accordance with the requirements of the PPPFA and its regulations.
57. Contracts were awarded to bidders that did not score the highest points in the evaluation process, in contravention of section 2(1)(f) of the PPPFA.



58. 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 SCM regulation 46(2)(e).
59. I could not obtain sufficient appropriate audit evidence that contracts were only awarded to providers whose tax matters had been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.
60. I could not obtain sufficient appropriate audit evidence to confirm that measures to combat the abuse of the SCM system were implemented as per the requirements of SCM regulation 38(1). Awards were made to providers who:
- during the last five years, failed to perform satisfactorily on a previous contract with the municipality
  - committed a corrupt or fraudulent act in competing for the contract
  - abused the SCM system of the municipality
  - had been convicted of fraud or corruption during the past five years.

### **Internal control**

61. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

### **Leadership**

62. There was insufficient oversight to ensure consistent implementation and monitoring of controls over financial, 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. The inadequate performance information reporting prevented the municipality from adequately monitoring the achievement of its objectives.
63. Consequence management was not implemented against officials who were responsible for incurring unauthorised, irregular and fruitless and wasteful expenditure, as investigations were not executed during the year under review.

### **Financial and performance management**

64. 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 qualified audit opinion. In addition, inadequate integration between the budget and treasury office and other departments within the municipality also contributed to material misstatements identified during the audit process.

65. The supporting information was not maintained for performance reporting. There was a lack of information relating to the collection, collation, verification, storing and reporting of actual performance information and the setting of performance targets. This was due to the municipality not having approved standard operating procedures to ensure that all documentation is properly maintained for performance management and not preparing complete, accurate and reliable monthly and quarterly performance reports. As a result, the municipality did not identify errors timeously, resulting in material misstatements not corrected.
66. 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 respect of management of the operations of the municipality. As a result, inadequate steps were taken to prevent and detect the incurrence of unauthorised, irregular and fruitless and wasteful expenditure, and this promoted the culture of acceptability of non-compliance with legislation.

## **Governance**

67. The reporting provided by the internal audit was not timely resulting in recommendations by internal audit not adequately implemented by management to address or reduce findings identified through the external audit process. In addition, the audit committee did not review the municipality's performance management system adequately throughout the financial year and did not make recommendations to the council in this regard.
68. The fraud prevention plan was last reviewed and updated during September 2013 and as a result controls were not timeously designed and implemented to mitigate risks that exist over financial, service delivery and compliance processes for the year under review.

*Auditor-General*

East London

15 December 2016



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*