



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

FINAL MANAGEMENT REPORT

KNYSNA MUNICIPALITY

30 June 2019

Communicated to the accounting officer on: 30 November 2019





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MANAGEMENT REPORT

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INTRODUCTION	4
OVERALL MESSAGE	7
SECTION 1: Interactions with stakeholders responsible for oversight and governance	7
SECTION 2: Matters relating to the auditor's report	9
AUDIT OF THE FINANCIAL STATEMENTS	9
MATTERS TO BE BROUGHT TO THE ATTENTION OF USERS	10
AUDIT OF THE ANNUAL PERFORMANCE REPORT	10
AUDIT OF COMPLIANCE WITH LEGISLATION	12
OTHER INFORMATION	12
INTERNAL CONTROLS	13
SECTION 3: Assurance providers and status of implementation commitments and recommendations	15
ASSESSMENT OF ASSURANCE PROVIDERS	15
STATUS OF IMPLEMENTING COMMITMENTS AND RECOMMENDATIONS	17
SECTION 4: Specific focus areas	22
FINANCIAL VIABILITY	22
PROCUREMENT AND CONTRACT MANAGEMENT	24
FRAUD AND CONSEQUENCE MANAGEMENT	25
USE OF CONSULTANTS	26
PUBLIC PARTICIPATION	26
CONDITIONAL GRANTS	26
ROADS INFRASTRUCTURE	27
SUPPORT TO LOCAL GOVERNMENT	28
SECTION 5: Using the work of internal audit	28
SECTION 6: Emerging risks	33
SECTION 7: Ratings of detailed audit findings	33





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SECTION 8: Conclusion	33
SECTION 9: Summary of detailed audit findings	34
Detailed audit findings contained in annexures A to C	37
Annexure D: Performance management and reporting framework	236
Annexure E: Auditor-general's responsibility for the audit of the reported performance information	238
QUALITY CONTROL RELATING TO ASSURANCE ENGAGEMENTS	238
REPORTED PERFORMANCE INFORMATION	238
COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE	238
Annexure F: Assessment of internal controls	239



MANAGEMENT REPORT TO THE ACCOUNTING OFFICER ON THE AUDIT OF THE KNYSNA MUNICIPALITY FOR THE YEAR ENDED 30 June 2019

INTRODUCTION










1. The purpose of the management report is to communicate audit findings and other key audit observations to the accounting officer and does not constitute public information. This management report includes audit findings arising from the audit of the financial statements, performance information and compliance with legislation for the year ended 30 June 2019.
2. These findings were communicated to management and the report details management's response to these findings. The report includes information on the internal control deficiencies that we identified as the root causes of the matters reported. Addressing these deficiencies will help to improve the audit outcome.
3. In accordance with the terms of engagement, our responsibility in this regard is to:
 - express an opinion on the financial statements
 - express an opinion in the management report on the usefulness and reliability of the reported performance information for selected objectives, and report the material findings in the auditor's report
 - report on material findings raised on compliance with specific requirements in key applicable legislation, as set out in the general notice issued in terms of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA).

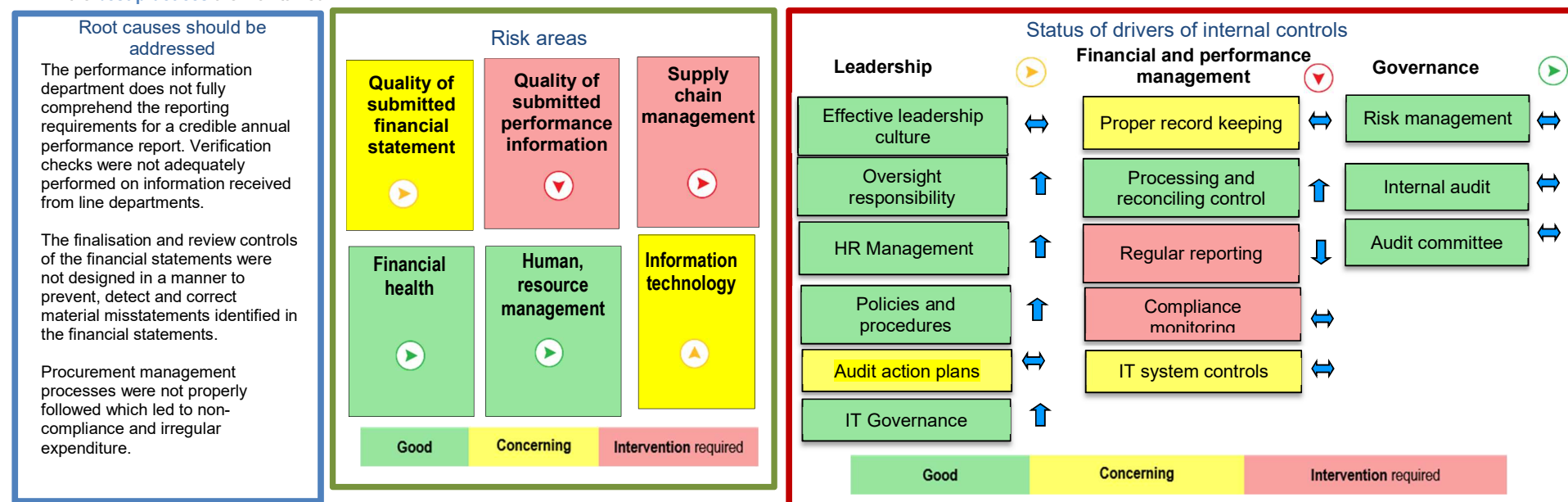
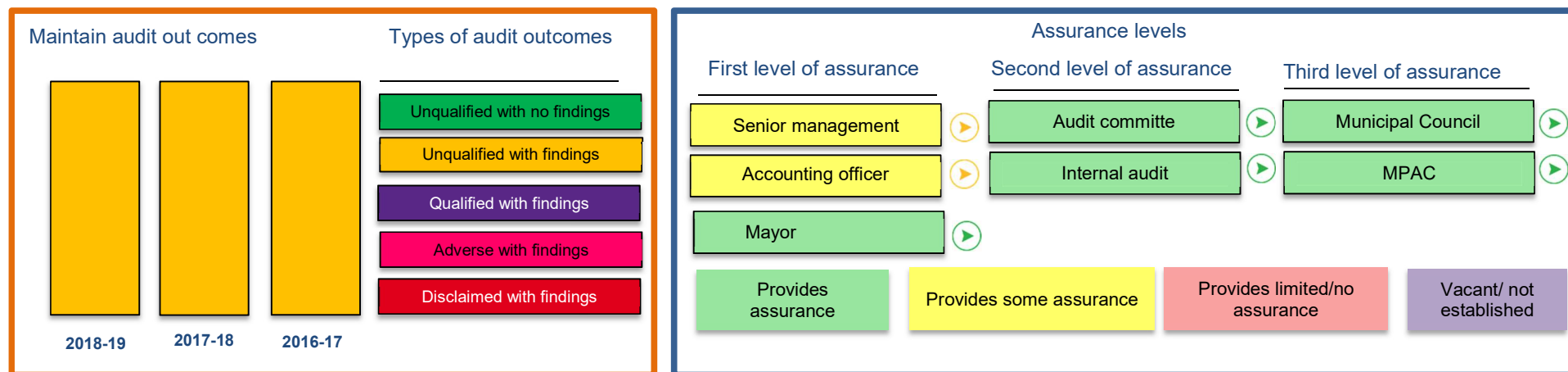
Our engagement letter sets out our responsibilities and those of the accounting officer in detail.

4. This management report consists of the overall message arising from the audit, summary of key findings and observations, annexures containing the detailed audit findings, annexures to the report on the audit of performance information as well as the annexure to internal control deficiencies reported.
5. The auditor's report is finalised only after the management report has been communicated. All matters included in this report that relate to the auditor's report remain in draft form until the final auditor's report is signed. In adherence to section 50 of the PAA, we do not disclose any information obtained during the audit and contained in this management report.
6. Please note that the information contained in these documents is confidential, privileged and only for the information of the intended recipient(s) and may not be used, published or redistributed without the prior written consent of the Auditor-General of South Africa (AGSA). Any form of reproduction, dissemination, copying, disclosure, modification, distribution and or publication of this material is strictly prohibited. Should the information be used or processed in a manner that contravenes any laws in the Republic, the AGSA is fully indemnified from liability that may arise from such contravention.
7. The **figure** that follows provides a pictorial summary of the audit results and our key messages on how to improve the audit outcomes with the focus on the following:
 - Status of the audit outcomes
 - Status of the level of assurance provided by key role players
 - Status of the drivers of internal controls
 - Status of risk areas
 - Root causes to be addressed



Movement from the previous year is depicted as follows:

 / 	Improved
    / 	Unchanged / slight improvement / slight regression
 / 	Regressed



OVERALL MESSAGE

8. The audit outcome of the municipality has been maintained as being unqualified with findings on predetermined objectives and compliance with legislation.
9. The quality of the financial statements submitted for auditing on 31 August 2019 remains a concern. Various material misstatements relating to inventory disclosure, irregular expenditure, financial instruments and statutory receivables were detected in the financial statements. These misstatements could have been detected before submission of the financial statements for auditing had a thorough review of the financial statements been performed by management.
10. Management did not ensure that the bid adjudication committee is in compliance with the municipal supply chain management regulations on awarding all tenders.
11. The audit of performance information resulted in material misstatements being identified. This resulted in a qualification on the annual performance report for strategic focus area 1, as a result of the performance department not fully comprehending the reporting requirements for a credible annual performance report.
12. The significant number of audit findings impacted senior management as a key assurance provider for the audit. Management is encouraged to develop a credible action plan which needs to be continuously monitored in an appropriate manner in order to prevent a breakdown in controls from reoccurring.

SECTION 1: Interactions with stakeholders responsible for oversight and governance

13. During the audit cycle, we met with the following key stakeholders responsible for oversight and governance to communicate matters relating to the audit outcome of the municipality:

Key stakeholder	Purpose of interaction	Number of interactions
Municipal council	• Discussion of the 2017/18 management report	1
Municipal manager	• PAA interaction • ASC meetings • Draft management report discussions	3
Chief Financial Officer	• Engagement letter discussion • Audit strategy discussion • ASC meetings • Draft management report discussions • Audit findings	6
Audit committee	• Engagement letter discussion • Audit strategy discussion • ASC meetings • Draft management report discussiond	5

14. At these interactions, we shared the following key matters affecting audit outcomes and the auditee:

- Engagement letter
- Audit strategy
- Progress of the audit

- Discussion of audit findings and possible audit outcomes
 - Fraud and related parties
 - Actual vs budgeted audit fee
 - The Public Audit Act
15. Some stakeholders made commitments to implement initiatives that can improve the audit outcome. The commitments given and the progress of previous commitments are included in section 3, which deals with the assessment of assurance providers.

SECTION 2: Matters relating to the auditor's report

AUDIT OF THE FINANCIAL STATEMENTS

16. We identified material misstatements in the financial statements during the audit. These misstatements were not prevented or detected by the municipality's system of internal control. These material misstatements do not constitute a material non-compliance with section 122 of the Municipal Finance Management Act (MFMA).

Material misstatement			Impact R current year	Impact R previous year
Financial statement item	Finding (Include a brief description of the misstatement as per the findings and the auditor’s report. Include the reasons for the auditee not correcting the misstatement when applicable.)	Occurred in prior year (Insert Yes/No)		
Material misstatements not corrected				
None				
Material misstatements corrected				
Disclosure				
Statutory Receivables	The comparative figure of Statutory Receivables were understated (COMAF 19)	No	-	9 894 354
Inventory	Inventory recognised as an expense in note 3 does not agree to inventory consumed note 38 (COMAF 24)	No	19 451 155	35 322 741
Financial instruments	Unpaid Conditional grants were not recognised as a Financial Instrument (COMAF 19)	No	30 775 924	14 981 801
Irregular expenditure	Irregular expenditure note was understated. The amounts listed below made up the material understatement:	No	91 536 985	25 183 230
	Irregular piggy back contracts (COMAF 32)	No	70 666 948	23 094 947
	The composition of Bid Adjudication Committee is not in terms of MSCM Regulation 29 (2) (COMAF 40)	No	20 870 037	2 088 283



MATTERS TO BE BROUGHT TO THE ATTENTION OF USERS

Emphasis of matter paragraphs

17. The following emphasis of matter paragraphs will be included in our auditor's report to draw the users' attention to matters presented or disclosed in the financial statements:

Restatement of corresponding figures

18. As disclosed in note 45 to the financial statements, the corresponding figures as at 30 June 2018 have been restated as a result of errors in the financial statements of the municipality at, and for the year ended, 30 June 2019.

Material impairments

19. As disclosed in note 5 and 6 to the financial statements, the municipality has provided for impairment of receivables from exchange transactions amounting to R137 196 132 (2018: R120 733 123) and receivables from non-exchange transactions amounting to R138 624 846 (2018: R116 391 077) respectively.

Other matter paragraphs

20. The following other matter paragraphs will be included in our auditor's report to draw the users' attention to matters regarding the audit, the auditor's responsibilities and the auditor's report:

Unaudited supplementary schedules


21. The supplementary information set out on pages 106 to 112 does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion on it.

AUDIT OF THE ANNUAL PERFORMANCE REPORT

22. In terms of the general notice issued in terms of the PAA, the opinion on the audit of reported information will be included in the management report. The report is included below to enable management and those charged with governance to see what the report will look like once it is published in the auditor's report. We will report all the audit findings included under the basis for opinion and the other matter sections of this report in the auditor's report.

Introduction and scope

23. We have undertaken a reasonable assurance engagement on the reported performance information for the following selected strategic focus area presented in the annual performance report of the municipality for the year ended 30 June 2019:

Strategic Focus Areas	Pages in annual performance report	Opinion	Movement
SFA 1: Basic Service Delivery	34 – 39	Qualified	

24. We conducted our reasonable assurance engagement in accordance with the International Standard on Assurance Engagements, ISAE 3000: *Assurance engagements other than audits or reviews of historical financial information*.

25. We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Strategic Focus Area 1: Basic Service Delivery

Qualified opinion

26. In our opinion, except for the possible effects of the matters described in the basis for qualified opinion section of my report the reported performance information for SFA 1: Basic Service Delivery is useful and reliable in accordance with the applicable criteria as developed from the performance management and reporting framework as set out in annexure D to this report.

Basis for Qualified opinion

TL 3 - The number of single residential properties with access to basic level of sanitation

27. The reported achievement for the target was misstated as the audit evidence provided was incomplete by excluding certain single residential household with access to a basic level of sanitation and by containing duplicated residential properties. A projected overstatement of 3 229 units was communicated which results in a 22% deviation rate.

TL 27 - Provision of bulk services through the electrification of Informal Settlements

28. The source information for achieving the planned indicator was not clearly defined. The indicator and its definition was not clear and unambiguous. The indicator is defined as electrifying informal settlements whereas the target and the achievement is measured as number of informal houses being electrified. The use of the term “settlements” implies a larger area being electrified which is not consistent with the way in which the indicator is being reported on.

Other matters

29. We draw attention to the matters below. Our opinion is not modified in respect of these matters.

Achievement of planned targets

30. Refer to the annual performance report on pages 34 to 39 for information on the achievement of planned targets for the year. This information should be considered in the context of the qualified opinions expressed on the usefulness and reliability of the reported performance information in paragraphs 28 to 30 of this report.

Adjustment of material misstatements

31. We identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of SFA 1: Basic Service Delivery. As management subsequently corrected only some of the misstatements, we raised material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are included in the basis for qualified opinion paragraphs.

Responsibilities of the accounting officer for the reported performance information

32. 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

33. Our objectives are to obtain reasonable assurance about whether the reported performance information for the selected strategic objectives presented in the annual performance report is free from material misstatement, and to issue a management report that includes our 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.
34. Our procedures address the reported performance information, which must be based on the approved performance planning documents of the Municipality. We have not evaluated the appropriateness of the performance indicators established and included in the planning documents. Our procedures do not extend to any disclosures or assertions relating to planned performance strategies and information relating to future periods that may be included as part of the reported performance. Accordingly, our opinion does not extend to these matters.
35. A further description of our responsibilities for the reasonable assurance engagement on reported performance information is included in annexure E to this report.

AUDIT OF COMPLIANCE WITH LEGISLATION

36. Included below are material findings on compliance with selected specific requirements of applicable legislation, as set out in the general notice issued in terms of the PAA.

Expenditure Management

37. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA.

Procurement and contract management

38. Some of the competitive bids were adjudicated by a bid adjudication committee that was not composed in accordance with SCM regulation 29(2).

OTHER INFORMATION

39. 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 financial statements, the auditor's report and those selected objectives presented in the annual performance report that have been specifically reported in the auditor's report.
40. Our opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and we do not express an audit opinion or any form of assurance conclusion thereon.
41. In connection with our audit, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected objectives presented in the annual performance report, or our knowledge obtained in the audit, or otherwise appears to be materially misstated.
42. No other material inconsistencies were identified in the other information. I have nothing to report in this regard.

43. Should any inconsistencies be identified subsequent to the date of the auditor's report, this will be reported accordingly.

INTERNAL CONTROLS

44. The significant deficiencies in internal control which led to our overall assessment of the status of the drivers of key controls, as included in the figure in paragraph 7, is described below. The detailed assessment of the implementation of the drivers of internal control in the areas of financial statements, performance reporting and compliance with legislation is included in annexure F.

Leadership

Action plans to address internal control deficiencies

45. Leadership failed to adequately address the credibility of the action plan developed by the municipality in response to control weaknesses identified over financial and performance management and compliance with laws and regulations. Some of the controls implemented were not sustainable to ensure that findings raised from the audit process would not reoccur. Furthermore, actions committed by management were reactive to control weaknesses identified and not detailed assessments of the overall control environment established for financial and performance management and compliance with laws and regulations.

Financial and performance management

Proper record keeping

46. Management did not ensure that supply chain information is adequately filed and therefore readily available on request.

Regular, accurate and complete financial and performance reports

47. A significant number of material findings were noted on performance report indicators. Adequate verification checks were not performed when information is received from the relevant line departments.
48. Various misstatements were noted in the annual financial statements submitted for audit. Material misstatements relating to inventory disclosure, financial instruments and statutory receivables and irregular expenditure were identified and corrected. This is a result of a lack of understanding into the applicable reporting requirements and inadequate review of the financial statements by management.

Compliance monitoring

49. Management did not identify that its historical interpretation and application of SCM regulation 32 has resulted in non-compliance with the regulation and/or has failed to provide audit with evidence that the expenditure incurred by it on so-called "piggy-back" contracts were limited to the portion forfeited by the other organ of state, resulting in the incurring of irregular expenditure.
50. Management did not have adequate controls in place to ensure that all invoices are settled within 30 days.
51. Management should ensure that the bid adjudication committee is in compliance with the municipal supply chain management regulations on awarding all tenders.

Information technology systems

Although we commend the municipality on the improvement around the IT environment, there are still findings that must be addressed to ensure that further improvements are made.

IT service continuity

52. The Disaster Recovery (DR) site is located within 100 meters of the Knysna Municipality and lacks adequate environmental and physical access controls.

Security management

53. The firewall is outdated and is a Linux based open source firewall that does not have the features available to allow for real-time alerting and only has limited storage space for the retention of logs. Furthermore, due to the delay in the procurement of the fibre lines this has impacted the replacement of the firewall.

User Access Management

54. The PROMUN system administrators were found to have transactional access on the financial application. In addition, system administrator activities, user activity logs and user access logon and violations for PROMUN were not reviewed.

We commend management for the progress made in the area of information systems as the findings from the previous years has been reduced.

Summary

55. The matters above, as they relate to the basis for the qualified opinion, findings on the annual performance report and findings on compliance with legislation, will be summarised in the auditor's report as follows:
56. Management did not establish and implement controls to ensure the validity of performance information received from line departments before compilation of the annual performance report.
57. Management did not establish sound controls that would prevent and detect non-compliance with laws and regulations which resulted in irregular expenditure.

SECTION 3: Assurance providers and status of implementation of commitments and recommendations

ASSESSMENT OF ASSURANCE PROVIDERS

58. The annual report is used to report on the financial position of auditees, their performance against predetermined objectives and overall governance. One of the important oversight functions of the municipal council is to consider auditees' annual reports. To perform this oversight function, they need assurance that the information in the annual report is credible. To this end, the annual report includes our auditor's report, which provides assurance on the credibility of the financial statements and the annual performance report, as well as on the auditee's compliance with legislation.
59. Our reporting and oversight processes reflect on past events, as they take place after the end of the financial year. However, management, the leadership and those charged with governance contribute throughout the year to the credibility of financial and performance information and compliance with legislation by ensuring that adequate internal controls are implemented.
60. We assess the level of assurance provided by these assurance providers based on the status of internal controls (as reported in section 2.6) and the impact of the different role players on these controls. We provide our assessment for this audit cycle below.

First level of assurance

Senior management: provides some assurance

61. Senior management, which includes the chief financial officer, the head of the supply chain management unit and other senior managers, should provide assurance by implementing basic financial, performance and compliance related controls.
62. Senior management, however, did not adequately implement appropriate and sufficient review controls to ensure that performance and financial reporting was accurate as material misstatements were identified in the annual performance report and annual financial statements that were submitted for audit.
63. Senior management should improve the level of assurance they provide by conducting proper reviews of the underlying information supporting the financial statements and perform validation checks on performance information.

Accounting officer: provides some assurance

64. The municipal manager is responsible for the municipality's internal controls, including leadership, planning, risk management, as well as oversight and monitoring. While the municipal manager depends on senior management for designing and implementing the required financial, performance management and compliance related controls, the accounting officer should create an environment that helps to improve such controls.
65. The accounting officer was not able to consistently exercise oversight on the internal control processes currently implemented, in the area of financial and performance reporting and performance management in order to ensure that the improvements in the internal control environment are sustained.

Mayor: provides assurance

66. The mayor has a monitoring and oversight role at the municipality. The mayor has specific oversight responsibilities in terms of the MFMA and the MSA, which include reviewing the

integrated development plan and budget management, as well as ensuring that the municipality address the matters raised in audit reports.

