

Report of the auditor-general to the Eastern Cape Provincial Legislature and the Council on Nelson Mandela Bay Metropolitan 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 Nelson Mandela Bay Metropolitan Municipality and its subsidiaries set out on pages 1 to 103 (Volume II), which comprise the consolidated and separate statement of financial position as at 30 June 2018, the consolidated and separate statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the 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 this auditor's report, the consolidated and separate financial statements present fairly, in all material respects, the consolidated and separate financial position of the Nelson Mandela Bay Metropolitan Municipality as at 30 June 2018, and the group's 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, 2003 (Act no. 56 of 2003) (MFMA) and Division of Revenue Act, 2017 (Act no.3 of 2017) (Dora).

Basis for qualified opinion

Exchange revenue – service charges

3. The municipality did not bill for and record all revenue owing to it for services rendered, as required by SA Standard of GRAP 9, *Revenue from exchange transactions*. This was related to service charge revenue from the assistance to the poor (ATTP) subsidy. Consequently, service charge revenue was understated by R86,8 million, with a corresponding understatement on trade receivables - exchange transactions. In addition, I was unable to obtain sufficient and appropriate audit evidence that electricity revenue of R3,5 billion was fully accounted for, due to poor controls over the management of prepaid meters. I was unable to confirm this electricity revenue through alternative means. Consequently, I was unable to determine if any further adjustments were necessary to service charge revenue stated at R5,2 billion in note 21.1 of the consolidated and separate financial statements.

Property, plant and equipment (PPE)

4. The municipality did not adequately assess whether there were any indications that its expectations on the useful lives of PPE (moveable and immovable assets) had changed, as required by SA Standard of GRAP 17, *Property, plant and equipment*. In addition, I was unable to obtain sufficient appropriate audit evidence to confirm that land was registered in the name of the municipality nor could I physically verify all moveable assets due to the status of accounting records. I was unable to confirm PPE through alternative means. Consequently,

I was unable to determine whether any adjustments were necessary to PPE stated at R16,5 billion (2016-17: R15,4 billion) as disclosed in note 9 to the consolidated and separate financial statements and the depreciation expenses of R636,8 million (2016-17: R301,2 million) as disclosed in note 31.1 to the consolidated and separate financial statements.

Intangible assets

5. The municipality did not adequately assess whether there were any indications that its expectations on the useful lives of intangible assets had changed, as required by SA Standard of GRAP 31, *Intangible assets*. In addition, I was unable to obtain sufficient appropriate audit evidence for intangible assets as they could not be physically verified, due to the status of accounting records. I was unable to confirm intangible assets through alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the intangible assets stated at R442,7 million (2016-17: R83,4 million) as disclosed in note 11 to the consolidated and separate financial statements and the amortisation expense of R356,7 million (2016-17: R6,8 million) as disclosed in note 31.2 to the consolidated and separate financial statements.

Irregular expenditure

6. The municipality did not have proper systems in place to identify and record all irregular expenditure disclosed in note 44.2 to the consolidated and separate financial statements, as required by section 125(2)(d) of the MFMA. This expenditure resulted from payments made in contravention of the supply chain management (SCM) requirements. I was unable to confirm the amount of irregular expenditure by alternative means and it was impracticable to determine the full extent of the understatement of irregular expenditure. Consequently, I was unable to determine whether any adjustments were necessary to the irregular expenditure disclosed at R12,4 billion (2016-17: R11,6 billion) in the consolidated and separate financial statements.

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 this auditor's report.
8. 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.
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 2017 were restated as a result of an error in the consolidated and separate financial statements of the municipality at, and for the year ended, 30 June 2018.

Material losses and impairments

12. As disclosed in note 15 and 16 to the consolidated and separate financial statements, material impairment allowances of R1,8 billion (2016-17: R1,3 billion) and R831,9 million (2016-17: R701,7 million) were made against trade receivables - exchange transactions and other receivables – exchange and non-exchange transactions. The net movement in these allowances together with the bad debt write-offs resulted in an impairment expense of R872,7 million (2016-17: R603,5 million).

13. As disclosed in note 35.10 to the consolidated and separate financial statements, material water losses of R152,9 million (2016-17: R169,7 million) were incurred, which represents 41,1% (2016-17: 35,5%) of total water purchased. The non-technical losses of 39,1% are a result of physical losses, theft, illegal water drawn from fire hydrants and meter inaccuracies.

14. As disclosed in note 35.11 to the consolidated and separate financial statements, material electricity losses of R339,5 million (2016-17: R326,2 million) were incurred, which represents 13,95% (2016-17:13.6%) of total electricity purchased. The non-technical losses of 5% was as a result of faulty meters, theft from illegal connections and meter tampering.

Unauthorised expenditure

15. As disclosed in note 44.1 to the consolidated and separate financial statements, the municipality incurred unauthorised expenditure of R260,2 million (2016-17: R431,9 million), as the total actual expenditure per budget vote exceeded the approved adjustments budget for certain directorates, which included non-cash items.

Fruitless and wasteful expenditure

16. As disclosed in note 44.3 to the consolidated and separate financial statements, the municipality accumulated fruitless and wasteful expenditure of R659,2 million (2016-17: R656,5 million) in previous years that was not investigated.

Responsibilities of accounting officer for the financial statements

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

18. In preparing the consolidated and separate financial statements, the accounting officer is responsible for assessing the Nelson Mandela Bay Metropolitan 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

19. 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.

20. 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

21. 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 priority presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.

22. 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.