Second level of assurance

Internal audit unit: provides assurance

67. Legislation in South Africa requires the establishment, roles, and responsibilities of internal audit units. Internal audit units must form part of the internal control and governance structures of the municipality and must play an important role in its monitoring activities. Internal audit must provide an independent assessment of the municipality governance, risk management and internal control processes.
68. The internal audit unit of a municipality must prepare a risk-based audit plan and internal audit programme for each financial year. It must advise the accounting officer and report to the audit committee on implementation of the internal audit plan and matters relating to internal audit; internal controls; accounting procedures and practices; risk and risk management; performance management; loss control and compliance with the MFMA. The internal audit unit must also perform such other duties as may be assigned by the accounting officer.
69. During the quarterly audit committee meetings, the audit committee demonstrated their satisfaction with the work of the internal audit unit which included key risk areas identified as well as those internal audits required by the MFMA. The internal audit work was utilised for risk identification and the year end inventory count.

Audit committee: provides assurance

70. The audit committee is an independent advisory body to the council, accounting officer and the management and staff of the municipality on matters relating to internal financial control and internal audits; risk management; accounting policies; the adequacy, reliability and accuracy of financial reporting and information; performance management; effective governance; the MFMA and any other applicable legislation; performance evaluation and any other issues.
71. The audit committee is also expected to review the annual financial statements to provide an authoritative and credible view of the municipality its efficiency and effectiveness and its overall level of compliance with the applicable legislation.
72. The audit committee has carried out its functions in accordance with its mandate. It meets on a quarterly basis to evaluate internal audit work and the risks affecting the municipality's business. A draft version of the financial statements was reviewed on a high level by the audit committee prior to submission thereof for audit purposes.
73. The work of the audit committee provides assurance and the committee covered all the required aspects in terms its mandate.

Third level of assurance

Municipal council: provides assurance

74. The municipal council met regularly to consider matters in terms of its mandate and functions and has been assessed as providing assurance.

Municipal public account committee (MPAC): provides assurance

75. The extent to which the council adopted the MPAC guides has been considered in the assessment of MPAC as an assurance provider.
76. The MPAC met regularly to consider, advise and provide recommendations to council in terms of its functions and therefore is assessed as providing assurance.

STATUS OF IMPLEMENTING COMMITMENTS AND RECOMMENDATIONS

77. Below is our assessment of the progress in implementing the commitments made by the municipality to address the previous and current years' audit findings.

No.	Commitment	Made by	Date	Origin of commitment	Status
1	<u>Asset management – Non-compliance with investment regulations</u> Council approved the investment without considering compliance with the investment regulation and council policies in terms of institutions to invest in.	None	Not specified	COMAF 3 of 2018	Resolved
2	<u>HR Management - Performance agreements and disclosure of financial interest</u> Management will ensure performance agreements are reviewed and signed.	Municipal Manager	20 July 2018	COMAF 23 of 2018	In process
3	<u>Commitments – Authorised capital expenditure</u> The disclosure will be corrected in the AFS and review controls relating to the commitment register will be improved.	CFO	31 August 2019	COMAF 15 of 2018	In process
4	<u>Performance Information: - Scope Limitation on TL 24 and TL25</u> The Director planning and development will sign off all reported performance targets before they are reported in the AR.	Director planning and Development	30 June 2019	COMAF 25 of 2018	In process
5	<u>Performance information - TL1: Access to basic level electricity not reliable</u> Management is preparing to go out on a tender for an integrated ERP/Financial system solution which will have GIS capabilities linking each address and house on the map. The APR on TL1 will be amended to reflect 19 628	CFO	20 Feb 2019	COMAF 27 of 2018	In process
6	<u>Expenditure: Individually Material items not disclosed separately</u> Expanded disclosure in the note 36 (contracted services) as agreed with the AG for consistency purposes. We however still disagree as per our responses above as the original disclosure was seen in accordance with the requirements of GRAP. Expanded disclosure if better information is presented is always encouraged and consequently the agreement to expand the note.	None	Not specified	COMAF 24 of 2018	Resolved
7	<u>Local content – non-compliance</u> Awards made in non-compliance with the requirements for local production and content.	None	Not specified	COMAF 11 of 2018	In process
8	<u>Procurement and Contract Management: Non-compliance</u> Management will include pricing in evaluation even on expression of interest where prices are fixed in order to fully comply with 80/20 rule.	SCM manager	31 Jan 2019	COMAF 12 of 2018	In process
9	<u>Procurement and Contract Management: Local content sub-contracting</u> Tenderers will be required to indicate upfront which EME's will be subcontracted and this will not be left for later stage after award	SCM manager	31 Jan 2019	COMAF 20 of 2018	In process

No.	Commitment	Made by	Date	Origin of commitment	Status
10	<u>Procurement and Contract Management: Deviations</u> <ul style="list-style-type: none"> Management test the market to see if there is no other service providers before considering deviations. Staff will be trained and on the deviation criteria that must be satisfied before consideration of a deviation. The two matters contained in 1 and 6 above will be amended and disclosed as irregular expenditure. 	SCM manager	30 Nov 2018 and 30 Apr 2019	COMAF 30 of 2018	In process
11	<u>Procurement and Contract Management – Annual procurement plan</u> Quarterly reports by the Municipal manager to finance and governance section 80 committee meeting on monitoring and implementation of projects.	Accounting officer	Quarterly in 2018/19 financial year	COMAF 2 of 2018	Resolved
12	<u>Human Resource Management - Staff Establishment</u> Job placement and advertising of vacant positions will commence due to the new Organizational structure being approved on 29/10/2018.	MM and HR	31 Jan 2019	COMAF 4 of 2018	Resolved
13	<u>Human Resource Management – Minimum Competencies</u> Review employment contracts and performance agreements before they are signed	Director: Corporate Services	Whenever appointments of senior managers are made	COMAF 5 of 2018	Resolved
14	<u>Contingent Liabilities – Cases not disclosed</u> All information on attorney letters to be reviewed against contingent liability note for 2018/19 AFS	Chief Accountant: Treasury & Accounting	30 Jul 2019	COMAF 7 of 2018	In process
15	<u>Employee Costs – Overtime not in the correct period</u> Raise accrual for overtime worked in June, but paid in July 2019	Accountant: Payroll	31 Jul 2019	COMAF 9 of 2018	In process
16	<u>Procurement and Contract Management - Preference point system</u> The matter will be referred to the Western Cape SCM forum for PT/NT to provide guidance through a circular.	SCM manager	30 Mar 2019	COMAF 10 of 2018	Resolved
17	<u>Cash and Cash Equivalents</u> General Ledger accounts for interest on investments must agree to 3 rd party bank statements before AFS disclosure is compiled	Chief Accountant: Treasury & Accounting	Jul 2019	COMAF 14 of 2018	In process
18	<u>Human Resource Management - Upper limits for total remuneration</u> Council has already resolved that the Municipal manager engage with Cogta and report back to council	MM	20 Feb 2019	COMAF 22 of 2018	In process
19	<u>Expenditure</u> No amendment to the 2018 financial statements as this is immaterial. Correction of the transaction in the general ledger in order to ensure correction on the next VAT return submission to SARS.	Accountant: Treasury	Nov and Dec 2018	COMAF 16 of 2018	Resolved
20	<u>Procurement and Contract Management - Declaration of Interests</u> Management will continue to evaluate all award above R10, 000.00 and use a	SCM Manager	Apr 2019	COMAF 17 of 2018	In process

No.	Commitment	Made by	Date	Origin of commitment	Status
	combination of available systems to do the verification.				
21	<u>Related Parties</u> - Ensure expenditure is processed in the correct financial year - Ensure related parties note is based on expenditure on GL.	Creditors Accountant: Accounting	Jul 2019 Jul 2019	COMAF 19 of 2018	In process
22	<u>Performance Information</u> Knysna Municipality will be going out on tender for an integrated ERP/Financial management system, which will mitigate and reduce risk of manual process and human errors.	Manager Income	31 Jul 2019	COMAF 26 of 2018	In process
23	<u>Performance Information – Presentation and disclosure</u> <ul style="list-style-type: none"> Technical engagements were held with project implementers as well as province and process agreed for brining project risks to management attention, so that mitigations can be timeously implemented. The Director planning and development will sign off all reported performance targets before they are reported in the AR. 	Manager: HIS	31 Jul 2019	COMAF 28 of 2018	Resolved
24	<u>Performance Management – Non-Compliance</u> Management will implement the Financial Management Maturity Model to monitor legislative compliance.	CFO	20 Jan 2019	COMAF 29 of 2018	Resolved
25	<u>Procurement and Contract management – Record keeping</u> A senior SCM official will further do a review of the register.	SCM Manager	30 Jun 2019	COMAF 31 of 2018	In process
26	<u>Property plant and equipment: Asset register internal control deficiencies</u> There is a time leg on the matter. It is not a control deficiency as it is done when the AFS were prepared and submitted. Management will however check this every year.	Manager Budget and Accountant Assets	30 Aug 2019	COMAF 32 of 2018	Resolved
27	<u>Procurement and Contract Management – Contract Management</u> All contracts will be reviewed against the expenditure on quarterly basis to identify potential over spending earlier.	Manager expenditure	30 May 2019	COMAF 33 of 2018	In process
28	<u>Performance Information – Annual Performance Report errors</u> Implementation of the Organizational Structure approved by Council on 29 October 2019. Completion of the tender and review process for the acquisition and implementation of an EMS. The APR will be amended and submitted to the AG in line with points 1. 2. and 3 as per the audit finding.	Municipal Manager and Directors Director Finance and Manager IT Manager PIARM	30 Jun 2021 30 Jun 2019 30 Nov 2018	COMAF 34 of 2018	In process

No.	Commitment	Made by	Date	Origin of commitment	Status
29	<u>Performance Information – TL 5: Free basic electricity</u> Management has relooked the indicator and will amend the reported actual to only reflect registered indigent for now until such time that the indicator is amended to include consumers on 20 Amp circuit break. This will be done with the February adjustment budget. The two policies will also be aligned.	CFO	30 November 2018 and then 28 February 2019	COMAF 35 of 2018	In process
30	<u>HR Management: Annual Leave taken without prior approval</u> Management is in a process of procuring an ERP system that is integrated in order to improve on the shortcomings of current system. Organizational structure has also been approved and manager's positions will be filled.	HR Manager	30 May 2019	COMAF 36 of 2018	Resolved
31	<u>Human Resource Management - No Job description</u> Management has approved a new org structure in October 2018. All post job descriptions will be redone based on the new org structure.	HR Manager	30 May 2019	COMAF 21 of 2018	Resolved
32	<u>Performance Information – TL2: Residential properties with access to basic water</u> Manual reconciliation will be done on the listing while we are in a process to source an ERP system that will give a long-term solution on the matter.	CFO	30 Jun 2019	COMAF 37 of 2018	In process
33	<u>Consequence Management</u> <ul style="list-style-type: none"> Management has already appointed experts service providers to assist MPAC with investigation. The report is expected to be tabled in MPAC meeting on 28 November 2018. MPAC will then recommend to council. AG will be provide with the report once there is resolution from council. 	MM	31 Jan 2019	COMAF 39 of 2018	Resolved
34	<u>Revenue from non-exchange – Provincial Traffic fines not accounted</u> Going forward and based on the AGSA consistency conclusion, controls will be evaluated and implemented in order to resolve a service level agreement with Provincial traffic. We will also make contact with Provincial traffic in order to obtain the required reports in order to account for this provincial traffic fines as proposed by AGSA in the future, if this is concluded to be required by the AGSA.	None	None	COMAF 40 of 2018	In process
35	<u>Information systems Audit: Issue 1- No monitoring of vendor performance (IGNITE and PROMUN)</u> <ul style="list-style-type: none"> - Administration to move to IT - IT Service Level Agreement Management Policy (External Service Providers/Vendors) requirements to be communicated to system vendors / service providers - A Third Party risk management action plan to be developed 	All organisation IT Manager IT Manager	Jul 2019 Dec 2018 Mar 2019	COMAF 1 of 2018	Resolved

No.	Commitment	Made by	Date	Origin of commitment	Status
36	<u>Information systems Audit: Issue 2 - IT Strategic Plan not approved</u> The IT strategy will be developed and approved	IT Manager	Jun 2019	COMAF 1 of 2018	Resolved
37	<u>Information systems Audit: Issue 3 - Weaknesses in the management of user accounts for PROMUN</u> Administration of PROMUN will become an IT department function with the implementation of the new organogram. IT will endeavour to implement the requirements Councils IT policies.	IT Manager	Jul 2019	COMAF 1 of 2018	In process
38	<u>Information systems Audit: Issue 4 - Weaknesses in the management of user accounts for IGNITE</u> Management will ensure that reviews are performed. Management will implement a password reset process.	IT Manager	Jul 2019	COMAF 1 of 2018	Resolved
39	<u>Information systems Audit: Issue 5 - Inadequate monitoring of the firewall</u> Quarterly review of firewall ruleset Procure firewall and additional services	IT Manager IT Manager	Ongoing Jul 2020	COMAF 1 of 2018	In process
40	<u>Information systems Audit: Issue 6 - The Disaster Recovery Plan (DRP) is currently outdated and has not been tested</u> Develop an IT DR strategy Review the IT DR plan Implement a new IT DR solution	IT Manager IT Manager IT Manager	Jun 2019 Jun 2019 Jun 2021	COMAF 1 of 2018	In process
41	<u>Information systems Audit Issue 7 - Lack of adequate data restoration tests</u> Backup restorations will be documented	Financial System Administrator	Jun 2019	COMAF 1 of 2018	Resolved
42	<u>Information systems Audit Issue 8 - Non-compliance to approved change management procedures</u> Administration of PROMUN will be transferred to IT	CFO / IT Manager	Jul 2019	COMAF 1 of 2018	Resolved
43	<u>Expenditure – Cost Containment Measures</u> Remedial action has been taken with the approval of the org structure. An item will be written to council to indicate the cost of the work that will be performed intently compared to outsourcing.	MM	30 Jun 2019	COMAF 6 of 2018	In process

- 18 audit recommendations accepted by management in the previous year on matters included in the auditor's report and other important matters were implemented, or alternative actions were taken to resolve the finding.
- 25 recommendations are still being implemented and none have not been addressed, or very limited progress has been made.
- Details on the status of implementing the previous year(s) recommendations are provided in section 9, which summarises the detailed audit findings.

SECTION 4: Specific focus areas

FINANCIAL VIABILITY

78. Our audit included a high-level overview of the municipality's financial viability as at year-end. The financial viability assessment provides useful information for accountability and decision-making purposes and complements the financial statements by providing insights and perspectives thereon. The financial viability assessment is expected to enhance timely remedial decision-making and policy reforms where financial viability may be at risk. It will also highlight to management those issues that may require corrective action and the urgency and magnitude of the reforms and decisions necessary to maintain operations. The information should be used to complement, rather than substitute, management's own financial assessment.

FINANCIAL VIABILITY ASSESSMENT			
		AS AT 30 JUNE 2019	AS AT 30 JUNE 2018
EXPENDITURE MANAGEMENT			
1.1	Creditor-payment period	62,2 Days	54,5 Days
REVENUE MANAGEMENT			
2.1	Debtor-collection period (after impairment)	71,2 Days	69,1 Days
2.2	Debtors impairment provision as a percentage of accounts receivable*	66,1%	65,8%
	• Amount of debtors impairment provision	R275 820 978	R237 124 200
	• Amount of accounts receivable	R417 279 869	R360 296 474
ASSET AND LIABILITY MANAGEMENT			
3.1	A deficit for the year was realised (total expenditure exceeded total revenue)	No	No
	• Amount of the surplus / (deficit) for the year	R50 398 748	R60 691 921
3.2	A net current liability position was realised (total current liabilities exceeded total current assets)	No	No
	• Amount of the net current assets / (liability) position	R54 825 895	R87 724 664
3.3	A net liability position was realised (total liabilities exceeded total assets)	No	No
	• Amount of the net asset / (liability) position	R1 040 256 952	R980 474 609
CASH MANAGEMENT			
4.1	The year-end bank balance was in overdraft	No	No
	• Amount of year-end bank balance (cash and cash equivalents) / (bank overdraft)	R 71 709 029	R 79 877 042
4.2	Net cash flows for the year from operating activities were negative	No	No
	• Amount of net cash in / (out)flows for the year from operating activities	R 100 672 233	R 88 825 164
4.3	Creditors as a percentage of cash and cash equivalents	104,6%	70,5%
	• Amount of creditors (accounts payable)	R 75 005 223	R 56 352 048
	• Amount of cash and cash equivalents / (bank overdraft) at year-end	R 71 709 029	R 79 877 042

FINANCIAL VIABILITY ASSESSMENT			
		AS AT 30 JUNE 2019	AS AT 30 JUNE 2018
4.4	Current liabilities as a percentage of next year's budgeted resources **	30,9%	23,5%
	• Amount of current liabilities	R221 891 974	R165 819 525
	• Amount of next year's budgeted income **	R717 184 000	R705 056 898
OVERALL ASSESSMENT			
Overall the financial viability is assessed as:		Green (Good)	Green (Good)
** This amount excludes the portion of next year's budgeted resources that is budgeted to be spent on "employee costs" and "remuneration of councillors".			

High-level comments

Expenditure Management

79. The credit payment period significantly exceeds 30 days. During the audit of expenditure, we identified where payments were made beyond 30 days. This an indication that the municipality may not be adequately managing its working capital or indicative that effective controls are not in place to ensure prompt payment of suppliers. Management is encouraged to implement improvements to the existing controls in place to ensure creditors are paid timely as legislatively required.

Revenue management

80. The municipality's debt collection remains a concern. The collection period is significantly longer than 30 days as it is 71,2 days and the impairment provision has increased from the previous year, it indicates poor debt structure and or debt collection problems. The municipality is continuously encouraged to keep strengthening its controls debt collection controls.

Cash management

81. The municipality needs to manage its cash effectively to ensure that there is adequate cash available to pay all creditors as they fall due. There was a regression in creditors as a percentage of the cash and cash equivalents in comparison to the prior year, and therefore management should monitor this on a continuous basis in correlation with the working capital cycle of the municipality.

PROCUREMENT AND CONTRACT MANAGEMENT

82. The audit included an assessment of procurement processes, contract management and the related controls in place. These processes and controls must comply with legislation to ensure a fair, equitable, transparent, competitive and cost-effective supply chain management (SCM) system and to reduce the likelihood of fraud, corruption, favouritism and unfair and other irregular practices. A summary of the findings from the audit are as follows:

Irregular expenditure

83. R91 536 986 (100%) of the irregular expenditure incurred in the current financial year was as a result of the contravention of SCM legislation. Further irregular expenditure incurred in previous years, amounting to R44 079 848, was also identified in the current year. 95% (57% of irregular expenditure relating to the previous year) of this irregular expenditure was identified during the audit process and not detected by the municipality's monitoring processes. The root cause of the lack of effective prevention and detection was due to a matter of interpretation relating to reg 32 and the composition of some of the Bid Adjudication Committees which resulted in the majority of the irregular expenditure.

Awards to persons in the service of the state

84. Regulation 44 prohibits awards to persons in the service of the auditee (i.e. employees and councillors), persons in the service of any other state institution and entities owned/managed by them. The audit included the identification of such prohibited awards. Further testing was also performed to determine whether the legislated requirements with regard to declarations of interest were adhered to.

85. No findings were identified :

Awards to close family members of persons in the service of the state

86. Awards to providers owned/managed by close family members of persons in the service of the state, whether at the municipality or any other state institution, are not prohibited. However, such awards of more than R2 000 must be disclosed in the financial statements of the municipality for the sake of transparency and as required by SCM regulation 45. The audit included the identification of awards to close family members. Further testing was performed to determine whether the financial statement disclosure was made and the legislated requirements with regard to declarations of interest were adhered to.

The findings were as follows:

- 1 of the awards to close family members, amounting to R1 905 659 was not disclosed in the financial statements.

Procurement processes

87. The table below is a summary of findings identified on procurement processes:

	Total		Quotations		Contracts	
	Number	Value R	Number	Value R	Number	Value R
Awards selected for testing	70	438 961 127	28	1 616 158	42	437 344 969
Expenditure incurred on selected awards – current year		201 108 840		1 616 158		199 189 463
Limitations – awards selected but could not be tested	0	0	0	0	0	0
Awards on which non-compliance was identified	15	91 536 987	0	0	15	91 536 987
Irregular expenditure identified	15	91 536 987	0	0	15	91 536 987

Procurement processes – general

- Five (5) contracts with expenditure of R70 666 948,44 were procured without inviting competitive bids.
- Ten (10) competitive bids with a value of R20 870 037 were adjudicated by adjudication committees that were not properly constituted.

Internal control deficiencies

88. Management did not identify that its historical interpretation and application of SCM regulation 32 resulted in non-compliance with the regulation and/or has failed to provide audit with evidence that the expenditure incurred by it on so-called “piggy-back” contracts were limited to the portion forfeited by the other organ of state, resulting in the incurring of irregular expenditure.

89. Management should ensure that bid adjudication committee is in compliance with the municipal supply chain management regulations on awarding all tenders.

FRAUD AND CONSEQUENCE MANAGEMENT

90. The primary responsibility for preventing and detecting fraud rests with management and those charged with governance. We are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error, and to issue an auditor’s report that includes our opinion. Due to the inherent limitations of an audit, there is a risk that some material misstatements, including fraud, may not be detected.

91. No fraud risk factors has been identified during the audit.

92. The MFMA and its regulations clearly stipulate that matters such as incurring unauthorised, irregular and fruitless and wasteful expenditure; the possible abuse of the SCM system (including fraud and improper conduct); and allegations of financial misconduct should be

investigated. Disciplinary steps should be taken based on the results of the investigations. Our audits included an assessment of the municipality's management of consequences. No findings were identified in this regard.

Ongoing investigations

93. A total of 3 investigations was ongoing at year-end on allegations relating to fraud or improper conduct in SCM. The Municipal Regulations on Financial Misconduct, Procedures and Criminal Proceedings and the Disciplinary Regulations for Senior Managers require that each investigation must be completed within 30 days from the date of appointing the investigator. The table below provides a summary of investigations which had not been completed as at year-end:

Total number of ongoing investigations as at year-end	3
• Number of SCM-related investigations	2
• Number of fraud-related investigations	1
Number of investigations exceeding a period of 3 months	3

USE OF CONSULTANTS

94. The audit included an assessment of the effective use of consultants. In the local government environment, the partnership between the private and public sectors has become important in driving strategic goals. To optimise the value of this partnership, we identified areas that need attention to get the best value for money.
95. The total expenditure on consultants was R4 043 545.
96. A summary of the significant findings from the audit is as follows:

Transfer of skills

- There was no evidence that skills were transferred or training programmes took place.

Internal control deficiencies

- Management did not ensure that a formal skills transfer plan was prepared and agreed with the consultant relating to the upskilling of staff in respect of accounting and auditing concepts and processes

PUBLIC PARTICIPATION

97. As part of the audit of predetermined objectives we audit compliance with the provisions of the Municipal Systems Act relevant to community participation. No findings were identified.

CONDITIONAL GRANTS

98. For the financial year under review, the audit included an assessment of the effectiveness of the municipality's use of the following conditional grants received:
- Municipal Infrastructure Grant (MIG)
99. No findings were identified on the utilisation of funds.

100. For the grant tested as per the above, we selected key projects funded by the grant and audited the use of grants on the projects. The audit findings raised on each project are reported in the table below.

Key projects/initiatives funded by the grant		
Summary of selected key project and result of testing	Details	Details
Name of grant	Municipal Infrastructure Grant (MIG)	Municipal Infrastructure Grant (MIG)
Project/initiative funded by the grant	Upgrade of Main Sewer Pump Station and Sewers CBD	Knysna North and North East Bulk Water Supply
Audit findings		
Planned completion target for the selected project were not achieved		

ROADS INFRASTRUCTURE

101. The audit included an assessment of the roads infrastructure service delivery objective. Procedures were performed in relation to the following:

- Performance planning and reporting on roads infrastructure
- Planning for renewal and routine roads maintenance projects
- Planning for new or refurbished roads infrastructure projects
- Follow-up on the previous year's findings
- Key roads infrastructure projects

102. A summary of the significant findings from the audit are as follows:

Planning for renewal and routine roads maintenance projects

- The roads infrastructure included in the asset register was not included in the roads maintenance plan (RMP). This was due to the RRAMS system not including asset values.

Planning for new or refurbished roads infrastructure projects

- The supply chain policy did not support the implementation of the best practice requirements of the Standard for Infrastructure Procurement and Delivery Management (SIPDM) issued by National Treasury.

Roads infrastructure projects

103. The audit also included an understanding of planning, project management and commissioning of key roads infrastructure projects undertaken at the municipality. This included testing the timelines, spending against budget, compliance with procurement processes, appropriate recording of transactions in the financial statements and the quality of the goods and services delivered.

104. The table below summarises the audit findings on the selected key projects

Summary of the key findings	
Project name	<i>Surfacing of gravel roads for a period of three years</i>
Planning and budgeting for the project	
Brief description of key project	Surfacing of Gravel Roads Ward 1, 2, 3, 4, 5, 7 and 8
Source of funding	Own Funding
Project commenced as planned	No
Project completed within defined duration (applicable if completed)	N/A
Status of completion (applicable if WIP)	10%
Available budget for the year	R17 600 000
Actual amount spent in current year	R1 302 231
Total project budget (multi-year) – original / revised	R25 200 000
Actual amount spent from inception to date	R1 302 231
Audit findings	
Execution of the project	
Significant underspending on budget available for the year	

SUPPORT TO LOCAL GOVERNMENT

105. The audit included an assessment of the support provided to local government by relevant national and provincial departments. No findings identified.

SECTION 5: Using the work of internal auditors

106. The auditing standards allow external auditors the optional use of the work of internal audit for external audit purposes and for direct assistance. We have used internal audit as follows:

107. The following internal audit reports were used for risk identification purposes and reliance on the work of internal audit was placed in respect of the inventory count:

- Performance Management System Quarterly Reporting FY2018
- Division of Revenue Act Compliance for FY 2018
- Internal audit report Annual Stock Count FY 2018
- Internal audit findings: Annual Stock Count: FY19

SECTION 6: Emerging risks

Accounting, performance management/reporting and compliance matters

New pronouncements

Standards of GRAP

The ASB has issued the following GRAP pronouncements, with effective dates as indicated: GRAP pronouncement	Effective date
GRAP 18 - <i>Segment reporting</i>	1 April 2020
GRAP 20 - <i>Related-party disclosures</i>	1 April 2019
GRAP 32 - <i>Service concession arrangements: grantor</i>	1 April 2019
GRAP 34 - <i>Separate financial statements</i>	1 April 2020
GRAP 35 - <i>Consolidated financial statements</i>	1 April 2020
GRAP 36 - <i>Investments in associates and joint ventures</i>	1 April 2020
GRAP 37 - <i>Joint arrangements</i>	1 April 2020
GRAP 38 - <i>Disclosure of interests in other entities</i>	1 April 2020
GRAP 104 - <i>Financial instruments</i> (Revised April 2019)	To be determined
GRAP 108 - <i>Statutory receivables</i>	1 April 2019
GRAP 109 - <i>Accounting by principals and agents</i>	1 April 2019
GRAP 110 - <i>Living and non-living resources</i>	1 April 2020
IGRAP 1 <i>Applying the probability test on initial recognition revenue</i> (amendments)	1 April 2020
IGRAP 17 - <i>Service concession arrangements where a grantor controls a significant residual interest in an asset</i>	1 April 2019
IGRAP 18 - <i>Recognition and derecognition of land</i>	1 April 2019
IGRAP 19 - <i>Liabilities to pay levies</i>	1 April 2019
IGRAP 20 <i>Accounting for adjustments to revenue</i>	1 April 2020
Guideline <i>Accounting for arrangements undertaken in terms of the national housing programme</i>	1 April 2019
Guideline <i>Accounting for landfill sites</i>	To be determined
Guideline <i>The application of materiality to financial statements</i>	Voluntary*
* The Guideline on <i>The application of materiality to financial statements</i> was issued in April 2019. The Guideline is available for immediate consideration, to assist entities to apply the concept of materiality when preparing financial statements in accordance with Standards of GRAP. Although the application of the Guideline is voluntary, application is encouraged.	

New Legislation

B-BBEE Act

- Paragraph 13G requires all spheres of government, public entities and organs of state to report on their compliance with broad-based black economic empowerment in their audited annual financial statements and annual reports. Discussions are ongoing between the AGSA and B-BBEE Commission to scope this requirement into the audit for the 2019-20 financial year.

RISKS THAT REQUIRE CONTINUOUS MONITORING

SCM Regulation 32

108. The supply chain management regulations issued in terms of the MFMA allows for the accounting officer to procure goods and services for the municipality or municipal entity under a contract secured by another organ of state in terms of regulation 32. However, the procurement must occur whilst the originating contract is enforceable, i.e. active contract, and the nature, scope and duration of the contract must be consistent. Contracts secured through the application of regulation 32 cannot be amended, in terms of section 116(3) of the MFMA, if those amendments change the scope of the original contract. Non-adherence to these principles will be considered for non-compliance.
109. We wish to remind all municipalities of the principles and conditions when participating in contract secured by another organ of state in terms of regulation 32, which are as follows:
 - The contract must have been procured through a competitive bidding process (not a deviation).
 - The contract must be active at the time of participation.
 - The procuring institution may not procure beyond the scope of the original contract, i.e., the original contract price, term and goods and services must remain unchanged.

Bid Adjudication Committee (BAC) composition

110. MFMA regulation 29(2) states that a BAC must consist of at least four senior managers of the municipality or municipal entity which must include-
 - The chief financial officer (CFO) or, if the CFO is not available, another manager in the budget and treasury office reporting directly to the CFO and designated by the CFO
 - at least one senior supply chain management (SCM) practitioner who is an official of the municipality or municipal entity; and
 - a technical expert in the relevant field who is an official of the municipality or municipal entity, if the municipality or municipal entity has such an expert.
111. Each award should be adjudicated by a committee that is composed in compliance with regulation 29(2).
112. The following principles were confirmed with National Treasury:
 - the senior manager referred to above are managers as envisaged by s56 of the Municipal Systems Act
 - the senior SCM practitioner does not have to be a manager as envisaged by s56 of the Municipal Systems Act
 - The CFO cannot fulfil the role of both the CFO and the SCM practitioner
 - Not any senior manager can fulfil the role of SCM practitioner for purpose of the BAC – the SCM practitioner's daily duties and functions should primarily include SCM functions

- A voting member of a bid evaluation committee (BEC) cannot also be a member of the BAC. A member of the BEC can be present to provide clarity but may not do work of the BAC i.e. to review the decision of the BAC
113. It is understandable that in some cases, municipalities/municipal entities do not have the staff establishment to have an adequately composed BAC however this does not negate the responsibility of complying with regulation 29(2). We direct municipalities/municipal entities to s170 of the MFMA regarding departures from treasury regulations or conditions.

Local content

114. The compliance requirements of local content for commodities within designated sectors are applicable for all tenders. The term tender in terms of the Preferential Procurement Regulations of 2017 is attributed to all awards above R30 000.

B-BBEE certificates

115. Footnote 3 in Treasury Instruction 4A of 2016-17 noted that the Central Supplier Database (CSD) does not verify B-BBEE status level and set a date for verification of B-BBEE status (1 October 2016). The office of the chief procurement officer (OCPO) failed to achieve this deadline and up to now the CSD does not verify the B-BBEE status of suppliers. The instruction did not exempt institutions from complying with the PPPF Act requirements for obtaining a valid evidence of B-BBEE level status (e.g. sworn affidavits)

Suppliers in service of state – monitoring by CSD

116. The central supplier database has a field to indicate whether any directors of the company are government employees. Based on feedback received from Provincial Treasury, this field interfaces with the PERSAL system for departments and the employee records from municipalities. The possibility exists that employees that are employed in public entities or other spheres of government may not be identified by this field. A request will be made to the National Treasury audit team to include this field in their walk through's to assess whether reliance can be placed on the field. The municipality should however monitor this to prevent non-compliance and also use alternate sources of information to confirm that directors of companies are not employed by the state.

Deviations

117. In terms of Municipal Supply Chain Management Regulation 36, an accounting officer may deviate from competitive bidding procurement processes, provided that such deviation is properly approved and justifiable
118. Our audits at municipalities have brought to light that this regulation is increasingly being used by departments and approved by the accounting officer even though it was not impractical to invite competitive bids. Future audits will continue to focus on evaluating whether the deviations are appropriately justified and/or that the justification can be appropriately supported through adequately documented reasons, to confirm that this regulation is not being used to circumvent competitive bidding.
119. The municipality is advised to ensure that, where deviations are unavoidable, such cases are properly motivated/justifiable and documented and that the requirements of section 217 of the Constitution of the Republic of South Africa, 1996, i.e. fair, equitable, transparent, competitive and cost-effective, are considered throughout

Material irregularities

120. In terms of section 1(g) of the Public Audit Amendment Act, 2018 (Act No. 5 of 2018) a material irregularity is defined as any non-compliance with, or contravention of, legislation, fraud, theft or a breach of a fiduciary duty identified during an audit performed under this Act that resulted in or is likely to result in a material financial loss, the misuse or loss of a material public resource or substantial harm to a public sector institution or the general public.
121. Accounting officers have a legal obligation to prevent all irregularities and take action if it occurred. The AGSA's focus is only on material irregularities.
122. Accounting officers commit financial misconduct if they:
 - wilfully or negligently contravene sections 94 to 100 of the PFMA which deal with their responsibilities
 - incur or permit unauthorised, irregular or fruitless and wasteful expenditure misconduct.
123. Officials commit financial misconduct if they wilfully or negligently fail to exercise duty or power assigned by the accounting officer.
124. Financial misconduct must be investigated and appropriate action taken.
125. Auditors will take the following action upon detection of known or suspected material irregularities:
 - The accounting officer will be notified without delay of the material irregularity in writing
 - The content of the notification and the response required from the accounting officer are prescribed in the material irregularity regulations.
 - The notification will provide all the relevant information on the material irregularity and will request written feedback, substantiating documents and other forms of proof within 20 working days that appropriate steps are being taken to:
 - stop the irregularity (if ongoing)
 - prevent any loss, misuse or harm, or recover any losses
 - determine who the responsible person or entity (e.g. supplier or implementing agent) is and take appropriate action
126. The material irregularity will be reported in the audit report. A certificate of debt can be avoided by implementing the directive to quantify the financial loss and take steps to recover the losses.
127. The commencement date agreed with the president is 1 April 2019. For the 2018-19 financial year a phased in approach was implemented on selected auditees only, but the requirements of the Act will be applicable to all auditees for the 2019-20 financial year's audit process.

Audit findings on the annual performance report that may have an impact on the audit opinion in future

128. The planned and reported performance information of selected objectives was audited against the following additional criteria as developed from the Performance Management Reporting Framework:
 - **Presentation and disclosure – Overall presentation:**
 - Overall presentation of the performance information in the annual performance report is comparable and understandable
 - **Relevance – Completeness of relevant indicators:**
 - Completeness of relevant indicators in terms of the mandate of the auditee, including:
 - relevant core functions are prioritised in the period under review

- relevant performance indicators are included for the core functions prioritised in the period under review
129. Material audit findings arising from the audit against the additional criteria do not have an impact on the audit opinion(s) of the selected objectives in this report. However, it may impact on the audit opinion in future.
130. No material findings were identified in respect of the additional criteria.

SECTION 7: Ratings of detailed audit findings

131. For the purposes of this report, the detailed audit findings included in annexures A to C have been classified as follows:
- Matters to be included in the auditor's report: these matters should be addressed as a matter of urgency.
 - Other important matters: these matters should be addressed to prevent them from leading to material misstatements of the financial statements or material findings on the performance report and compliance with legislation in future.
 - Administrative matters: these matters are unlikely to result in material misstatements of the financial statements or material findings on the performance report and compliance with legislation.

SECTION 8: Conclusion

132. The matters communicated throughout this report relate to the three fundamentals of internal control that should be addressed to achieve sustained clean administration. Our staff remains committed to assisting in identifying and communicating good practices to improve governance and accountability and to build public confidence in government's ability to account for public resources in a transparent manner.

Yours faithfully



Melanie Joffe
Senior Manager: Western Cape

30 November 2019

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Distribution:
CFO
Internal audit
Audit committee

SECTION 9: Summary of detailed audit findings

Page no.	Finding	Classification					Rating			Number of times reported in previous three years	Status of implementation of previous year(s) recommendation
		Misstatements in financial statements	Misstatements in annual performance report	Non-compliance with legislation	Internal control deficiency	Service delivery	Matters affecting the auditor's report	Other important matters	Administrative matters		
	Predetermined objectives										
37	Annual Performance report matters (Comaf 2)		✓				✓			0	
44	Performance indicators Misstated (Comaf 4)		✓				✓			3	In process
129	APR not consistent with SDBIP (Comaf 7)		✓					✓		0	
	Revenue										
60	Revenue from exchange_Electricity misstated (Comaf 5)	✓						✓		0	
139	Sale of electricity and non-compliance (Comaf 10)	✓						✓		0	
148	Parking fines - completeness (Comaf 11)	✓						✓		0	
154	Sewerage and Sanitation misstated (Comaf 14)	✓						✓		0	
166	Grant Revenue misstated (Comaf 17)	✓						✓		0	
202	Traffic fines overstated (Comaf 3)	✓						✓		0	
	Expenditure										
152	Finance cost misstated (Comaf 13)	✓						✓		0	
179	Expenditure Management (Comaf 29)			✓				✓		0	
	Employee costs										
132	Performance agreement signed late (Comaf 8)			✓				✓		1	In process
163	Overtime (Comaf 16)	✓						✓		1	In process



Page no.	Finding	Classification					Rating			Number of times reported in previous three years	Status of implementation of previous year(s) recommendation
		Misstatements in financial statements	Misstatements in annual performance report	Non-compliance with legislation	Internal control deficiency	Service delivery	Matters affecting the auditor's report	Other important matters	Administrative matters		
	Property , plant and Equipment										
60	Impairment reversal (Comaf 30)	✓						✓		0	
201	Assets Non-compliance with GRAP (Comaf 38)	✓						✓		0	
	Supply Chain Management										
91	Local Content (Comaf 25)			✓				✓		0	
182	Unjustifiable deviation (Comaf 27)			✓				✓		0	
67	Non-compliance with Supply chain regulation 32 (Comaf 32)			✓				✓		0	
102	SCM deviations (Comaf 36)			✓				✓		0	
56	BAC composition (Comaf 40)			✓			✓			0	
	Receivables										
151	Impairment allowance misstated (Comaf 12)	✓						✓		0	
	Inventory										
102	Inventory Disclosure misstated (Comaf 24)	✓						✓		0	
	Budget statement										
175	Disclosure note 47 and budget statement misstated (Comaf 21)	✓						✓		0	
182	Statement of comparison and budget and Actual amounts misstated (Comaf 31)	✓						✓		0	



Page no.	Finding	Classification					Rating			Number of times reported in previous three years	Status of implementation of previous year(s) recommendation
		Misstatements in financial statements	Misstatements in annual performance report	Non-compliance with legislation	Internal control deficiency	Service delivery	Matters affecting the auditor's report	Other important matters	Administrative matters		
	Cash flow statement										
172	Cash flow Statement misstated (Comaf 18)	✓						✓			
	Disclosure										
135	Related parties misstated (Comaf 9)	✓						✓		1	In process
161	Contingent Liabilities misstated (Comaf 15)	✓						✓		0	
55	Financial Instruments and Statutory Receivables misstated (Comaf 19)	✓						✓		0	
191	Contingent Assets Disclosure Misstated (Comaf 33)	✓						✓		0	
60	Capitall commitments – misstated (Comaf 34)	✓						✓		1	In process
196	Presentation and disclosure (Comaf 35)	✓						✓		0	
	IT Findings										
123	Weaknesses in the management of user accounts for PROMUN (Comaf 6)				✓			✓		2	In process
125	The Disaster Recovery (DR) site is within 100 meters of Knysna Municipality (Comaf 6)				✓			✓		2	In process
127	Inadequate monitoring of the firewall (Comaf 6)				✓			✓		2	In process
	Value add matters										
199	Use of consultant (Comaf 37)				✓			✓		1	In process
210	Bloemfontein Housing Project of 150 top structures in Knysna (Comaf 1)				✓			✓		0	



ANNEXURE A: MATTERS AFFECTING THE AUDITOR'S REPORT

Predetermined objectives

Annual Performance Report Matters - COMAF 2

Audit finding

In terms of Section 41 (1) of the Municipal Systems Act no. 32 of 2000 (MSA), the Annual Report must

“(a) set appropriate key performance indicators as a yardstick for measuring performance, including outcomes and impact, with regard to the municipality's development priorities and objectives set out in its integrated development plan; (b) set measurable performance targets with regard to each of those development priorities and objectives; (c) with regard to each of those development priorities and objectives and against the key performance indicators and targets set in terms of paragraphs (a) and (b)—
(i) monitor performance; and
(ii) measure and review performance at least once per year;
(d) take steps to improve performance with regard to those development priorities and objectives where performance targets are not met.”

In terms of Section 46 of the Municipal Systems Act no. 32 of 2000 (MSA), *“the Annual Report must*
a) include the performance of the municipality and of each external service provider during that financial year; b) a comparison of the performances referred to in paragraph (a) with targets set for and performances in the previous financial year; and c) measures taken to improve performance.”

Section 3.2(b) of the National Treasury Framework for Managing Programme Performance Information (FMPPi) states that *“a good performance indicator should be well-defined; which means that the indicator needs to have a clear, unambiguous definition so that data will be collected consistently, and be easy to understand and use.”*

In terms of section 121 (3)(f) of the MFMA, *“the annual report of a municipality must include an assessment by the municipality's accounting officer of the municipality's performance against the measurable performance objectives referred to in section 17 (3) (b) for revenue collection from each revenue source and for each vote in the municipality's approved budget for the relevant financial year”*

The following findings were however noted during the audit of the 2018-19 annual performance report:

Issue 1 – Consistency of Objective

It was identified that the wording of Strategic Objective 1 was not consistent within the 2017-2022 Final Integrated Development Plan (IDP), the 2018-2019 Annual Performance Report (APR) and the 2018/19 Adjustment Service Delivery Budget and Implementation Plan (SDBIP). Details as follows:

Wording as per IDP	Wording as per SDBIP	Wording as per APR
Pages 15, 49, 50 and 206	Pages – None	Pages 9, 32 and 34
“To ensure the provision of bulk infrastructure and basic service through the upgrading and replacement of ageing infrastructure, and the expansion of new infrastructure”	None	“To ensure the provision of bulk infrastructure and basic service through the upgrading and replacement of ageing infrastructure, and the expansion of new infrastructure”
	Pages 8, 16, and 29	Page 7 and 12
	“To improve and maintain current basic service delivery through specific infrastructural development projects”	“To improve and maintain current basic service delivery through specific infrastructural development projects”

The wording for strategic objective one (SO1) as reported in the APR on pages 9, 32 and 34 were found not to be included in the final approved SDBIP and therefore incorrectly reported on in the APR resulting in non-compliance with section 41 (1) of the MSA and Section 3.2(b) of the National Treasury Framework for Managing Programme Performance Information (FMPPI). The APR may be materially misstated as a result of this finding.

Issue 2 – Consistency of Indicators

It was identified that the wording of Indicators TL5 to TL8 were not consistently reported in the SDBIP and the APR. The wording in the Annual Performance Report does not reflect the word “**residential**” in the indicator measures reported therein. Details as follows:

Ref	Wording as per IDP:	Wording as per SDBIP:	Wording as per APR:
TL5	“The number of residential properties with access to basic level of electricity”	“The number of formalised single residential properties with access to free basic services: ELECTRICITY”	“The number of formalised single properties with access to free basic services: ELECTRICITY”
TL6	“The number of residential properties with access to basic level of water”	“The number of formalised single residential properties with access to free basic services: WATER”	“The number of formalised single properties with access to free basic services: WATER”
TL7	“The number of residential properties with access to basic level of sanitation”	“The number of formalised single residential properties with access to free basic services: SANITATION”	“The number of formalised single properties with access to free basic services: SANITATION”
TL8	“The number of residential properties with access to basic level of solid waste removal”	“The number of formalised single residential properties with access to free basic services: SOLID WASTE/REFUSE”	“The number of formalised single properties with access to free basic services: SOLID WASTE/REFUSE”

The omission of the word **“residential”** fundamentally changes the meaning of the above indicators and may result in a material misstatement of the reported indicator measure. This furthermore results in non-compliance with section 41 (1) of the MSA and Section 3.2(b) of the National Treasury Framework for Managing Programme Performance Information (FMPPI).