23. 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 priority presented in the annual performance report of the municipality for the year ended 30 June 2018:

Development priority	Pages in the annual performance report
KPA 1 –Basic service delivery	294 – 298 (Volume I)

24. 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.
25. I did not raise any material findings on the usefulness of the reported performance information for this development priority. The material findings in respect of the reliability of the selected development priority are as follows:

KPA 1- Basic service delivery

Indicator: Percentage year-to-year reduction in electrical power outages on the high voltage network

26. The reported achievement of 6,67% for the target of 8% is not reliable as the municipality did not have an adequate performance management system to maintain records to enable reliable reporting on achievement of targets. As a result, I was unable to obtain sufficient appropriate audit evidence in some instances while in other cases the supporting evidence provided did not agree to the reported achievement. Based on the supporting evidence that was provided I was unable to further confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any further adjustments were required to the reported achievement.

Indicator: Average response time to emergencies within Nelson Mandela Bay

27. I was unable to obtain sufficient appropriate audit evidence for the reported achievement for this indicator which had a planned response time of 15 minutes for both traffic and fire emergencies. This was due to limitations placed on the scope of my work. I was unable to confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievements of 7 minutes 29 seconds for traffic emergencies and 12 minutes 16 seconds for fire emergencies.

Other matters

28. I draw attention to the matters below.

Achievement of planned targets

29. Refer to the annual performance report on pages 293 to 305 (Volume I) for information on the achievement of planned targets for the year. This information should be considered in the context of material findings on the usefulness and reliability of the reported performance information in paragraphs 26 to 27 of this report.

Adjustment of material misstatements

30. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of KPA 1 – basic service delivery. 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.

Report on the audit of compliance with legislation

Introduction and scope

31. 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.
32. The material findings on compliance with specific matters in key legislations are as follows:

Consolidated and separate annual financial statements

33. 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 disclosure items identified by the auditors in the submitted consolidated and separate 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 consolidated and separate financial statements receiving a qualified audit opinion.

Strategic planning and performance management

34. The performance management system and related controls were not maintained as it did not describe how the performance review and improvement processes should be organised, as required by section 7(1) of the municipal planning and performance management regulations.

Revenue management

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

Expenditure management

36. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The expenditure disclosed does not reflect the full extent of the irregular expenditure incurred as indicated in the basis for qualification paragraph. Irregular expenditure of R2,7 billion was as a result of non-compliance with SCM regulations.
37. Reasonable steps were not taken to prevent fruitless and wasteful expenditure of R2,9 million, as disclosed in note 44.3 to the consolidated and separate financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed fruitless and wasteful expenditure was caused by expenditure incurred in vain.
38. Reasonable steps were not taken to prevent unauthorised expenditure of R260,2 million, as disclosed in note 44.1 to the consolidated and separate financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused

by over expenditure on budget allocated to the affected votes. Unauthorised expenditure of R260,2 million was incurred on safety and security and water services projects.

Asset management

39. 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.
40. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

Consequence management

41. Unauthorised expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a) of the MFMA.
42. Irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA and section 75(1) of the municipal budget and reporting regulations.
43. Losses resulting from irregular expenditure were certified by council as irrecoverable without having conducted an investigation to determine the recoverability of the expenditure, in contravention of section 32(2)(b) of the MFMA.

Procurement and contract management

44. Sufficient appropriate audit evidence could not be obtained that contracts were awarded only to bidders who submitted a declaration on whether they were employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
45. Some of the competitive bids were adjudicated by a bid adjudication committee that was not composed in accordance with SCM regulation 29(2).
46. Some of the contracts were awarded to bidders that did not score the highest points in the evaluation process, as required by section 2(1)(f) of the Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000) and Preferential Procurement Regulations (PPR) of 2017. Similar non-compliance was also reported in the prior year.
47. 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 regulation 8(5) of the PPR. Similar non-compliance was also reported in the prior year.
48. Sufficient appropriate audit evidence could not be obtained that all extensions or modifications to contracts were approved by a properly delegated official, as required by SCM regulation 5.
49. 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.

50. The contract performance and monitoring measures and methods were not sufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
51. Persons in the service of the municipality who 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), the code of conduct for councillors issued in terms of the Municipal Systems Act, 2000 (Act no. 32 of 2000) (MSA) and the code of conduct for staff members issued in terms of the MSA.
52. 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).

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 the selected development priority 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 development priority presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
56. If, based on the work I have performed on the other information obtained prior to the date of this auditor's report, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

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 performance information and the findings on compliance with legislation included in this report.
58. Leadership did not take decisive steps to implement adequate consequence management, action plans, and key controls, nor monitor policies and procedures in a manner that promoted a sound control environment for the municipality. Consequently daily, weekly and monthly financial and performance management disciplines were not consistently implemented. Systemic weaknesses in information technology (IT) systems that were

reported on for many years were not addressed. Key risks relating to financial and performance reporting and supply chain management were not actively managed during the year under review.

Other reports

59. I draw attention to the following engagements conducted by various parties that 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.

Investigations

60. There were 38 investigations during the year under review, three have been finalised, while the others are still in progress. Two of the completed reports relate to forged qualifications and unethical behaviour and have been referred to internal audit for review. The remaining completed report were closed as there were no irregularities noted.

Auditor - General

East London

12 December 2018



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 the selected development priority and on the municipality’s compliance with respect to the selected subject matters.

Consolidated and separate 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 Nelson Mandela Bay Metropolitan Municipality 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 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 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
 - 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 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.