Issue 3 – Measurability of Indicators

Ambiguity in definition

It was identified that for TL 27 - Provision of bulk services through the electrification of Informal Settlements, the indicator and its definition was not clear and unambiguous. The indicator is defined as electrifying informal settlements whereas the target and the achievement is measured as number of informal houses being electrified. The use of the term “settlements” implies a larger area being electrified which is not consistent with the way in which the indicator is being reported on.

Furthermore, it was also identified that indicator TL 29 - Human Settlement Implementation – Services and its definition is not clear and unambiguous in that the terms “servicing” and “sites” is not clearly defined so as to allow the user of the APR to understand exactly what is being reported on for the financial year.

Wording as per APR:

Ref	Key Performance Indicator	Definition	Target	Actual
TL27	"Provision of bulk services through the electrification of Informal Settlements"	"The provision of affordable housing units remains a high priority for the Council in order to restore the dignity of poor people and provide them with shelter as enshrined in the Constitution of South Africa."	300	359
TL29	Human Settlement Implementation – Services	"Provide housing opportunities through servicing sites."	65	0

The ambiguity in definition for the above indicators may result in a material misstatement of the reported indicator measures in the APR. This furthermore results in non-compliance with section 41 (1) of the MSA and Section 3.2(b) of the National Treasury Framework for Managing Programme Performance Information (FMPPI).

Issue 4 – Presentation and Disclosure / Accuracy and completeness indicator results

It was noted that for TL 29 - Human Settlement Implementation – Services, the Actual indicator results reported for the 2018/19 financial year was “0” and that the measures taken to improve performance were documented as: *“Awaiting information from Directorate”*.

This may indicate that the Actual indicator results for the 2018/19 financial year as well as the measures taken to improve performance were not accurately captured and reported on in the APR resulting in this indicator being potentially materially misstated in the APR.

Ref	Key Performance Indicator	Definition	Target	Actual	Status Achieved	Measures taken to improve performance
TL29	Human Settlement Implementation - Services	Provide housing opportunities through servicing sites.	65	0	KPI Not Met	Awaiting information from Directorate

The presentation and disclosure for the above indicator may result in a material misstatement of the reported indicator measure in the APR. This furthermore results in non-compliance with section 46 of the MSA.

Internal control deficiency

Financial and performance management

Prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information.

Management did not thoroughly review the SDBIP and the APR to ensure that these were consistent and accurately reported on in the 2018/19 financial year.

Recommendation

Management should ensure that adequate reviews are performed between the SDBIP and the APR to ensure that these were consistent and accurately reported on in the 2018/19 financial year.

Management is also requested to implement the following recommendations per issue reported on:

Issue 1

The APR should be amended to accurately reflect the wording for strategic objective one (SO1) to ensure that this is consistent with the wording as included in the final approved SDBIP for 2018/19.

Issue 2

The APR should be amended to accurately reflect the wording for indicator measures TL5 to TL8 to ensure that this is consistent with the wording as included in the final approved SDBIP for 2018/19.

Issue 3

As no remedial action can be implemented in the 2018/19 APR, it is recommended that the indicator measure definitions for TL27 and TL29 be revised in line with the principles per section 3.2(b) of the National Treasury Framework for Managing Programme Performance Information (FMPPI) in order to remove any ambiguity in the definition and the updated indicator definitions be presented to council for approval as part of the budget adjustments process for the 2019-20 financial year.

Issue 4

The APR should be amended to reflect the actual indicator results for the 2018/19 financial year as well as any measures taken to improve performance should the indicator target not have been achieved for the 2018/19 financial year.

Management response

Management comment on the audit finding:

Issue 1

Management agrees with the audit finding.

Issue 2

Management agrees with the audit finding.

Issue 3

Management agrees with the audit finding.

Issue 4

Management agrees with the audit finding.

Management comment on the root cause identified within the audit finding:**Issue 1**

To address the root cause management has adopted a two-pronged approach which is to be implemented over the medium-term to resolve various issues related to the IDP, SDBIP, APR and AR process including those identified in this ComAF.

The first part of the approach was to undertake an organisational review of the departments tasked with the IDP, SDBIP, APR and AR processes. The departments involved were the IDP Department (Planning and Development Directorate) responsible for the IDP the PIARM department (Municipal Managers Office) responsibility SDBIP and APR and the Administration Section (Corporate Services Directorate) responsibility the AR. The processes identified above were incorporated into a single division the Integrated Development Plan & Institutional Performance Management Division. Council approved the reviewed organogram during October 2018.

The second part of managements approach is the acquisition and implementation of an ERP system, to reduce and where possible remove manual systems. The current implementation date for the ERP system is in 2020/2021.

Issue 2

Same as above.

Issue 3

The Integrated Development Plan & Institutional Performance Management Division will assist management with the development of indicator definitions to remove ambiguities in definitions as part of the IDP and SDBIP processes.

Issue 4

Performance reporting challenges were mainly due to the Manager Housing post being vacant for a significant portion of 2018/2019. In addition, there was a change in directors responsible for Integrated Human Settlements function. The Director IHS Mr Joel Mkunqwana was appointed in May 2019 and a Manager IHS Mr Lindile Petuna was appointed in August 2019. It is anticipated that these appointments will resolve the performance related issues experienced in 2018/2019.

Management comment on the recommendation:**Issue 1**

Management agrees with the recommendation and will amend and submit the APR to the Auditor General.

I

Issue 2

Management agrees with the recommendation and will amend and submit the APR to the Auditor General.

Issue 3

Management agrees with the recommendation and will remove any ambiguity in definitions and update indicator definitions for presentation to Council for approval as part of the IDP review/budget adjustments process for the 2019-20 financial year.

Issue 4

Management agrees with the recommendation and will amend and submit the APR to the Auditor General.

Remedial action:**What actions will be taken:****Issues 1 and 2**

Amend and submit the APR to the Auditor General as per the audit finding recommendations.

Issue 3

Update indicator definitions for presentation to Council for approval as part of the IDP review/budget adjustments process in the 2019-20 financial year.

Issue 4

Amend and submit the APR to the Auditor General as per the audit finding recommendations.

By whom:

Issues 1 and 2
Manager PIARM

Issue 3
Manager IDP & IPM

Issue 4
Manager PIARM

By when:

Issues 1 and 2
1 October 2019

Issue 3
February – March 2020

Issue 4
1 October 2019

If the above findings affects an amount (s) disclosed in the financial statements:

YES

NO **X**

Please give an indication of whether the correcting journal entry shall be processed:

YES

NO

N/A
X

If yes, please indicate the accounting entry:

N/A

If no, please provide the reason why such a conclusion:

N/A

Name: **Dr. SW Vatala**
Position: **Municipal Manager**
Date: **01 October 2019**



Auditor's conclusion

Audit notes management's amendment of the APR which have been assessed as follows:

Issue 1

Management's response is noted. We received the adjusted APR and the amendments were found to have been made correctly. This matter will be remain in the management report as an "other important matter".

Issue 2

Management's response is noted. We received the adjusted APR and the amendments were found to have been made correctly. This matter will be remain in the management report as an "other important matter".

Issue 3

Management's response is noted. Management is unable to update the wording of TL 27 and TL 29 of the SDBIP therefore the misstatement still exists. This results in a material misstatement on the usefulness of the indicator which will be reported in the management and audit report.

Issue 4

Management's response is noted. We received the adjusted APR and the amendments were found to have been made correctly. This matter will be remain in the management report as an "other important matter".

Performance Indicators Misstated – COMAF 4

Audit Finding

Section 3 paragraph 2 of the National Treasury Framework for managing programme performance information (FMPPI) requires that a good performance indicator should be verifiable. It must be possible to validate the processes and systems that produce the indicator.

In terms of paragraph 5 the municipality's Indigent Support Policy and Procedures:

5.2: "Only registered owner occupiers will qualify."

5.4: "Only household/occupants/residents / dependants who do not own more than one property, qualify."

The following misstatements were identified per indicator:

ISSUE 1 - TL 1 - The number of single residential properties with access to basic level of electricity

During the audit of TL 1 - *The number of single residential properties with access to basic level of electricity*, the following issues were identified:

Accuracy:

The listing of the number of single residential properties with access to basic level of electricity submitted in support of the actual reported achievement for the year was found not to be in agreement with the actual results as reported on in the 2018/19 annual performance report. Details as follows:

Description	2018/19
Actual achievement per the APR	19 506
Actual achievement per the evidence provided	19 317
Overstatement of indicator result	189

The reported indicator results were consequently found to be overstated by 189 (0,97% deviation rate) at year end. The misstatement is not considered to be material.

ISSUE 2 - TL 2 - The number of single residential properties with Access to basic level of water

During the testing of TL 2 - *The number of single residential properties with Access to basic level of water*, the following issues were identified:

Accuracy:

The listing submitted in support of the actual reported achievement for the year was found not to be in agreement with the actual results as reported on in the 2018/19 annual performance report. Details as follows:

Description	2018/19
Actual achievement per the APR	11 050
Actual achievement per the evidence provided	10 305
Overstatement of indicator result	745

The reported indicator is consequently overstated by 745 (6,74% deviation rate) at year end. The misstatement is not considered to be material.

ISSUE 3 - TL 3 - The number of single residential properties with access to basic level of sanitation

During the testing of TL 3 - *The number of single residential properties with access to basic level of sanitation*, the following issues were identified:

Accuracy:

The listing submitted in support of the actual reported achievement for the year was found not to be in agreement with the actual results as reported on in the 2018/19 annual performance report. Details as follows:

Description	2018/19
Actual achievement per the APR	14 497
Actual achievement per the evidence provided	13 496
Overstatement of indicator result	1 001

The reported indicator is consequently overstated by 1 001 (7,41% deviation rate) at year end. The misstatement is not considered to be material.

Validity:

During the audit of TL 3 it was found that there were a number of duplicate account numbers included within the reported results for the year. The duplicate entries were found to relate to long outstanding debtor accounts which have been handed over for debt collection purposes and incorrectly added to the actual indicator results for the year.

The following customer accounts were found to be incorrectly duplicated in the sample selected for audit verification, details include:

NO.	ACCOUNT
1	10082600166
2	10823300015
3	11003500011
4	11598400013
5	20337500288
6	50018000176
7	111488000016

The reported indicator is consequently overstated by a projected misstatement of 3 499 (25,93% deviation rate) at year end.

The misstatement is considered to be material.

Completeness:

The following single residential properties selected from the valuation roll were found to have access to sewerage services during the year but were found to be excluded from the actual results as reported on in the 2018/19 annual performance report. Details as follows:

No.	Street Name	Street Number	Linked PROMUN account number
1	RAWSON STREET	11	100558000027
2	CIRCULAR DRIVE	39	104307000135

The reported indicator is consequently overstated by a projected misstatement of 1 271 (7,41% deviation rate) at year end.

The misstatement is not considered to be material.



ISSUE 4 - TL 4 - The number of single residential properties with level of solid waste removal

During the testing of TL 4 - *The number of single residential properties with access to basic level of solid waste removal*, the following issues were identified:

Accuracy:

The listing submitted in support of the actual reported achievement for the year was found not to be in agreement with the actual results as reported on in the 2018/19 annual performance report. Details as follows:

Description	2018/19
Actual achievement per the APR	15 351
Actual achievement per the evidence provided	15 350
Overstatement of indicator result	1

The reported indicator is consequently overstated by 1 (0,01% deviation rate) at year end.

The misstatement is not considered to be material.

Validity:

During the audit of TL 4 it was found that there were a number of duplicate account numbers included within the reported results for the year. The duplicate entries were found to relate to long outstanding debtor accounts which have been handed over for debt collection purposes and incorrectly added to the actual indicator results for the year.

The following customer accounts were found to be incorrectly duplicated in the sample selected:

NO.	ACCOUNT
1	11274400017
2	11501200014
3	20437300134
4	50057700179
5	99444400016
6	111501000012

The reported indicator is consequently overstated by a projected misstatement of 3 411 (22,22% deviation rate) at year end.

The misstatement is considered to be material.

ISSUE 5 - TL 5 - The number of formalised single properties with access to free ELECTRICITY

During the testing of TL 5 - *The number of formalised single properties with access to free electricity*, the following issues were identified:

Completeness:

The following indigent application forms in the sample selected were approved for all basic services including electricity but found to be excluded from the actual reported results for the year. Details are as follow:

No.	Promun Account	Owner	Meter number	Pre-paid account number
1	1-05752-000-01-2	TERBLANCHE J	1081547588	AGR/KN/02482
2	9-90046-000-11-3	BOTHA R	84625605898	AGR12300863
3	9-90039-000-10-1	MORRIS MSS	7076177208	AGR11250863
4	9-90034-000-10-5	HARTNICK DM	7076177190	AGR12040863
5	1-05856-000-01-1	LUITERS N	1076192374	AGR/KN/06200
6	1-05603-000-01-4	GROOTBOOM T & J	1075531614	105603000014
7	1-04001-000-01-7	BARNARD SSM & F	1317844841	104001000017

The reported indicator may therefore be overstated by a projected misstatement of 2 276 (25,93% deviation rate) at year end.

The misstatement is considered to be material.

ISSUE 6 - TL 6, 7, 8 - The number of formalised single properties with access to free basic service: WATER, SANITATION / SEWERAGE, SOLID WASTE / REFUSE

During the testing of TL 6, 7, 8 - *The number of formalised single properties with access to free basic service: WATER, SANITATION / SEWERAGE, SOLID WASTE / REFUSE* the following issues were identified:

Accuracy:

The listing to support the actual reported achievement for the year was found not to be in agreement with the indicator result as reported on in the 2018/19 annual report.

Description	2018/19
Actual achievement per the APR	1 721
Actual achievement per the evidence provided (excluding duplicates)	1 715
Overstatement of indicator result	6

It was noted that 6 duplicate account numbers were included in the above listing. Details as follows:

No.	Account	ERF	Owner
1	1-07311-000-01-3	1-07311-000	DAMONS BB & PC
	1-07311-000-01-3	1-07311-000	HANSEN MS
2	1-06517-000-01-1	1-06517-000	DAMONS AM
	1-06517-000-01-1	1-06517-000	LANGISA W & B
3	1-06264-000-01-8	1-06264-000	MEYER (SAAIERS) JL
	1-06264-000-01-8	1-06264-000	MEYER JL (SAAIERS)
4	1-06002-000-01-4	1-06002-000	JACOBS L
	1-06002-000-01-4	1-06002-000	KOCK GD
5	1-05482-000-01-5	1-05482-000	FREDERICKS S
	1-05482-000-01-5	1-05482-000	FREDERICKS S

No.	Account	ERF	Owner
6	1-04817-000-01-8	1-04817-000	KAPP V
	1-04817-000-01-8	1-04817-000	KAPP V

The reported indicator is consequently overstated by 6 items (0,35% deviation rate) at year end. The misstatement is not considered to be material.

Completeness:

The following indigent application forms from the sample selected were found to be approved per inspection of the signatures on the application forms and further inspection of the debtor accounts on the Promun system. The account numbers were however found to be excluded from the actual reported results for the year. Details include:

No.	Promun Account	Owner
1	1-05752-000-01-2	TERBLANCHE J
2	1-09936-000-01-8	DICK LL
3	1-09187-000-01-8	SIPHOKAZI S

The reported indicator results for the year were consequently found be understated by a projected misstatement of 191 (11,11% deviation rate) at year end.

The misstatement is considered to be material.

ISSUE 7 - TL 27 - Provision of bulk services through the electrification of Informal Settlements

During the audit of TL 27 - *Provision of bulk services through the electrification of Informal Settlements*, the following issues were identified:

Accuracy:

No listing was provided therefore reliance had to be placed on the actual Certificates of Compliance (COC) as supporting evidence. The following differences were identified:

Description	2018/19
Actual achievement per the APR	359
Actual achievement per the number of COC's provided	353
Difference (Overstatement)	6

Furthermore, as part of the total population of Certificates of Compliance provided, the following were duplicated:

No.	COC Number
1	E-COC-M0109048
2	E-COC-M0090463
3	E-COC-M0090474
4	E-COC-M0109009
5	E-COC-M0109014
6	E-COC-M0109008

The total accuracy misstatement is as follows:

	Number
Actual achievement per the APR	359
Total recalculation (excluding duplicates)	347
Difference (overstatement)	12

The reported indicator is consequently overstated by 12 (3,34% deviation rate) at year end.

The misstatement is not considered to be material.

Validity:

From the sample selected, the following certificates of compliance were installed after 30 June 2019 and therefore should not have been included in the 2018/19 APR:

Number	Information as per COC			
	Certificate number	Area	Meter number	Installation date
1	E-COC-M0109046	Endloveny, EN 29	42662521153	2019/08/30
2	E-COC-M0109011	Endloveny, EN 14	42662521310	2019/08/30
3	E-COC-M0090474	BS5 Blade Square	42662527846	2019/08/30

The reported indicator is overstated by a projected misstatement of 39 (11,11% deviation rate) at year end.

The misstatement is considered to be material.

Completeness:

The ONTEC report detailing all meter numbers installed and connected during the 2018/19 financial year subject to the Tariff scheme name "ELECTRIFICATION SCHEME 22" was used as the population source for testing purposes. Sample items were then agreed from the ONTEC report to the certificates of compliance (COCs) submitted as evidence thereof and agreed to the listing provided for inclusion therein.

Based on the results of tests performed, the following meter numbers were found to be excluded from the actual indicator results for the year. The newly installed meters could also not be agreed to the certificates of compliance submitted for audit purposes resulting in the misstatement at year end. Details include:

No.	Meter No.	Status	Installation	Account	COC subsequently provided	Audit impact
1	4269678811	Active	2019/04/05	ET19/1	No	Limitation
2	4269752749	Active	2019/05/06	ET152	No	Limitation
3	84625992924	Active	2019/03/06	HV34	No	Limitation
4	84625997998	Active	2019/03/05	HV13	No	Limitation
5	84625961283	Active	2019/02/11	CE278	No	Limitation
6	84625959329	Active	2018/08/14	DS1703	No	Limitation
7	4269752749	Active	2019/05/06	ET152	No	Limitation
8	4269678837	Active	2019/05/03	ET21/1	No	Limitation
10	4269649317	Active	2019/04/17	245B	No	Limitation
11	4269649234	Active	2019/04/17	C489	No	Limitation
12	4269751303	Active	2019/05/03	ET84	No	Limitation
13	84625601517	Active	2018/07/26	DS289	No	Limitation

In addition to the above, the following meter number could be agreed to a COC certificate but was excluded from the actual indicator results for the year.

No.	Meter No.	Status	Installation	Account	COC subsequently provided	Audit impact
9	4266252529	Active	2019/03/05	BS38	Yes	Misstatement

The reported indicator results for the year were consequently found to be understated by a projected misstatement of 269 (48,15% deviation rate) at year end.

The misstatement is considered to be material for inclusion in the audit report.

Internal control deficiency

Financial and Performance Management

Prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information

Management did not ensure that achievements of indicators were recorded and reviewed on IGNITE on a quarterly basis as this only occurred at year end for annual performance reporting purposes. This resulted in misstatements not being timeously detected or corrected.

In addition, the following was noted per issue identified:

Issue 1 and 2:

Management did not ensure that the detailed listing per indicator agreed to the annual performance report.

Issue 3:

Management did not implement a second level review process of the casting calculation performed to ensure the correct amount was captured.

In addition, management did not review the listings to ensure that all residential properties receiving sewerage services from the municipality's sewerage infrastructure network were accounted for in the reported performance or that hand over accounts were excluded from the listing.

Issue 4:

Management did not implement a second level review process of the casting calculation performed to ensure the correct amount was captured.

In addition, management did not review the listings to ensure that hand over accounts were excluded from the listing.

Issue 5:

Management did not perform a reconciliation between the indigent application forms and the ONTEC report to ensure that all indigents are correctly reported on.

Issue 6:

Management did not review the indigent register to ensure all duplicate ERF numbers and account numbers are excluded.

Furthermore, management did not implement proper controls to ensure all approved indigent application forms are included in the indigent register.

Issue 7:

Management did not review the supporting evidence of certificates of completion to ensure the total number provided agreed to the Annual Performance Report or that the certificates of completion were dated within the 2018/19 financial year. Additionally, no reviews were performed to ensure no duplicate certificates of completion were taken into account for reporting purposes.

Furthermore, no reconciliations were performed between the certificates of completion and any other source of information (e.g. ONTEC listing of total meters installed) to ensure all completion certificates were reported on.

Recommendation

Management should ensure that IGNITE is updated with the indicator achievement and reviewed on a quarterly basis to ensure that all information is valid, accurate and complete.

Issue 1 and 2:

Management should amend the annual performance report to accurately reflect the actual achievement for this indicator.

Issue 3:

Management should amend the Annual Performance Report to ensure all single residential properties with access to sewerage is included, all hand over accounts removed and the accurate amount should be reported on.

The updated listing should also be provided as audit evidence.

Issue 4:

Management should amend the Annual Performance Report to all hand over accounts and report on the accurate amount. The updated listing should be provided as audit evidence.

Issue 5:

Management should update the performance indicator for all approved indigent application forms for basic services and provide an updated listing as audit evidence.

Issue 6:

Management should update the Annual Performance Report and the indigent register with all indigent application forms as well as remove any duplicate ERF / Account numbers from the supporting indigent register.

Issue 7:

Management should ensure that they keep a listing of all COC's and perform regular reviews on the listing and the number of COC's.

Furthermore, management should inspect the full population of meters installed and provide the auditors with a detailed listing. Management should also update the Annual Performance Report to reflect the actual achievement for the indicator based on a reliable portfolio of evidence.

Management response

Management comment on the audit finding:

ISSUE 1 - TL 1 - The number of single residential properties with access to basic level of electricity

Management Response:

Management agrees with the finding, however the summary reports that were extracted from the system was used totalling to 19506, which agrees with the reported APR, the detailed report which was extracted afterwards did not agree, Management has considered and agreed that; for more accurate reporting the detailed report with the total of 19 317 must be used.

Conventional meters	3455
Prepaid meters	15862
Total	19317

ISSUE 2 - TL 2 - The number of single residential properties with Access to basic level of water

Management Response:

Management agrees with the finding, however the summary reports that were extracted from the system was used, totaling to 11050 which agrees with the reported APR, the detailed report which was extracted afterwards did not agree, Management has considered and agreed that; for more accurate reporting the detailed report with the total of 10305 must be used.

ISSUE 3 - TL 3 - The number of single residential properties with access to basic level of sanitation

Accuracy:

Management Response:

Management agrees with the finding, however it should be noted that this was a pure human error (capturing error), as it can be seen from the reported evidence that was submitted which had 13496, Management will rectify and amend the report.

Validity:

Management Response:

Management agrees with the finding as far as it relates to duplicates. An age analysis report was used for reporting on the APR. This report we have learned that it include all outstanding balances per account number and not per debtor. After consulting with the service provider it was discovered that the report used for the detailed listing (mun080) was incorrect as it included Handed over accounts. Management has reviewed the full population and excluded the duplicate accounts, giving 10800 number of single residential properties with access to sanitation. The reported APR will be amended accordingly.

Completeness:

Management Response

Management agrees with the finding. After consulting with the service provider it was discovered that the report used for the detailed listing (mun080) was incorrect as it excluded annual paying customers. Since these customers are not behind or have paid annually the Mun080 report is the age analysis, which will exclude accounts that are not outstanding. After consultation with R-data, Management used mun837, which is the report that has all the services per customer giving 10800 with no duplications, and all services included. The reported APR will be amended accordingly.

ISSUE 4 - TL 4 - The number of single residential properties with level of solid waste removal

Accuracy:

Management Response:

Management agrees with the finding, however this is a pure human error (typing error), as it can be seen from the evidence report that was submitted, which has 15 350, it was an error to capture 15 351. Management will rectify and amend the report.

Validity:

Management Response:

Management agrees with the finding as far as it relates to duplicates. An age analysis report was used for reporting on the APR. This report we have learned that it include all outstanding balances per account number and not per debtor. After consulting with the service provider it was discovered that the report used for the detailed listing (mun080) was incorrect as it included Handed over accounts. Management then used mun837 giving a total of 15306 number of single residential properties with level of solid waste removal

ISSUE 5 - TL 5 - The number of single residential properties with access to basic level of electricity

Management Response

Management disagree with the finding. Although customers may qualify in terms of income as indigent. For free electricity, a customer has to be on 20Amps to get the free electricity. If a customer is above 20Amps will not qualify free electricity. The seven customers mentioned, six are on 30Amps and one on 40Amps hence they will not receive free electricity units. **See attached tariff listing for 2018/19.**

ISSUE 6 - TL 6, 7 and 8 - The number of formalised single properties with access to basic services: Water, Sanitation and Solid Waste.

Management Response

Accuracy:

Management partially agree with the audit finding. After reviewing the information only number 3, 5 and 6 were duplicate: The others were human error in capturing, where account numbers and erf number were typed wrongly against the costumer while the customer names were different. The correct account numbers and erf numbers for number 1, 2 and 4 were captured correctly. A full review of the total population was performed and found only 3 duplications.

Completeness:

Management Response

Management agree with the audit finding. A full review of the total population was performed and it was found that not only the 3, but also additional 33 were not captured in the register and excluded from the reported results. These were then captured and the register updated.

Management comment on the root cause identified within the audit finding:

Management do not necessarily agree that the indicators were not recorded and reviewed in so far as issue 1 to 4. As stated, the reports submitted did agree but were summary report instead of the detailed listing report. In addition, the age analysis report, mun080 was used instead of the mun837. Management have agreed to use the more accurate reports, which is the detailed report and mun837.

Management does not agree with the root cause on issue 5

Management agrees with root cause in so far as it relate to proper reviews and controls in issue number 6.

<p><u>Management comment on the recommendation:</u> Management does review the indicators however due to separate systems and not having an ERP solution the information is extracted on excel from financial system and then captured on IGNITE manually. There is no seamless integration between the two systems causing these errors.</p> <p>Management agrees with the recommendations as far as issue 1 to 4 and will amend the APR and submit evidence for retesting and auditing.</p> <p>Management disagree with recommendations on issue 5 as per the reasons given that not all customers having 20Amps above qualify for free electricity units.</p> <p>Management agrees. The indigent register total population was reviewed and management has amended and updated the register.</p>			
<u>Remedial action:</u>			
<u>What actions will be taken:</u> Management has already evaluated these challenges and resolved to go out on tender for an ERP system which will be adjudicated by the BAC on 21 October 2019 and be awarded by the Municipal Manager before end of October. The reports will then be in one integrated system and taking away any human error of capturing manually.	<u>By whom:</u> CFO	<u>By when:</u> 30 November 2019	
If the above findings affects an amount (s) disclosed in the financial statements:		NO	
Please give an indication of whether the correcting journal entry shall be processed:			N/A
If yes, please indicate the accounting entry: N/A			
If no, please provide the reason why such a conclusion: N/A			

Auditor's conclusion

Issue 1

Management's comments are noted. We received the adjusted APR and the amendments were found to have been made correctly. This matter will remain in the management report and as other important matter.

Issue 2

Management's comments are noted. We received the adjusted APR and the amendments were found to have been made correctly. This matter will remain in the management report and as other important matter.

Issue 3

Management's comments are noted. The updated listing provided however was not free from misstatements therefore audit has reverted back to the initial projected misstatement. This results in a material misstatement in the Annual Performance Report on reliability which will be reported in the Management Report and Audit Report.

Issue 4

Management's comments are noted. The updated listing was tested and found to be free from misstatements based on sampling. We received the adjusted APR and the amendments were found to have been made correctly. This matter will remain in the management report and as other important matter.

Issue 5

Management's comments are noted. Duplicate receipts were subsequently provided proving the customers did not receive free basic electricity during the 2018/19 financial year and was therefore correctly excluded from the indicator. This matter will remain in the management report and as other important matter.

Issue 6

Management's comments are noted. The updated listing was tested and found to be free from misstatements based on sampling. We received the adjusted APR and the amendments were found to have been made correctly. This matter will remain in the management report and as other important matter

Issue 7

Management did not provide a response to Issue 7. We however received an updated listing from management. We inspected the adjusted APR and the amendments were found to have been made correctly. This matter will remain in the management report and as other important matter.

Bid Adjudication Committee Composition – COMAF 40

Local Government: Municipal Finance Management Act, 2003, Municipal Supply Chain Management Regulations states that:

Bid adjudication committees

“29. (2) A bid adjudication committee must consist of at **least four senior managers** of the municipality or municipal entity which must include -
 (i) the chief financial officer or, if the chief financial officer is not available, another manager in the budget and treasury office reporting directly to the chief financial officer and designated by the chief financial officer;
 (ii) at least one senior supply chain management practitioner who is an official of the municipality or municipal entity; and
 (iii) a technical expert in the relevant field who is an official of the municipality or municipal entity, if the municipality or municipal entity has such an expert.”

Local Government: Municipal Finance Management Act No. 56 of 2003 states that:

“Senior manager–

(a) in relation to a municipality, means a manager referred to in section 56 of the Municipal Systems Act.”

Issue:

During the audit of procurement and contract management, the Bid Committees of the following tenders were evaluated and it was identified that the composition of Bid Adjudication Committee is not appropriate as it was not made up of at least four (4) senior managers:

Tender No.	Bid Adjudication Committee Members	Expenditure since inception (R)	Expenditure current year (R)
T09 of 2018/19	M. Memani (CFO) - Chairperson F. Kruger (Manager. Expenditure) G. Boshoff (Community Services) D. Louw (Secretariat) P. Hariparsad (Technical Services)	1 302 231.00	1 302 231.00
T49 of 2018/19	M. Memani (CFO) - Chairperson F. Kruger (Manager. SCM) E Phillips (Acting director: Planning and development) D. Louw (Secretariat) P. Hariparsad (Technical Services)	829 654.69	829 654.69
T40 of 2018/19	M. Memani (Chairperson) E. Phillips (Acting Director Community Services) P. Hariparsad (Director: Technical Services) F. Kruger (Manager: SCM) D. Louw (Secretariat)	2 270 439.00	2 270 439.00
T42 of 2018/19	>M. Memani (Chairperson) >G. Boshoff (Director Community Services) >F. Kruger (Manager: SCM) >P. Makoma (Director: Corporate Services) >D. Louw (Secretariat)	2 490 107.55	2 490 107.55

Tender No.	Bid Adjudication Committee Members	Expenditure since inception (R)	Expenditure current year (R)
T43 of 2018/19	>M. Memani (Chairperson) >G. Boshoff (Director Community Services) >F. Kruger (Manager SCM) >P. Makoma (Director: Corporate Services) >D. Louw (Secretariat)	-	-
T58 of 2017/18	M. Memani (Chief Financial Officer) - Chairperson F. Kruger (Manager: Expenditure) N. Nelson (Finance) R. Parry (Technical Services) X. Frans (Community Services) – Acting	2 402 874.48	314 592.00
T70 of 2017/18	M. Memani (Chief Financial Officer) - Chairperson N. Nelson (Secretariat) - Acting R. Parry (Technical) R. Healing (Secretariat) F. Kruger (Manager: Expenditure) X. Frans (Community services) - Acting M. Boyce (Planning and development) - Absent with leave	9 167 132.00	9 167 132.00
T29 of 2018/19	>M. Memani (Chairperson) >G. Boshoff (Director Community Services) >P. Hariparsad (Director Technical Services) >F. Kruger (Manager SCM) >D. Louw (Secretariat)	1 128 907.46	1 128 907.46
T31 of 2018/19	>M. Memani (Chairperson) >E. Phillips (Acting Director Community Services) >P. Hariparsad (Director: Technical Services) >F. Kruger (Manager: SCM) >D. Louw (Secretariat)	3 366 974.20	3 366 974.20
T55 of 2018/19	M. Memani (CFO) - Chairperson J. Kalani (Acting Director: Planning and Development) P. Hariparsad (Technical Services) F. Kruger (Manager: SCM) D. Louw (Secretariat)	-	-

As a result of the above, this results in irregular expenditure since inception of the contracts to an amount of R22 958 320,38 (current year irregular expenditure R20 870 037,90).

Internal control deficiency

Financial and performance management

Review and monitor compliance with applicable laws and regulations

Management did not ensure that bid adjudication committee is in compliance with the MSCM regulations on awarding the above tenders.

Recommendation

It is recommended that management disclose irregular expenditure in the financial statements to the amount of R22 958 320,38.

Management should ensure that bid adjudication committee is in compliance with the municipal supply chain management regulations on awarding all tenders.

Management response

Management comment on the audit finding:

Management disagrees with the audit findings. Management wants to bring the following to the attention of the Auditor General-

1. Our interpretation and understanding of regulation 29 is that it speaks to the composition of the BAC.
2. We want to quote the following key words "The BAC ***must consist*** of 4 Senior Managers". The word "must" and the word "consist" read together clearly speak to the composition of the BAC.
3. The SCM policy provides for a quorum of the BAC meetings, which is 50% plus 1. In all BAC meetings, the quorum has been met.
4. One can imagine a decision taken in Parliament, a Board or a Council meeting that it could be illegal on the basis that not all members of Parliament or the Board or Council were present in a meeting. Any decision-making in a democratic state of South Africa is based on the majority. In Parliament, the majority of two-thirds will be required and not all members. We therefore differ with the AG's interpretation.

Management comment on the root cause identified within the audit finding:

Management disagrees with the root cause identified. The root cause is the misinterpretation of the regulation by the AG-SA.

Management comment on the recommendation:

Management disagrees with the recommendation and has already made representations to the AG. Management has stated its position on this matter however, due to the insistence of the AG, Management resolved to disclose the expenditure as irregular. It must however be stated on record that Management is in disagreement with this audit finding.

Remedial action:

<u>What actions will be taken:</u>	<u>By whom:</u>	<u>By when:</u>
The municipality will consider a declaratory order for this matter to be resolved	Municipal Manager	31 March 2020
If the above findings affects an amount (s) disclosed in the financial statements:	YES	
Please give an indication of whether the correcting journal entry shall be processed:		NO
No journal entry required. Disclosure Note 49 to be amended only		
If yes, please indicate the accounting entry:		
N/A		
If no, please provide the reason why such a conclusion:		
Management disagrees with the audit finding		

Auditor's conclusion

Management's comments are noted.

Subsequent to issuing the findings management agreed to adjust the annual financial statements. We have inspected the adjusted annual financial statements and confirmed that the irregular expenditure has been correctly disclosed. This finding resulted in a material non-compliance and will be reported in the management report under "Matters affecting the Audit Report".

ANNEXURE B: OTHER IMPORTANT MATTERS

Impairment Reversal - COMAF 30

Audit Finding

The Municipal Finance Management Act no. 56 of 2003 (MFMA), section 122 (1) (a) states that:

“Every municipality and every municipal entity must for each financial year prepare annual financial statements which fairly presents the state of affairs of the municipality or entity, its performance against its budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results, and its financial position as at the end of the financial year.”

Paragraph 17 of the Generally Recognised Accounting Practice (GRAP) 1 - Presentation of Financial Statements states that:

“Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, revenue and expenses. The application of Standards of GRAP with additional disclosures, when necessary, is presumed to result in financial statements that achieve a fair presentation.”

Paragraph 5 of the Standard of Generally Recognised Accounting Practice (GRAP 1) – Presentation of Financial Statements defines expenses and revenue as follows:

“Expenses are decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrences of liabilities that result in decreases in net assets, other than those relating to distributions to owners.”

“Revenue is the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets, other than increases relating to contributions from owners.”

Paragraph 10 of the Standard of Generally Recognised Accounting Practice (GRAP 21) – Impairment of Non-cash generating Assets defines the recoverable service amount and the value in use of non-cash generating assets as follows:

“Recoverable service amount is the higher of a non-cash-generating asset’s fair value less costs to sell and its value in use.”

“Value in use of a non-cash-generating asset is the present value of the asset’s remaining service potential.”

Paragraph 79 of GRAP 21 states that:

“An entity shall disclose the following for each material impairment loss recognised or reversed during the period:

- (a) The events and circumstances that led to the recognition or reversal of the impairment loss;*
- (b) The amount of the impairment loss recognised or reversed;*
- (c) The nature of the asset;*
- (d) If the entity reports segment information in accordance with GRAP 18, the reportable segment to which the asset belongs; GRAP 21*
- (e) Whether the recoverable service amount of the asset is its fair value less costs to sell or its value in use;*

- (f) if the recoverable service amount is fair value less costs to sell, the basis used to determine fair value less costs to sell (such as whether fair value was determined by reference to an active market);
- (g) if the recoverable service amount is value in use, the method and significant assumptions applied, including the discount rate(s) used in the current estimate and previous estimate (if any) of value in use; and
- (h) Whether an independent valuer was used to determine the recoverable service amount.”

Issue 1 – AFS Non-disclosure

During the audit of capital assets, it was noted that municipal property was subject to an impairment reversal based on a 5% improvement in the market values of properties within Knysna, per the valuation report issued by the management expert.

For the impairment loss recognised, it was disclosed in note 32 of the Notes to the Annual Financial Statements for the year ended 30 June 2019 that the recoverable amount of the asset was based on its value in use.

However, for the reversal of impairments, the requirement as per paragraph 79 (e) of GRAP 21 was not adhered to, as it was not disclosed whether the recoverable service amount of the asset is its fair value less costs to sell or its value in use. Consequently, the requirements as per paragraph 79 (f) and paragraph 79 (g) of GRAP 21 was also not adhered to.

Furthermore, it was not disclosed whether an independent valuer was used to determine the recoverable service amount as required by paragraph 79 (h).

Based on the afore-mentioned, the fair presentation of the reversal of impairments was not achieved. The identified finding is however not regarded as material.

Issue 2 – Valuation of asset items impaired

As per GRAP 21, the recoverable service amount of a non-cash generating asset is the higher of its fair value less costs to sell and its value in use. The recoverable amount of the assets was based on its value in use. No information pertaining to the asset's fair value less costs to sell was provided to audit. Consequently, audit was unable to determine if the recoverable amount of the asset was correctly calculated as the higher of the fair value less costs to sell and its value in use.

The identified finding could potentially result in the reversal of impairments and the value of assets being materially misstated.

Issue 3 – Expenditure classification

During the audit of impairment of assets / (Reversal of impairments), it was identified that the reversal of impairments amounting to R8 748 339 was presented as expenditure and incorrectly included in the total expenditure in the Statement of Financial Performance for the year ended 30 June 2019.

As per GRAP 1, the reversal of impairment meets the definition of revenue, as it is a gross inflow of economic benefits that results in the increase of net assets. The reversal of impairments does not meet the definition of expenses as per GRAP 1, as it is not a decrease in economic benefits or service potential.

The identified finding has resulted in a factual misstatement of R8 748 339 and the understatement of total expenditure and total revenue.

Internal control deficiency

Financial and performance management

Prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information

Issue 1

Management did not adequately review the AFS against the GRAP disclosure checklist to ensure that all required disclosures were made.

Issue 2

Management did not obtain the fair value of asset items and the costs to sell these items in order to calculate the recoverable amount in accordance with GRAP 21.

Issue 3

Management did not adequately review the AFS to ensure that expenditure and revenue items were appropriately presented in the AFS in line with GRAP 1 reporting requirements.

Recommendation

Management should investigate the causes of the misstatements and make the appropriate adjustments.

In addition, the following is also recommended per issue reported on:

Issue 1

Management should assess the AFS against the GRAP disclosure requirements to ensure that all disclosures required by GRAP is made.

Issue 2

Management should assess the fair value of asset items and the costs to sell these items to determine whether the recoverable amount of the asset items were accurately calculated and the assets therefore appropriately valued.

Issue 3

Management should strengthen its reviews of the AFS to ensure that expenditure and revenue items are appropriately presented and classified in terms of the GRAP 1 reporting requirements.

Management response

Management comment on the audit finding:

Issue 1

The disclosure relating to the impairment loss indicate that it is based on property market valuations. This is by implication then fair value less cost to sell.

We however take note of the finding and can change the disclosure to more clearly state fair value less cost to sell as well as to include that an independent valuer was used.

Issue 2

We disagree with the findings. The impairment refers to the landfill site rehabilitation decommissioning and restoration changes. This is accounted for in accordance with the requirements of IGRAP 2.

Extracts from IGRAP 2 – Changes in existing decommissioning, restoration and similar liabilities:

.05 If the related asset is measured using the cost model:

(a) subject to (b), changes in the liability shall be added to, or deducted from, the cost of the related asset in the current period.

(c) if the adjustment results in an addition to the cost of an asset, the entity shall consider whether this is an indication that the new carrying amount of the asset may not be fully recoverable. If it is such an indication, the entity shall test the asset for impairment by estimating its recoverable amount or recoverable service amount, and shall account for any impairment loss, in accordance with the Standards of GRAP on Impairment of Non-cash-generating Assets or Impairment of Cash-generating Assets.

.07 The adjusted depreciable amount of the asset is depreciated over its useful life. Therefore, once the related asset has reached the end of its useful life, all subsequent changes in the liability shall be recognised in surplus or deficit as they occur. This applies under both the cost model and the revaluation model.

As these landfill sites are all at the end of its useful life, the change in the liability effect on the asset was impaired in order to recognize in surplus or deficit for the year. The carrying amount of the assets can't be increased due to being at the end of its useful life and consequently the impairment as required by IGRAP2 par 05(c).

It should also be noted that this impairment is due to an increase in the carrying value of the asset due to the increase in the liability as per IGRAP 2. It is consequently not a normal impairment of the existing carrying value of the asset, but evaluation whether the increase in the carrying value due to the increase in the liability is justified. In Knysna's case the increase in the carrying value was evaluated and treated as to be impaired per IGRAP 2.

Methods of impairment used and evaluation per GRAP 21:

i) Impairment of tipsite:

Value in use was used as fair value less cost to sell is not applicable in this instance. Waste removal sites are zoned and licenced as such and is a function of the municipality. Fair value less cost to sell is consequently not possible in the current state and condition as this is a municipal function. Par 33 of GRAP 21 is consequently applicable.

GRAP 21 extracts:

.33 It may be possible to determine fair value less costs to sell, even if an asset is not traded in an active market. Paragraph .39 sets out possible alternative bases for estimating fair value less costs to sell when an active market for the asset does not exist. However, sometimes it will not be possible to determine fair value less costs to sell because there is no basis for making a reliable estimate of the amount obtainable from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. In this case, the entity may use the asset's value in use as its recoverable service amount.

.39 If there is no binding sale agreement or active market for an asset, fair value less costs to sell is based on the best information available to reflect the amount that an entity could obtain, at reporting date, from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs of disposal. In determining this amount, an entity could consider the outcome of recent transactions for similar assets within the same industry. Fair value less costs to sell does not reflect a forced sale, unless management is compelled to sell immediately.

ii) Reversal of impairment:

Refer to extracts from GRAP 21:

.34 If there is no reason to believe that an asset's value in use materially exceeds its fair value less costs to sell, the asset's fair value less costs to sell may be used as its recoverable service amount.

.61 The list in paragraph .59 is not exhaustive. An entity may identify other indications of a reversal of an impairment loss that would also require the entity to re-estimate the asset's recoverable service amount. For example, any of the following may be an indication that the impairment loss may have reversed:

(a) a significant rise in an asset's market value;

.64 An impairment loss recognised in prior periods for an asset shall be reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable service amount since the last impairment loss was recognised. If this is the case, the carrying amount of the asset shall, except as described in paragraph .67, be increased to its recoverable service amount. That increase is a reversal of an impairment loss.

The majority of the reversal of impairment (R 7 804 040) relates to land. Please see the summary below:

	Land	Buildings	Total
Investment Property	1 846 535	396 073	2 242 608
Property, plant and equipment	5 222 505	544 274	5 766 779
Heritage assets	735 000	3 952	738 952
	7 804 040	944 299	8 748 339

Land:

Due to the nature of land, it is established that the asset's value in use will not exceed fair value less cost to sell. The value in use approaches per par .43 to .47 in GRAP 21 will also not always be applicable due to the nature of land. By evaluating the approaches, the restoration cost approach and the service units approaches is not applicable on land. As depreciation is also not applicable on land the fair value less cost to sell will be equal to the depreciated replacement cost as the replacement cost will be the fair value less cost to sell at that stage.

Consequently, per the evaluation the fair value less cost to sell on land, as used in the financial statements, is the correct approach per GRAP 21.

Buildings:

The buildings impairments are immaterial in total. Deemed cost was used at GRAP implementation date for the initial recognition and measurement of buildings. Due to this initial recognition it was evaluated that the value in use of buildings should not differ materially from the fair value less cost to sell. As these buildings are not service delivery buildings, but primarily operational buildings the depreciated replacement cost will be the most applicable approach. As the previous impairments were based on decline in market values indicators the restoration cost and the service units approaches are not regarded as applicable.

We evaluated the largest reversal of impairment relating to buildings (Erf 1115 building). The total reversal of impairment on this building amounted to R 364 596 (representing 39% of the R 944 299 reversal).

The depreciated replacement cost of the building was recalculated based on the average building cost of R 7 020 per m² for the Western Cape.

Key information about the building (Erf 1115) are as follows at 30 June 2019:

Size: 1853 m² (as per latest approved building plans – refer to the attached building plans)

Carrying value: R 11 962 106 (after reversal of impairment excluding WIP)

Based on R 7 020 per m² the depreciated replacement cost of the asset amounts to R 10 321 249 excluding VAT. Based in the evaluation the fair value less cost to sell is the higher when compared to the value in use as recalculated. Refer to the attached recalculation.

Based on this and the initial recognition as mentioned earlier in the response it is regarded that the value in use and the fair value less cost to sell will not differ materially and that the fair value less cost to sell is the higher, was used for the initial impairment and is consequently reversed as such and treated correctly in the fixed asset register and financial statements.

Issue 3

We disagree with the finding. The reversal of the impairment does not result in a gross inflow of economic benefits. The nature of the reversal is a reversal of previously recognised impairment through expenses. It is consequently not an income but a reversal of previously recognised expenditure. Consequently, based on the definitions in GRAP and the substance of the reversal being a reversal of previously recognised expenditure it is correctly presented and disclosed in the financial statements.

Management comment on the root cause identified within the audit finding:

We disagree as the financial statements were reviewed by various parties and the presentation and disclosure is in accordance with the GRAP accounting standards and interpretations as explained above.

Management comment on the recommendation:

We are in disagreement as stated in the response on the finding. The current treatment and presentation and disclosure is in accordance with the GRAP accounting standards and interpretations. We however take note of the disclosure as per issue 1 and will adjust and elaborate the current disclosure in the AFS.

Remedial action:			
What actions will be taken:	By whom:		By when:
None			
If the above findings affects an amount (s) disclosed in the financial statements:			NO
Please give an indication of whether the correcting journal entry shall be processed:			N/A
If yes, please indicate the accounting entry:			
N/a			
If no, please provide the reason why such a conclusion:			
N/a			

Auditor's Conclusion

Management's response is noted.

Subsequent to the issuing of the communication of audit finding, the following was identified:

The entity used an external source of information to determine if there is an indication that the impairment loss recognised in prior periods should be reversed. The external information should be used to determine if a significant long-term change with a favourable effect on the entity has taken place during the period. The valuation report indicated that there has been a 5% increase in the market value of properties in the greater Knysna area. A 5% increase is not a **significant** long-term change with a favourable effect on the entity. Furthermore, there was not a **long-term change** with a favourable effect on the entity.

Based on the assessment, it was concluded that the reversal of impairment did not occur. The reversal of impairment is therefore misstated. The misstatement amounts to R8 487 969.

Management is in agreement with this assessment.

The auditors inspected the adjusted AFS and confirmed that the necessary amendments were made to correct the misstatement.

Issue 1

Based on the afore-mentioned, it was concluded that the reversal of impairment did not occur. Issue 1 is therefore resolved as no reversal of impairment occurred.

Issue 2

The auditors are in agreement with management. Based on discussions with management, the fair value less costs to sell of the assets (landfill sites) subject to impairment will be less than the value in use of the assets. The recoverable amount is therefore the value in use. The finding is therefore resolved.

Issue 3

Based on the afore-mentioned, it was concluded that the reversal of impairment did not occur. Issue 3 is therefore resolved as no reversal of impairment occurred.

This finding will remain in the management report as an "other important matter" for the control deficiency identified to be addressed.

Non-compliance with Municipal Supply Chain Regulation 32 – COMAF 32

Audit finding

Section 1 of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) defines irregular expenditure as “*expenditure incurred by a municipality or municipal entity in contravention of, or that is not in accordance with, a requirement of this Act, and which has not been condoned in terms of section 170*”.

Section 110(2)(c) of the MFMA states that Chapter 11, Part 1: Supply chain management, states that: “*This Part, except where specifically provided otherwise, does not apply if a municipality or municipal entity contracts with another organ of state for the procurement of goods and services under a contract secured by that other organ of state, provided that the relevant supplier has agreed to such procurement*”.

Regulation 32 of the Municipal Supply Chain Management Regulations (SCM Regulations) reads as follows:

- (1) *A supply chain management policy may allow the accounting officer to procure goods or services for the municipality or municipal entity under a contract secured by another organ of state, but only if-*
 - (a) *the contract has been secured by that organ of state by means of a competitive bidding process applicable to that organ of state;*
 - (b) *the municipality or entity has no reason to believe that such contract was not validly procured;*
 - (c) *there are demonstrable discounts or benefits for the municipality or entity to do so; and*
 - (d) *that the other organ of state and the provider have consented to such procurement in writing.*

The following two court cases provided rulings on the interpretation of SCM regulation 32:

- Blue Nightingale Trading 397 (Pty) Ltd t/a Siyenza Group v Amathole District Municipality [2016] 1 All SA 721 (ELC)
- Kwadukuza Municipality v Skilful 1169 CC and Another (11060/2017) [2018] ZAKZDHC 35

These court rulings have the force of law and must form the basis against which the application of regulation 32 is tested.

The above court case provides the following example and rulings in terms of the interpretation of section 110(2)(c) of the MFMA (referred to as LGMFMA in rulings):

- (a) Ruling 32: The usual example would be where an organ of state contracts, in accordance with a Section 217 compliant process, with a supplier to supply say R5 Million Rand's worth of A4 paper. If that organ of state thereafter does not intend to utilize the entire consignment, it is permissible for another organ of state to, as it were, 'take up the slack' in respect of the remaining portion of the same contract.
- (b) Ruling 33: I must add that the second organ of state will do so by procuring the A4 paper under the contract between the first organ of state and the supplier, as required by section 110(2)(c).
- (c) Ruling 34: The constitutionality of the exemption will always depend on the facts of the particular case. For the exemption to operate under section 110(2) of LGMFMA, I cannot conceive compliance with the constitutional imperatives unless the goods or services procured by the second organ of state are the same as that required by the first organ of state, and the contract price is the same

- (d) Ruling 35: In my respectful view, the terms and conditions of a procurement contract between the second organ of state and the supplier which complies with Chapter 11 of the LGMFMA (including section 116 thereof which requires the contract to be in writing and stipulates the nature of the terms and conditions thereof and the management of the contract) cannot be deleted or amended or compromised in such a manner as to render the contract with the first organ of state not compliant with either Chapter 11 or with the constitutional imperatives.
- (e) Ruling 36: The words "... under a contract secured by another organ of state ..." in the Regulation can only refer to the "... contract with another organ of state ..." as contemplated by section 110(2) of the empowering legislation (LGMFMA).
- (f) Ruling 37: In my respectful view, this can only refer to the situation where the municipality, with the consent of the supplier, either becomes a party to the existing contract between the other organ of state and the supplier; or where the other organ of state concludes a contract with the supplier for the benefit of a third party, namely for the benefit of the municipality, against payment by the municipality of the approved contract price. In either case, the material terms and contract price of the contract already secured by that organ of state remain binding, and thus remain compliant with section 217 of the Constitution and with the procurement policy of the other organ of state, and therefore with LGMFMA.

MFMA Circular No. 96 was issued on 24 July 2019 *to provide further elaboration to municipalities and municipal entities on the principle as captured in Regulation 32 of SCM Regulations when procuring good or services from contracts secured by other organs of state.*

The legal interpretation results in the application of regulation 32 in a procurement process, effectively meaning that the accounting officer of the original contracting organ of state is willing to forfeit a portion of its contract, in terms of contract value and quantity that has not already been utilised, to the accounting officer who is requesting to procure under that contract.

Issue

The following regulation 32 deviations were identified on which expenditure was incurred during the 2018-19 financial year:

Other organ of state	Award number	Contract start date	Supplier name	Award value	Expenditure incurred in 2018-19
Saldanha Bay Municipality	T26 of 2018/19	17/08/2018	Moore Stephens Mo Incorporated Mubesko Africa CC	"Cost will be incurred in accordance with the tender rates"	R4 043 454.51
City of Cape Town	T39 of 2017/18	2017/18	Sakhikhaya Suppliers CC	"Various rates"	R41 187 138.98

Other organ of state	Award number	Contract start date	Supplier name	Award value	Expenditure incurred in 2018-19
Mosselbay Municipality	T45 of 2017/18	25/10/2017	Element Consulting Engineers Royal Haskoning DHV t/a SSI Engineers and Environm Aurecon SA Pty (Ltd) UWP Consulting (Pty) LTd Clinkscapes Maughan-Brown (South) Pty Ltd Uhambiso Consult (Pty) Ltd SMEC South Africa (Pty) Ltd Kantley & Templer (Pty) Ltd Cobus Louw Professional Engineer Chauke Quantity Surveyors Bosch Projects (Pty) Ltd V3 Consulting Engineers C (Pty) Ltd Neil Lyners and Associates Close Corporation Quantra Consulting (Pty) Ltd Urhwebo Transand Willvest 23 (Pty) Ltd BDE Consulting Engineers Makukhane Consulting Engineers CC CSM Consulting Services Gibb Pty Ltd Van Coller Trading and Services t/a Shama Consulta Re-solve/Eas JV	"Various rates"	R21 945 082
Bitou Municipality	T49 of 2017/18	23/08/2018	Chauke Quantity Surveyors CC	"Various rates"	R3 135 163.43
Bitou Municipality	T75 of 2017/18	31/10/2017	Agito Minds (Pty) Ltd	"Various rates"	R356 109.52
Total				"Various rates"	R70 666 948.44

No supporting information was submitted relating to the regulation 32 awards listed above, indicating that the award value of these individual contracts was equivalent to the portion of the original contract that was forfeited by the other organ of state.

It was also identified that expenditure incurred on the above listed contracts from the inception of the contract to the end of financial year 2018-19 was not expenditure incurred based on the portion of the original contract value which was forfeited by the other organ of states. As such the total expenditure since inception amounting to R93 761 895.46 on these active contracts is irregular expenditure as it is non-compliant with section 1 of the MFMA.

This also constitutes non-compliance with SCM regulation 19, which has been assessed as material.

Furthermore, based on evidence submitted to audit as part of the documents supporting the regulation 32 awards listed above, there was no form of analysis performed by the Knysna Municipality to determine the cost savings / benefits / discounts that will be achieved by procuring from the contract which is secured by the other organ of state. This constitutes non-compliance with SCM regulation 32(1)(c).

Internal control deficiency

Financial and performance management-

Review and monitor compliance with applicable laws and regulations.

Management did not identify that its historical interpretation and application of SCM regulation 32 has resulted in non-compliance with the regulation and/or has failed to provide audit with evidence that the expenditure incurred by it on so-called “piggy-back” contracts were limited to the portion forfeited by the other organ of state, resulting in the incurring of irregular expenditure.

Recommendation

Management should review its interpretation and implementation of SCM regulation 32 and implement the principles as clarified by the courts in the matters of *Blue Nightingale Trading 397 (Pty) Ltd t/a Siyenza Group v Amathole District Municipality* and *Kwadukuza Municipality v Skilful 1169 CC and Another* as it has the force of law and must form the basis against which the application of regulation 32 is measured.

The outcomes of the court judgement are to be applied retrospectively and applies to contracts where expenditure has been incurred in the 2018-19 financial year.

Management should investigate all regulation 32 contracts on which expenditure was incurred in 2018-19 to identify any other instances where the prescribed requirements were not complied with, or alternatively, provide audit with evidence, obtained from the other organ of state, confirming that that expenditure was incurred on a forfeited portion of the original award. Evidence of any such investigation, as well as the outcome thereof, should be provided for auditing.

Management is advised to review their existing SCM policies and effect the necessary amendments where appropriate for approval by the municipal council.

Management response

Management comment on the audit finding:

Management disagree with the finding.

1. In considering the validity of the AG's interpretation, author reviewed the following 30 points of reference:

Case law (common law):

- 1) Blue Nightingale Trading 397 (Pty) Ltd t/a Siyenza Group v Amathole District Municipality [2016] 1 All SA 721 (ELC) – [Blue Nightingale judgement]
- 2) Kwadukuza Municipality v Skilful 1169 CC and Another (11060/2017) [2018] ZAKZDHC 35 – [KDM judgement].
- 3) Kaknis v Absa Bank Limited & another (08/16) [2016] ZASCA 206 (15 December 2016).
- 4) Fidelity Services (Pty) LTD v Mogale City Local Municipality and others, Case number 32719/15, Gauteng High Court [2016].

- 5) Sizabonke vs Zululand DM [CASE NO: 10878/2009].
- 6) AllPay Consolidated Investments Holdings (Pty) Ltd and Others v Chief Executive Officer of the South African Social Security Agency and Others (No 2) CCT 48/13.
- 7) City of Cape Town v Aurecon SA (Pty) Ltd [2017] ZACC 5.
- 8) Buffalo City Metropolitan Municipality v ASLA Construction (Pty) Ltd, [2019], ZACC 15.
- 9) Transnet Ltd v Chairman, National Transport Commission, & others 1999 (4) SA 1 (SCA).

Legislation (statutory law):

- 10) The Constitution of RSA.
- 11) The Municipal Finance Management Act, 2003 (Act 56 of 2003) – [MFMA]
- 12) Public Finance Management Act, 2003 (Act 1 of 1999) – [PFMA]
- 13) The relevant MFMA SCM Regulations [SCMR] issued in terms of the MFMA.
- 14) The relevant MFMA SCM Regulations [SCMR] issued in terms of the PFMA [SCMR 16A].
- 15) Promotion of Administrative Justice Act, 2000 (Act 3 of 2000)-[PAJA]
- 16) Interpretation Act, 1957 (Act 33 of 1957)
- 17) Public Audit Act, 2004 (Act 25 of 2004 as amended by Act 5 of 2018)
- 18) The Municipal SCM Policy [SCMP].

Treasury circulars:

- 19) MFMA Treasury Circular 96 of July 2019 relating to SCMR 32 contracts;
- 20) MFMA Treasury Circular 80 of March 2016 and its amendment on 18 October 2016 as well as the Treasury letter of 5 February 2019, relating to RT 25-2016 transversal contract and the application of SCMR 32.
- 21) MFMA Treasury Circular 62 of July 2013 relating to various SCM matters including the amendment of contracts.
- 22) MFMA circular 68, as updated in June 2019 relating to unauthorized, irregular and fruitless and wasteful expenditure.
- 23) Kwa Zulu Natal Provincial Treasury, circular 01/2016, effective from 1 April 2017, relating to SCMR 32 contracts.

Treasury guidelines:

- 24) National Treasury Guide to Participation in Transversal Term Contracts Facilitated by National Treasury, March 2017

Academic records:

- 25) Prof P Bolton in '*The Law of Government Procurement in South Africa*', LexisNexis Butterworths, Durban, 2007.
- 26) Adv Reason Misiwa Baloyi in '*Termination of Contracts by Organs of State*', Master Thesis (Student No.: 16395922), January 2018.
- 27) '*Researching South African Law*', by Amanda Barratt and Pamela Snyman and updated by Salona Lutchman in March 2018
- 28) '*The Government Procurement Review*', 6th edition, May 2018 Law Business Research, Adams & Adams.
- 29) Lourens M du Plessis, '*The Re-Interpretation of Statutes*', LexisNexis, 2002.
- 30) LM du Plessis "Statute Law and Interpretation" LAWSA (volume 25(1) 2nd ed) para 302.

DISCUSSION

2. It is argued that the validity of the AG's interpretation in this matter is challengeable and may be set aside by a competent court of law, based on the following **NINE** considerations [*heads of argument*], which is discussed on a high-level further in the document:

A. Incorrect understanding of the application of case-law, specifically in terms of:

- A1. Jurisdiction of a high court judgement.**
- A2. 'Case law' when compared with 'customary law'.**
- A3. 'Ruling' versus 'Dictum'.**

B. Incorrect interpretation and application of the retrospective application of 'case law'.

- C. Incorrect interpretation and application of section 1 of the MFMA, i.e. definition of irregular expenditure.**
- D. Failure to consider and test of all relevant legislation.**
- E. Incorrect understanding and application of Treasury circulars.**
- F. Inconsistent interpretation of application of its audit test at various municipalities.**
- G. Incorrect interpretation and application of SCMR 32 as a 'deviation'.**
- H. Alternative arguments [potential points in limine]:**
 - H1. Blue Nightingale judgement poses grounds for further judicial review.**
 - H2. KDM judgement poses grounds for further judicial review.**
 - H3. The legality and enforceability of MFMA, section 110(2) (c) read with and applied with SCMR's 2(4), 11(3), 19(a) and 32.**
- I. Impact of AG finding is enforced.**
- J. Alternative solution.**

A1. INCORRECT UNDERSTANDING OF THE APPLICATION OF CASE-LAW, SPECIFICALLY IN TERMS OF JURISDICTION OF A HIGH COURT JUDGEMENT:

3. It appears that the AG is uncertain of how the judiciary system in South Africa is applied and what the jurisdiction of the various courts are.
4. Clarity is provided by the Governmental website¹ - www.gov.za, stipulating that:
 - (i) The judicial authority in South Africa is vested in the courts, which are independent and subject only to the Constitution and the law.
 - (ii) The Constitution provides for the following courts:
 - i. Constitutional Court.
 - ii. Supreme Court of Appeal.
 - iii. High courts, including any high court of Appeal that may be established by an Act of Parliament to hear appeals from high courts.
 - iv. Magistrates' courts
 - v. Any other court established or recognized in terms of an Act of Parliament, including any court of a status similar to either high courts or magistrates' courts.
 - (iii) In consideration of the jurisdiction of the courts, the following is relevant:
 - i. **The Constitutional Court [CC]** makes the **final decision** on whether an Act of Parliament, a provincial Act or the conduct of the President **is constitutional**.
 - ii. **The Supreme Court of Appeal [SCA]** has jurisdiction to hear and determine an appeal against any decision of a High Court. **Decisions** of the Supreme Court of Appeal **are binding on all courts of a lower order**.
 - iii. **14 High Courts in the country** hear matters that are of such a serious nature that the lower courts would not be competent to make an appropriate judgment or to impose a penalty. Decisions of high courts are **binding on magistrates' courts within the respective areas of jurisdiction of the divisions**.
5. Additionally, it is important to understand that **statutory law**² is defined as: "*The body of law consisting of written laws adopted by a legislative body. Statute law is often **contrasted with case law**, which originates from decisions of the **appellate courts**; and with constitutional law, based on a country's written constitution.*" [Own emphasis].

¹ <https://www.gov.za/about-government/judicial-system#transformation> – accessed on 3 November 2019

² <http://www.businessdictionary.com/definition/statute-law.html> - accessed on 3 November 2019

6. It must be noted that the Blue Nightingale judgement was made by a high court in the Eastern Cape and the KDM judgement by a high court in KwaZulu-Natal, which means that the application of the stated judgements is limited to the relevant jurisdictions of the Eastern Cape and KwaZulu-Natal Provinces.
7. Neither of these judgements were tested by the Supreme Court of Appeal or the Constitutional Court, which means that its application of the **stated judgements to the country as a whole is not allowed**.
8. Lastly, both judgements concluded that the relevant contracts were unconstitutional and therefore invalid, unlawful and *void ab initio*. These judgements are bound by the principle that an order of constitutional invalidity has no force unless confirmed by the Constitutional Court³.
9. **Argument in A1: The AG erred in its understanding of the application of case-law, specifically in terms of jurisdiction of a high court judgement, as:**
 - (i) *A judgement from a high court is limited to the jurisdiction of the province where it applies. The Blue Nightingale judgement was made by a high court in the Eastern Cape and the KDM judgement by a high court in KwaZulu-Natal, which means that the application of the stated judgements is limited to the relevant jurisdictions of the Eastern Cape and KwaZulu-Natal Provinces.*
 - (ii) *Neither of these judgements were tested by the Supreme Court of Appeal or the Constitutional Court, which means that its application of the stated judgements to the country as a whole is not allowed.*
 - (iii) *Both judgements tested the constitutionality of the contracts and concluded that the relevant contracts were unconstitutional and therefore invalid, unlawful and void ab initio. These judgements are therefore bound by the principle that an order of constitutional invalidity has no force unless confirmed by the Constitutional Court⁴.*

A2. INCORRECT UNDERSTANDING OF THE APPLICATION OF CASE-LAW, SPECIFICALLY IN TERMS OF 'CASE LAW' COMPARED TO 'CUSTOMARY LAW':

10. It is important to understand the difference between the different 'types of law' and its interpretation, as:
 - (i) **Customary law** is defined as: "*Traditional common rule or practice that has become an intrinsic part of the accepted and expected conduct in a community, profession, or trade and is treated as a legal requirement⁵.*" [Own emphasis]
 - (ii) **Case law** is defined as: "*Part of common law, consisting of judgments given by higher (appellate) courts in interpreting the statutes (or the provisions of a constitution) applicable in cases brought before them. Called precedents, they are binding on all courts (within the same jurisdiction) to be followed as the law in similar cases. Over time, these precedents are recognized, affirmed, and enforced by the subsequent court decisions, thus continually expanding the common law⁶.*" [Own emphasis].
11. Based on the above definitions, the following is evident:
 - (i) 'Customary law' considers a common rule or practice which has become an integral part of acceptable conduct and therefore treated as a legal requirement.
 - (ii) 'Case law' on the other hand interprets legislation and is given by higher (appellate) courts and binding on all courts within the same jurisdiction.

³ <http://www.justice.gov.za/sca/aboutsca.htm> - accessed on 3 November 2019

⁴ <http://www.justice.gov.za/sca/aboutsca.htm> - accessed on 3 November 2019

⁵ <http://www.businessdictionary.com/definition/customary-law.html> - accessed on 3 November 2019

⁶ <http://www.businessdictionary.com/definition/case-law.html> - accessed on 3 November 2019

12. In terms of the South African Constitution, sections 30 and 31, customary law is an equal partner to the hybrid legal system⁷. Customary law has been defined by the Constitutional Court of South Africa in *Bhe v Magistrate Khayelitsha* (CCT 9/03)[2004] ZACC 17; 2005 (1) SA 580 (CC); 2005 (1) BCLR 1 (CC) (15 October 2004) as having three different forms, namely (1) law that is practiced in the community; (2) law that is found in statutes, (3) case law or textbooks on official customary law and academic law that is used for teaching purposes.
13. The common practice, since the promulgation of the MFMA in 2003 and its supporting SCM Regulation in 2005, was to apply SCMR 32 contracts, or so-called 'piggy back' contracts, where the participating municipality will conclude its own contract with the service provider, based materially on the same terms and conditions of the initial tender, subject to compliance with the provisions of SCMR 32(1) (a) – (d). This common practice was endorsed by guidelines provided by the National Treasury and certain provincial treasuries, such as:
- (i) National Treasury Guide to Participation in Transversal Term Contracts Facilitated by National Treasury, March 2017, refer to page 5.
 - (ii) MFMA Treasury Circular 80 of March 2016, refer to items 7 and 8 (pages 12 to 15).
 - (iii) MFMA Treasury Circular 80, amended on 18 October 2016, refer to item 3(iv).
 - (iv) National Treasury letter of 5 February 2019, relating to RT 25-2016 transversal contract and the application of SCMR 32.
 - (v) Kwa Zulu Natal Provincial Treasury, circular 01/2016, effective from 1 April 2017, relating to SCMR 32 contracts, Annexure A, items 3.1.2 and 3.1.3.
14. **Argument in A2: The AG erred in its understanding of the application of case-law, specifically in terms of 'case law' compared to 'customary law', specifically considering the practice in the application of SCMR 32, as:**
- (i) *The 'common practice or customary practice', since the promulgation of the MFMA in 2003 and its supporting SCM Regulation in 2005, was to apply SCMR 32 contracts, or so-called 'piggy back' contracts, where the participating municipality will conclude its own contract with the service provider, based materially on the same terms and conditions of the initial tender, subject to compliance with the provisions of SCMR 32(1) (a) – (d).*
 - (ii) *This common practice was endorsed through various National Treasury circulars and guidelines.*
 - (iii) *This means that for the past 14 years, municipalities applied a specific common practice, concluded and honoured contracts.*
 - (iv) *With the alternative interpretation by the stated judgements, it appears that the 'common practice' is now regarded as unconstitutional and therefore invalid, unlawful and void ab initio.*
 - (v) *Neither of these judgements considered the 'customary law' application of SCMR 32 and the implication thereof if such 'practice' is now impugned.*
 - (vi) *Prior to concluding that on matters of constitutional matters, whether 'case law' will trump 'customary law, by virtue of common practice', the impact must be tested by an appropriate court of law in order to reach a 'just and equitable remedy' as provided for in section 172(1) (b) of the Constitution.*

A3. INCORRECT UNDERSTANDING OF THE APPLICATION OF CASE-LAW, SPECIFICALLY IN TERMS OF 'A RULING' VERSUS 'AN OBITER DICTUM':

15. It is important to understand the difference between 'a court ruling' and 'an obiter dictum', its interpretation and its application, as:
- (i) **A court ruling** is defined as: "**A decision made by a court**"⁸ [own emphasis].

⁷ 'Researching South African Law', by Amanda Barratt and Pamela Snyman and updated by Salona Lutchman in March 2018 (accessible at https://www.nyulawglobal.org/globalex/South_Africa1.html).

⁸ <https://www.collinsdictionary.com/dictionary/english/court-ruling> - accessed on 4 November 2019

- (ii) **Obiter dictum is defined as:** “Obiter dictum is an opinion, or a remark made by a judge which does not form a necessary part of the court’s decision. The word obiter dicta is a Latin word which means “things said by the way.” Obiter dicta can be passing comments, **opinions or examples** provided by a judge. **Statements constituting obiter dicta are therefore not binding**.” [own emphasis]

16. The AG selectively referenced only 6 items of the Blue Nightingale judgement, namely items 32 to 37 and regard those excerpts as ‘**rulings**’, as follows:

***Ruling 32:** The usual example would be where an organ of state contracts, in accordance with a Section 217 compliant process, with a supplier to supply say R5 Million Rand’s worth of A4 paper. If that organ of state thereafter does not intend to utilize the entire consignment, it is permissible for another organ of state to, as it were, ‘take up the slack’ in respect of the remaining portion of the same contract.*

***Ruling 33:** I must add that the second organ of state will do so by procuring the A4 paper under the contract between the first organ of state and the supplier, as required by section 110(2)(c).*

***Ruling 34:** The constitutionality of the exemption will always depend on the facts of the particular case. For the exemption to operate under section 110(2) of LGMFMA, I cannot conceive compliance with the constitutional imperatives unless the goods or services procured by the second organ of state are the same as that required by the first organ of state, and the contract price is the same*

***Ruling 35:** In my respectful view, the terms and conditions of a procurement contract between the second organ of state and the supplier which complies with Chapter 11 of the LGMFMA (including section 116 thereof which requires the contract to be in writing and stipulates the nature of the terms and conditions thereof and the management of the contract) cannot be deleted or amended or compromised in such a manner as to render the contract with the first organ of state not compliant with either Chapter 11 or with the constitutional imperatives.*

***Ruling 36:** The words “... under a contract secured by another organ of state ...” in the Regulation can only refer to the “... contract with another organ of state ...” as contemplated by section 110(2) of the empowering legislation (LGMFMA).*

***Ruling 37:** In my respectful view, this can only refer to the situation where the municipality, with the consent of the supplier, either becomes a party to the existing contract between the other organ of state and the supplier; or where the other organ of state concludes a contract with the supplier for the benefit of a third party, namely for the benefit of the municipality, against payment by the municipality of the approved contract price. In either case, the material terms and contract price of the contract already secured by that organ of state remain binding, and thus remain compliant with section 217 of the Constitution and with the procurement policy of the other organ of state, and therefore with LGMFMA.’ [own emphasis]*

17. When the highlighted/emphasized portions above in paragraph 25 are considered, it is evident that in 5 of the 6 items quoted, the judge specifically referred to either an ‘**example**’ or an ‘**opinion**’, which means that 5 of the 6 items quoted are regarded as ‘**obiter dicta**’ which are not regarded as binding.

18. **Argument in A3: The AG erred in its understanding of the application of case-law, specifically in terms of ‘a ruling’ versus ‘an obiter dictum’, as:**

- (i) The AG regarded ‘obiter dicta’ as a ‘court ruling’, thereby incorrectly interpreted obiter dicta as binding on all organs of state.
- (ii) When the highlighted/emphasized portions in paragraph 25 are considered, it is evident that in 5 of the 6 items quoted, the judge specifically referred to either an ‘**example**’ or an ‘**opinion**’, which means that 5 of the 6 items quoted are regarded as ‘**obiter dicta**’ which are not regarded as binding.

⁹ <https://definitions.uslegal.com/o/obiter-dictum/> - accessed on 4 November 2019

B. INCORRECT INTERPRETATION AND APPLICATION OF THE RETROSPECTIVE APPLICATION OF 'CASE LAW':

19. Lourens M du Plessis, *'The Re-Interpretation of Statutes'*, LexisNexis, 2002¹⁰, advises that legislation in South-Africa should be interpreted according to the common law rules and presumptions, mindful of the interpretation measures provided for by the Constitution of 1996. One of the considerations is the common law presumptions adopted and applied by our courts since 1994, more specifically the presumption that: "**A statute does not apply retroactively, unless specifically so enacted**".
20. The Constitution, section 36(1) provides clear guidelines of when rights may be limited in terms of **law of general application** to the extent that the **limitation is reasonable and justifiable in an open and democratic society** based on human dignity, equality and freedom, taking into account all relevant factors, including—
- (a) the nature of the right;
 - (b) the importance of the purpose of the limitation;
 - (c) the nature and extent of the limitation;
 - (d) the relation between the limitation and its purpose; and
 - (e) less restrictive means to achieve the purpose.
21. In *Transnet Ltd v Chairman, National Transport Commission, & others* 1999 (4) SA 1 (SCA) para 12, Olivier JA said: '*One may start the conspectus by stating the time-honoured principle formulated in Peterson v Cuthbert & Co Ltd 1945 AD 420 at 430, based upon the Roman-Dutch law, that no statute is to be construed as having retrospective operation (in the sense of taking away or impairing a vested right acquired under existing laws), unless the Legislature clearly intended the statute to have that effect.*' [own emphasis]
22. In the 2007 SCA judgement of *Veldman v Director of Public Prosecutions, Witwatersrand Local Division* 2007 (3) SA 210 (CC) para 26, Mokgoro J held that: "**The principle that legislation will affect only future matters and not take away existing rights, is founded on the rule of law.** It also follows that if the **court is left in doubt** as to the retrospective effect of a provision, the presumption against the **retrospectivity would not be rebutted.**" [own emphasis]
23. In the 2016 SCA judgement of *Kaknis v Absa Bank Limited & another* (08/16) [2016] ZASCA 206 (15 December 2016), the court considered the following aspects:
- (i) [12] The reasoning behind the presumption against the retrospective application of legislation is premised upon the unwillingness of the courts to inhibit vested rights.
 - (ii) [13] Thus a statute is presumed not to apply retrospectively, unless it is expressly or by necessary implication provided otherwise in the relevant legislation. It is for that reason presumed that the legislature only intends to regulate future matters.
 - (iii) [14] It has been held that the crux of the matter is not the prospectively or retrospectivity of legislation as such, but the fair treatment befalling those subject to the legislation should the legislation be held to apply in that manner.
24. **Argument in B: The AG erred in its understanding of the application of the retrospective application of 'case law', as:**
- (i) *The common law of rules and presumptions presumes that a statute does not apply retroactively, unless specifically so enacted, which is supported by various SCA judgements as reflected in paragraphs 30 – 32 above.*
 - (ii) *Although 'case law' is not necessarily 'legislation or statutory law', it is argued that this presumption will also apply to 'case law' as the Constitution in section 36(1) provides clear guidelines of when rights may be limited in terms of law of general application to the extent that the limitation is reasonable and justifiable in an open and democratic society.*

¹⁰ ISBN 978 0 409 02509 5.

- (iii) *Prior to concluding that the relevant judgements as case law, must be applied retrospectively, it is argued that an appropriate court of law should consider, in terms of section 36(1) of the Constitution, whether a retrospective application will limit rights and whether such limitation is reasonable and justifiable in an open and democratic society section.*

C. INCORRECT INTERPRETATION AND APPLICATION OF SECTION 1 OF THE MFMA, i.e. DEFINITION OF IRREGULAR EXPENDITURE:

25. Mindful of the guidance provided in MFMA circular 68, as updated in June 2019, it is clear that in order to qualify as 'irregular expenditure' the 'expenditure' must relate to any use of municipal funds that is in contravention of the following legislation:
- Municipal Finance Management Act, Act 56 of 2003, and its regulations;
 - Municipal Systems Act, Act 32 of 2000, and its regulations;
 - Public Office-Bearers Act, Act 20 of 1998, and its regulations; and
 - The municipality's supply chain management policy, and any by-laws giving effect to that policy.
26. It is noted that the MFMA specifically refers to 'legislation' and not 'law'.
27. In applying the common law rules of interpretation adopted and applied by our courts since 1994, such as the Golden Rule, by adhering to the 'ordinary meaning-rule', it is argued that the intention of the legislature was to limit 'irregular expenditure' to a contravention of 'legislation', i.e. 'statutory law' and not 'case law' [*refer to relevant definitions in paragraphs 14 and 19 above*].
28. The above argument is supported in the Public Audit Act, where it defines "material irregularity" also specifically referencing to 'legislation', i.e: "*Any non-compliance with, or contravention of, legislation, fraud, theft or a breach of a fiduciary duty identified during an audit performed under this Act that resulted in or is likely to result in a material financial loss, the misuse or loss of a material public resource or substantial harm to a public sector institution or the general public.*" [*own emphasis*].
29. Where 'legislation' is regarded as inclusive of case-law, such will only be the case where such case law originates from decisions of the appellate courts, and not provincial high courts, as is the matter in this AG finding.
30. **Argument in C: The AG erred in its interpretation and application of section 1 of the MFMA, i.e. definition of irregular expenditure, as:**
- The MFMA specifically reference 'legislation' and not 'law', thereby limiting 'irregular expenditure' to a contravention of 'legislation', i.e. 'statutory law' and not 'case law'. This argument is supported by the Public Audit Act in its definition of 'material irregularity' to relate to "any non-compliance with, or contravention of, legislation..."*
 - Alternatively, where 'legislation' is regarded as inclusive of case-law, such will only be the case where such case law originates from decisions of the appellate courts, and not provincial high courts, as is the matter in this AG finding¹¹.*

D. FAILURE TO CONSIDER AND TEST OF ALL RELEVANT LEGISLATION:

31. In relation to SCM matters relevant to this matter, MFMA in section 1 provides that 'irregular expenditure' must relates to a contravention of the Municipal Finance Management Act, Act 56 of 2003, and its regulations.

¹¹ <http://www.businessdictionary.com/definition/statute-law.html> - accessed on 3 November 2019

32. It is argued that in order to test non-compliance or a contravention of the MFMA and its regulations, such test **MUST** consider and test all relevant legislative prescripts in relation to 'procurement of goods and services under a contract secured by another organ of state'.
33. The AG considered ONLY 3 of the following 9 MFMA and SCMR prescripts that relates to 'procurement of goods and services under a contract secured by another organ of state':
- (i) **MFMA section 1 defines irregular expenditure as:** *".. in relation to a municipality or municipal entity, means -(a) expenditure incurred by a municipality or municipal entity in contravention of, or that is not in accordance with, a requirement of this Act, and which has not been condoned in terms of section 170; or"*
 - (ii) **MFMA section 110(2)(c):** *"(2) This Part, except where specifically provided otherwise, does not apply if a municipality or municipal entity **contracts with another organ of state for - (c) the procurement of goods and services under a contract secured by that other organ of state, provided that the relevant supplier has agreed to such procurement.**"*
 - (iii) **MFMA section 112(1) (o):** *"(1) The supply chain management policy of a municipality or municipal entity must be fair, equitable, transparent, competitive and cost-effective and **comply with a prescribed regulatory framework** for municipal supply chain management, which must cover at least the following: (o) **the procurement of goods and services by municipalities or municipal entities through contracts procured by other organs of state.**"*
 - (iv) **SCMR 2(4) with regards to SCM Policies determine that:** *"Sub regulations (1), (2) and (3) do not apply in the circumstances described in section 110(2) of the Act, **except where specifically provided otherwise in these Regulations.**"*
 - (v) **SCMR 11 dealing with Acquisition Management under 11(2) provides that:** *"A supply chain management policy, **except where provided otherwise in these Regulations,** does not apply in respect of the procurement of goods and services contemplated in section 110(2) of the Act, including ..."*
 - (vi) **SCMR 11(3):** *"A municipality or municipal entity **procuring goods or services contemplated in section 11(2) of the Act must make public the fact that it procures such goods or services otherwise than through its supply chain management system, including-***
 - (a) the kind of goods or services; and*
 - (b) the name of the supplier."*
 - (vii) **SCMR 19(a):** *"A supply chain management policy must specify - (a) that goods or services above a transaction value of R200 000 (VAT included) and long term contracts may be procured by the municipality or municipal entity only through a competitive bidding process, **subject to regulation 11(2);..**"*
 - (viii) **SCMR 32:** *"A supply chain management policy **may allow the accounting officer to procure goods or services for the municipality or municipal entity under a contract secured by another organ of state, but only if-***
 - a) the contract has been secured by that organ of state by means of a competitive bidding process applicable to that organ of state;*
 - b) the municipality or entity has no reason to believe that such contract was not validly procured;*
 - c) there are demonstrable discounts or benefits for the municipality or entity to do so; and*
 - d) that the other organ of state and the provider have consented to such procurement in writing."*
 - (ix) **SCMR 36(2) and (3):** *"(2) The accounting officer must record the reasons for any deviations in terms of sub regulation (1)(a) and (b) and report them to the next meeting of the council, or board of directors in the case of a municipal entity, and include as a note to the annual financial statements. (3) Sub regulation (2) does not apply to the **procurement of goods and services contemplated in regulation 11(2).**"*

34. In considering the 'common law rules' that apply to legislative interpretation, the rule of Contextualism¹², provides that the meaning of a provision is determinable by reading its words in context. One of the specific rules relates to the *Interpretation ex visceribus actus*, meaning that a particular provision of a statute is to be understood as part of the **more encompassing legislative instrument in which it has been included**.
35. The rationale for such a rule is that when interpreting a specific provision, the interpreter should not apply nit-picking in only considering certain provisions of the Act but consider the provision in context as a whole.
36. This rule was also applied in 2016 SCA judgement of *Kaknis v Absa Bank Limited & another* (08/16) [2016] ZASCA 206 (15 December 2016), where the court applied this rule, stating that it considered the legislation comprehensively, as a whole (dicta 31).
37. Further guidance is provided in the South African Law Commission, Discussion Paper on the Interpretation Act, September 2006¹³ at item 6: "*When reading legislation as a whole in order to determine the meaning of a provision – (a) all the provisions of the legislation must be taken into account, including – (i) their sequence, segmentation and punctuation; and (ii) the general organization and structure of the legislation; ...*"
38. The importance of interpreting the provisions related to the 'procurement of goods and services under a contract secured by another organ of state', will be discussed in more detail in paragraphs 69 to 70 below.
39. **Argument in D: The AG failed to consider, and test of all relevant legislation related to the 'procurement of goods and services under a contract secured by another organ of state' as it considered ONLY 3 of the relevant 9 MFMA and SCMR prescripts.**

E. INCORRECT UNDERSTANDING AND APPLICATION OF TREASURY CIRCULARS:

40. MFMA section 168(3) determines that: "(3) **No guidelines issued in terms of subsection (1) are binding on - (a) a municipality unless adopted by its council.**" [own emphasis]
41. It is a general principle of South African law that a statutory instrument needs to be promulgated in order for that instrument to have the status of law. Promulgation is a process conceptually distinct from passing¹⁴.
42. An essential element of promulgation is that the instrument be officially published as confirmed in the Interpretation Act 33 of 1957. Section 13 of the Interpretation Act determines that a law will come into effect when published in the Gazette. The term "**law**" as used in section 13 is defined in section 2 as "*any law, proclamation, ordinance, Act of Parliament or other enactment having the force of law*".
43. The question at issue here is whether National Treasury MFMA circulars qualifies as secondary legislation, i.e. the power of sub-ordinate legislation. The absence of proper publication, as prescribed in the Interpretation Act, strips the National Treasury MFMA circulars of its potential legislative status. Simply put, the National Treasury MFMA circulars cannot qualify as legislation in the absence of publication in the Government Gazette.
44. **Alternatively, it is further argued that the legality and enforceability of some of the provisions of MFMA circular 96 are questionable as:**
 - (i) **The circular fails to indicate its application, i.e. retrospectively or prospectively.**

¹² Lourens du Plessis, 'The Re-Interpretation of Statutes', page 100 onwards, par. 5 3.

¹³ ISBN: 0-621-36904-7, page 54

¹⁴ LM du Plessis "Statute Law and Interpretation" LAWSA (volume 25(1) 2nd ed) para 302

- (ii) The circular fails to address transversal contracts.
 - (iii) Contradictory provisions are made in MFMA circular 80 and also the RT 25-2016 transversal contract, which is inconsistent with the intend and application of MFMA circular 96.
 - (iv) The provision that an 'addendum to the original contract' is required is inconsistent with the provisions of the Blue Nightingale judgement.
 - (v) The interpretation and application of the 'Implications for the contract owner' is ambiguous as:
 - i. The type of contract envisaged is unclear, i.e. 'tri-partite contract' or 'cession' or 'addendum'?
 - ii. No definition is provided for a 'shared contract' as referenced.
 - iii. No indication is given of the 'accountability and liability' arrangements as two accounting officers participate in the same contract.
 - iv. As the original contract owner may not participate contract anymore, it is not clear why he/she must maintain and enforce a contract on behalf of another organ of state.
 - (vi) The exclusion of framework agreements is inconsistent with CIDB practice note 15 of August 2010 which provides that: *"The Supply Chain Management Regulations issued in terms of the Public Finance Management Act and the Municipal Finance Management Act permit one organ of state to make use of another organ of state's contract that is put in place by means of a competitive procurement process. Framework contracts are well suited to such applications."*
 - (vii) It is unclear with the interpretation by the National Treasury stating the 'panels of service providers' are seen as *'not being contracts'* and therefore excluded from the application of SCMR 32.
 - (viii) The reference to and application of treasury 'transversal contracts' require clarity as it is not provided for in the MFMA or SCMR's and the current application in terms of RT 25-2016 is inconsistent with what the provision is this circular is purported to provide.
45. **Argument in E:** *The AG incorrectly understood the application of National Treasury MFMA circulars as the latter do not amount to valid and binding legislation, as contemplated by MFMA section 168(3). It follows that non-compliance with the provisions of a National Treasury MFMA circular cannot be the basis for a finding of irregular expenditure, unless the content was adopted by the relevant Municipal Council. Alternatively, it is important to note that the legality and enforceability of some of the provisions of MFMA circular 96 are questionable.*
- F. INCONSISTENT INTERPRETATION AND APPLICATION OF ITS AUDIT TEST AT VARIOUS MUNICIPALITIES:**
46. With a review of the AG findings in relation to the application of SCMR 32 contracts, the following findings were issued during the 2018/2019 municipal audits:
- (i) Mossel Bay – COMAF 13;
 - (ii) Hessequa – COMAF 9;
 - (iii) Bergrivier – COMAF tbd;
 - (iv) Theewaterskloof – COMAFS 13 & 14;
 - (v) Swellendam – COMAF 21;
 - (vi) Prins Albert – COMAF 24;
 - (vii) Siyancuma - ISS.27;
 - (viii) Oudtshoorn – COMAF 22 and
 - (ix) Knysna – COMAF 32.
47. A high-level review of the aforesaid AG findings confirms inconsistencies in the interpretation and application of SCMR 32 contracts as follows:
- (i) In some COMAF's the AG refers to non-compliance with SCMR 19 and in others non-compliance with SCMR 17&18.

- (ii) In certain findings the AG applied retrospective application of its finding and in others it is not the case.
- (iii) In some findings the AG refers to materiality and in others it is silent on the matter.
- (iv) In certain findings the AG refers to 'total expenditure' and in other findings the AG differentiate between the 'amounts awarded' versus the 'amount spend'.
- (v) In one finding the AG tested full compliance with National Treasury MFMA circular 96, whilst it only reference the circular in other findings.
- (vi) The recommendations are inconsistently applied for the same findings.

48. *Argument in F: The AG inconsistently interpreted and applied its audit test for non-compliance with SCMR 32 contracts at various municipalities. A high-level review of the aforesaid AG findings confirms inconsistencies in the interpretation and application of SCMR 32 contracts at eight (8) different municipalities as follows:*

- (i) *In some COMAF's the AG refers to non-compliance with SCMR 19 and in others non-compliance with SCMR 17&18.*
- (ii) *In certain findings the AG applied retrospective application of its finding and in others it is not the case.*
- (iii) *In some findings the AG refers to materiality and in others it is silent on the matter.*
- (iv) *In certain findings the AG refers to 'total expenditure' and in other findings the AG differentiate between the 'amounts awarded' versus the 'amount spend'.*
- (v) *In one finding the AG tested full compliance with National Treasury MFMA circular 96, whilst it only reference the circular in other findings.*
- (vi) *The recommendations are inconsistently applied for the same findings.*

G. ERROR IN LAW DUE TO INCORRECT INTERPRETATION AND APPLICATION OF SCMR 32 AS A 'DEVIATION':

- 49. **SCMR 36(2) and (3) in relation to Deviations provides that:** *"(2) The accounting officer must record the reasons for any deviations in terms of sub regulation (l) (a) and (b) and report them to the next meeting of the council, or board of directors in the case of a municipal entity, and include as a note to the annual financial statements. (3) Sub regulation (2) does not apply to the procurement of goods and services contemplated in regulation 11(2)."*
- 50. **SCMR 11 dealing with Acquisition Management under 11(2) provides that:** *"A supply chain management policy, except where provided otherwise in these Regulations, does not apply in respect of the procurement of goods and services contemplated in section 110(2) of the Act, including ..."*
- 51. In its finding at Mossel bay, COMAF 13, the AG concluded that: *"The following regulation 32 deviations were identified on which expenditure was incurred during the 2018-19 financial year: ..." [own emphasis]*
- 52. It is clear that the intention of the legislature is that 'SCMR 36 deviations' are DOES NOT APPLY to MFMA section 110(2) contracts.
- 53. ***Argument in G: The AG made an error in law due to incorrect interpretation and application of SCMR 32 as a 'deviation' as SCMR 36(3) clearly provides that deviations do not apply to the procurement of goods and services contemplated in regulation 11(2), i.e. MFMA section 110(2) contracts'.***

H1. ALTERNATIVE ARGUMENTS [POTENTIAL POINTS IN LIMINE] - BLUE NIGHTINGALE JUDGEMENT POSES GROUNDS FOR FURTHER JUDICIAL REVIEW:

- 54. As discussed above, in order for the Blue Nightingale judgement to be applicable to the country as a whole, it requires a judgement from the Supreme Court of Appeal [SCA], and if such judgement relates to constitutional invalidity, it will only be regarded as having force in law if confirmed by the Constitutional Court [CC].

55. It is however argued, that when this matter is brought to the SCA and/or CC, there are various considerations, that, on a balance of probabilities, may make the validity and enforceability of the judgement reviewable, of which the following is a high-level summary of some elements:

- (i) At paragraph 20 the court incorrectly concluded that: *'The procurement policy of an organ of state must therefore be compliant with section 217(1) and must be implemented within the framework prescribed by national legislation. The national legislation contemplated by sub-section (3) are the Preferential Procurement Policy Framework Act (PPPFA 5 of 2000) read with Part 1, Chapter 11 (Goods and Services) (ss110-120) of the LGMFMA' [own emphasis].* The required framework prescribed by national legislation is specifically provided for in section 217(3) of the Constitution and relates to the preferential procurement policy referred to in section 217(2). NO reference is made in section 217(3) to the system required by section 217(1) of the Constitution, which the court purports to link to the 'framework prescribed by national legislation'.
- (ii) The court failed to consider the current practice in the implementation of SCMR 32.
- (iii) The court failed to consider, and test of all relevant legislation related to the 'procurement of goods and services under a contract secured by another organ of state' as it considered ONLY 2 of the relevant 8 MFMA and SCMR prescripts.
- (iv) The court failed to consider the current practices in the application and differences between '**transversal contracts = PFMA Treasury Regulations 16A6.5¹⁵**' versus '**piggy-back contracts = SCMR 32**'.
- (v) It is argued that the intention of the legislature was that contracts intended by MFMA section 110(2) (c) differ from contracts intended by MFMA section 112(1) (o) read with SCMR 32 [refer to later discussion under paragraphs 69 to 70].
- (vi) The court failed to consider the type of contract required to adhere to its finding that as per MFMA section 110(2)(c) the municipality must contract with MISA, i.e. whether such a contract constitute a tri-partite agreement?
- (vii) The court failed to consider the liability and accountability requirements of its finding that as per MFMA section 110(2)(c) the municipality must contract with MISA as both organs of state are governed by different legislation, being the MFMA and the PFMA respectively.
- (viii) The court failed to consider the application of PAJA.
- (ix) The court failed to consider its jurisdiction under the matter, i.e. in terms of which legislation is this matter brought to court for review, i.e. contract law and/or administrative law and/or constitutional law.
- (x) The court failed to consider the implications of a 'just and equitable remedy' as guided by the Constitutional Court judgement in AllPay Consolidated Investments Holdings (Pty) Ltd and Others v Chief Executive Officer of the South African Social Security Agency and Others (No 2) CCT 48/13.

56. **Argument in H1: It is argued that the Blue Nightingale judgement poses grounds for further judicial review, as:**

- (i) *The judgement concluded that the constitutionality of the contracts and concluded that the relevant contracts were unconstitutional and therefore invalid, unlawful and void ab initio. These judgements are therefore bound by the principle that an order of constitutional invalidity has no force unless confirmed by the Constitutional Court.*
- (ii) *There are about ten (10) considerations that, on a balance of probabilities, may make the validity and enforceability of the judgement reviewable by a SCA or CC.*

H2. ALTERNATIVE ARGUMENTS [POTENTIAL POINTS IN LIMINE] - KDM JUDGEMENT POSES GROUNDS FOR FURTHER JUDICIAL REVIEW:

¹⁵ Guide to Participation in Transversal Term Contracts Facilitated by National Treasury (March 2017). "**Transversal Term Contract**" means a centrally facilitated contract arranged by the National Treasury for goods or services that are required by one or more than one institution.

57. As discussed above, in order for the KDM judgement to be applicable to the country as a whole, it requires a judgement from the Supreme Court of Appeal [SCA], and if such judgement relates to constitutional invalidity, it will only be regarded as having force in law if confirmed by the Constitutional Court [CC].
58. It is however argued, that when this matter is brought to the SCA and/or CC, there are various considerations, that, on a balance of probabilities, may make the validity and enforceability of the judgement reviewable, of which most of the same considerations listed in paragraph 63 above will apply *mutatis mutandis* in this regard as the judgement relied significantly on the Blue Nightingale judgement.
59. **Argument in H2: It is argued that the KDM judgement poses grounds for further judicial review, as:**
- (i) *The judgement concluded that the constitutionality of the contracts and concluded that the relevant contracts were unconstitutional and therefore invalid, unlawful and void ab initio. These judgements are therefore bound by the principle that an order of constitutional invalidity has no force unless confirmed by the Constitutional Court.*
 - (ii) *There are most of the same considerations listed in paragraph 63 above will apply mutatis mutandis, that, on a balance of probabilities, may make the validity and enforceability of the judgement reviewable by a SCA or CC.*

H3. ALTERNATIVE ARGUMENTS [POTENTIAL POINTS IN LIMINE] - THE LEGALITY AND ENFORCEABILITY OF MFMA, SECTIONS 110(2)(C) AND 112(1)(o) READ WITH AND APPLIED WITH SCMR'S 2(4), 11(3), 19(a) AND 32 ARE QUESTIONABLE:

60. The relevant sections are quoted in paragraph 43 above.
61. From a review of all the relevant prescripts in the MFMA and the SCMR it appears as if the prescripts provide for two (2) types of 'contracts' for the 'procurement of goods and services under a contract secured by another organ of state', namely:
- (i) **MFMA section 110(2) (c) contracts**, which provides for a contract with another organ of state for the procurement of goods and services under a contract secured by that other organ of state. It is notable that MFMA section 110(2) contracts are excluded from the Municipal SCM System framework as prescribed by the SCMR as contemplated by SCMR 2(4); SCMR 11(2) and (3) and SCMR 19(a).
 - (ii) **MFMA section 112(1) (o) contracts**, which provides for a procurement contract (so-called piggy-back contract) under a contract secured by another organ of state. It appears that these types of contracts are specifically catered for in SCMR 32. It is notable that both MFMA section 112(1)(o) and SCMR specifically excludes the reference to MFMA section 110(2) and also 'a contract with another organ of state' as contemplated in MFMA section 110(2).
62. **Argument H3: The legality and enforceability of MFMA sections 110(2)(c) and 112(1)(o) read with and applied with SCMR's 2(4), 11(3), 19(a) and 32 are questionable as:**
- (i) *The two judgements quoted by the AG only considered the application of MFMA section 110(2) read with SCMR 2(4); SCMR 11(2) and (3) and SCMR 19(a) – all provisions specifically reference MFMA section 110(2).*
 - (ii) *No consideration was taken to the fact that these provisions could cater for another type of contract, namely a MFMA section 112(1) (o) read with SCMR 32 – which specifically exclude the reference to MFMA section 110(2) and also 'a contract with another organ of state'.*
 - (iii) *It is therefore argued that an appropriate court of law should consider the legality and enforceability of the relevant prescripts in context and advise accordingly.*

I. IMPACT IF AG FINDING IS ENFORCED:

63. The court in *Oudekraal Estates (Pty) Ltd v The City of Cape Town and Others* 2004 (6) SA 222 (SCA) pointed out that a public authority cannot justify a refusal on its part to perform a public duty by relying, on the invalidity of the originating administrative act: ***it is required to take action to have it set aside and not simply to ignore it.***
64. The same court remarked that: “*The substantive validity or invalidity of an administrative act will seldom have relevance in isolation of the consequences that it is said to have produced – the validity of the administrative act might be relevant in relation to some consequences, or even in relation to some persons, and not in relation to others – and for this reason it will generally be inappropriate for a court to pronounce by way of declaration upon the validity or invalidity of such an act in isolation of particular consequences that are said to have been produced.*”
65. ***The above therefore means that if the AG insists on its finding that the interpretation and application of SCMR 32, contrary to current practice, is irregular, the impact would be significant cost implications, time delays, legal uncertainty and service delivery will be detrimentally affected as:***
- (i) *All implicated Municipalities will have to approach the court for a ‘declaratory order to invalidate its SCMR 32 contracts; and*
 - (ii) *The courts will have to consider each matter on own merits as it is regarded as inappropriate for a court to pronounce by way of declaration upon the validity or invalidity of such an act in isolation of particular consequences that are said to have been produced, and*
 - (iii) *Affected service providers may claim damages due to breach of contract, OR estoppel due to the creation of legitimate expectations, OR estoppel due to the principle of functus officio OR delictual claims OR remedies due to the ‘fettering of discretion’¹⁶.*

CONCLUSION

66. It is author’s considered opinion that the AG is incorrect in its finding and that the relevant COMAF’s related to SCMR 32, should be retracted, based on the following 13 reasons:

#	REASON	DISCUSSION REFERENCE
1.	<i>The AG erred in its understanding of the application of case-law, specifically in terms of jurisdiction of a high court judgement, as:</i> 1. A judgement from a high court is limited to the jurisdiction of the province where it applies. The Blue Nightingale judgement was made by a high court in the Eastern Cape and the KDM judgement by a high court in KwaZulu-Natal, which means that the application of the stated judgements is limited to the relevant jurisdictions of the Eastern Cape and KwaZulu-Natal Provinces. 2. Neither of these judgements were tested by the Supreme Court of Appeal or the Constitutional Court, which means that its application of the stated judgements to the country as a whole is not allowed. 3. Both judgements tested the constitutionality of the contracts and concluded that the relevant contracts were unconstitutional and therefore invalid, unlawful and void ab initio. These judgements are therefore bound by the principle that an order of constitutional invalidity has no force unless confirmed by the Constitutional Court.	Paragraphs 12 - 18

¹⁶ P Bolton book, ibid, page 86-97



	<p>2. The AG erred in its understanding of the application of case-law, specifically in terms of ‘case law’ compared to ‘customary law’, specifically considering the practice in the application of SCMR 32, as:</p> <ol style="list-style-type: none"> 1. The ‘common practice or customary practice’, since the promulgation of the MFMA in 2003 and its supporting SCM Regulation in 2005, was to apply SCMR 32 contracts, or so-called ‘piggy back’ contracts, where the participating municipality will conclude its own contract with the service provider, based materially on the same terms and conditions of the initial tender, subject to compliance with the provisions of SCMR 32(1) (a) – (d). 2. This common practice was endorsed through various National Treasury circulars and guidelines. 3. This means that for the past 14 years, municipalities applied a specific common practice, concluded and honoured contracts. 4. With the alternative interpretation by the stated judgements, it appears that the ‘common practice’ is now regarded as unconstitutional and therefore invalid, unlawful and void ab initio. 5. Neither of these judgements considered the ‘customary law’ application of SCMR 32 and the implication thereof if such ‘practice’ is now impugned. 6. Prior to concluding that on matters of constitutional matters, whether ‘case law’ will trump ‘customary law, by virtue of common practice’, the impact must be tested by an appropriate court of law in order to reach a ‘just and equitable remedy’ as provided for in section 172(1) (b) of the Constitution. 	<p>Paragraphs 19-23</p>
	<p>3. The AG erred in its understanding of the application of case-law, specifically in terms of ‘a ruling’ versus ‘an obiter dictum’, as:</p> <ol style="list-style-type: none"> 1. The AG regarded ‘obiter dicta’ as a ‘court ruling’, thereby incorrectly interpreted <i>obiter dicta</i> as binding on all organs of state. 2. When the highlighted/emphasized portions in paragraph 25 are considered, it is evident that in 5 of the 6 items quoted, the judge specifically referred to either an ‘example’ or an ‘opinion’, which means that 5 of the 6 items quoted are regarded as ‘obiter dicta’ which are not regarded as binding. 	<p>Paragraphs 24 - 27</p>
	<p>4. The AG erred in its understanding of the application of the retrospective application of ‘case law’, as:</p> <ol style="list-style-type: none"> 1. The common law of rules and presumptions presumes that a statute does not apply retroactively, unless specifically so enacted, which is supported by various SCA judgements as reflected in paragraphs 30 – 32 above. 2. Although ‘case law’ is not necessarily ‘legislation or statutory law’, it is argued that this presumption will also apply to ‘case law’ as the Constitution in section 36(1) provides clear guidelines of when rights may be limited in terms of law of general application to the extent that the limitation is reasonable and justifiable in an open and democratic society. 3. Prior to concluding that the relevant judgements as case law, must be applied retrospectively, it is argued that an appropriate court of law should consider, in terms of section 36(1) of the Constitution, whether a retrospective application will limit rights and whether such limitation is reasonable and justifiable in an open and democratic society section. 	<p>Paragraphs 28 - 33</p>

5.	<p><i>The AG erred in its interpretation and application of section 1 of the MFMA, i.e. definition of irregular expenditure, as:</i></p> <ol style="list-style-type: none"> 1. The MFMA specifically reference 'legislation' and not 'law', thereby limiting 'irregular expenditure' to a contravention of 'legislation', i.e. 'statutory law' and not 'case law'. This argument is supported by the Public Audit Act in its definition of 'material irregularity' to relate to "<i>any non-compliance with, or contravention of, legislation...</i>" 2. Alternatively, where 'legislation' is regarded as inclusive of case-law, such will only be the case where such case law originates from decisions of the appellate courts, and not provincial high courts, as is the matter in this AG finding¹⁷. 	Paragraphs 34 - 39
6.	<p><i>The AG failed to consider, and test of all relevant legislation related to the 'procurement of goods and services under a contract secured by another organ of state' as it considered ONLY 3 of the relevant 9 MFMA and SCMR prescripts.</i></p>	Paragraphs 40 - 48
7.	<p><i>The AG incorrectly understood the application of National Treasury MFMA circulars as:</i></p> <ol style="list-style-type: none"> 1. The latter do not amount to valid and binding legislation, as contemplated by MFMA section 168(3). 2. It follows that non-compliance with the provisions of a National Treasury MFMA circular cannot be the basis for a finding of irregular expenditure, unless the content was adopted by the relevant Municipal Council. 3. Alternatively, it is important to note that the legality and enforceability of some of the provisions of MFMA circular 96 are questionable. 	Paragraphs 49 - 54
8.	<p><i>The AG inconsistently interpreted and applied its audit test for non-compliance with SCMR 32 contracts at various municipalities. A high-level review of the aforesaid AG findings confirms inconsistencies in the interpretation and application of SCMR 32 contracts at eight (8) different municipalities as follows:</i></p> <ol style="list-style-type: none"> 1. In some COMAF's the AG refers to non-compliance with SCMR 19 and in others non-compliance with SCMR 17&18. 2. In certain findings the AG applied retrospective application of its finding and in others it is not the case. 3. In some findings the AG refers to materiality and in others it is silent on the matter. 4. In certain findings the AG refers to 'total expenditure' and in other findings the AG differentiate between the 'amounts awarded' versus the 'amount spend'. 5. In one finding the AG tested full compliance with National Treasury MFMA circular 96, whilst it only reference the circular in other findings. 6. The recommendations are inconsistently applied for the same findings. 	Paragraphs 55 - 57
9.	<p><i>The AG made an error in law due to incorrect interpretation and application of SCMR 32 as a 'deviation' as SCMR 36(3) clearly provides that deviations do not apply to the procurement of goods and services contemplated in regulation 11(2), i.e. MFMA section 110(2) contracts'.</i></p>	Paragraphs 58 - 62
10.	<p><i>It is argued that the Blue Nightingale judgement poses grounds for further judicial review, as:</i></p> <ol style="list-style-type: none"> 1. The judgement concluded that the constitutionality of the contracts and concluded that the relevant contracts were unconstitutional and therefore invalid, unlawful and void ab initio. 	Paragraphs 63 - 65

¹⁷ <http://www.businessdictionary.com/definition/statute-law.html> - accessed on 3 November 2019

	<p>These judgements are therefore bound by the principle that an order of constitutional invalidity has no force unless confirmed by the Constitutional Court.</p> <p>2. There are about ten (10) considerations, that, on a balance of probabilities, may make the validity and enforceability of the judgement reviewable by a SCA or CC.</p>	
11.	<p><i>It is argued that the KDM judgement poses grounds for further judicial review, as:</i></p> <p>1. The judgement concluded that the constitutionality of the contracts and concluded that the relevant contracts were unconstitutional and therefore invalid, unlawful and void ab initio. These judgements are therefore bound by the principle that an order of constitutional invalidity has no force unless confirmed by the Constitutional Court.</p> <p>2. There are most of the same considerations listed in paragraph 63 above will apply mutatis mutandis, that, on a balance of probabilities, may make the validity and enforceability of the judgement reviewable by a SCA or CC.</p>	Paragraphs 66 - 68
12.	<p><i>The legality and enforceability of MFMA sections 110(2)(c) and 112(1)(o) read with and applied with SCMR's 2(4), 11(3), 19(a) and 32 are questionable as:</i></p> <p>1. The two judgements quoted by the AG only considered the application of MFMA section 110(2) read with SCMR 2(4); SCMR 11(2) and (3) and SCMR 19(a) – all provisions specifically reference MFMA section 110(2).</p> <p>2. No consideration was had to the potential provision of another type of contract, namely a MFMA section 112(1) (o) read with SCMR 32 – which specifically excludes the reference to MFMA section 110(2) and also 'a contract with another organ of state'.</p> <p>3. It is therefore argued that an appropriate court of law should consider the legality and enforceability of the relevant prescripts in context and advise accordingly.</p>	Paragraphs 69 - 71
13.	<p><i>If the AG insists on its finding that the interpretation and application of SCMR 32, contrary to current practice, is irregular, the impact would result in significant cost implications, time delays, legal uncertainty and service delivery will be detrimentally affected, as:</i></p> <p>1. All implicated Municipalities will have to approach the court for a 'declaratory order to invalidate its SCMR 32 contracts; and</p> <p>2. The courts will have to consider each matter on own merits as it is regarded as inappropriate for a court to pronounce by way of declaration upon the validity or invalidity of such an act in isolation of particular consequences that are said to have been produced, and</p> <p>3. Affected service providers may claim damages due to breach of contract, OR estoppel due to the creation of legitimate expectations, OR estoppel due to the principle of functus officio OR delictual claims OR remedies due to the 'fettering of discretion'¹⁸</p>	Paragraphs 72 - 74
<p>RECOMMENDATION</p> <p>67. According to the Justice website, the doctrine of judicial precedent binds courts to uphold the law as expressed in previous decisions of superior courts, courts of co-ordinate jurisdiction and its own decisions. <i>A court may however depart from decisions of courts of co-ordinate jurisdiction or its own decisions if it can demonstrate that they were wrongly decided.</i></p>		

¹⁸ P Bolton book, ibid, page 86-97

68. It is therefore offered that mindful of the 13 considerations discussed above, consideration be given to consider the following alternative approach in that all implicated municipalities make a specific note under its disclosure note in relation to irregular expenditure that:

“The current interpretation and application of SCMR 32 contracts are inconsistent. Recent high court judgements attempted to provide clarity on interpretation. However, as the matter relates to the interpretation of various pieces of legislation and is underpinned by a constitutional test, only the Supreme Court of Appeal, endorsed by the Constitutional Court, may provide appropriate interpretation advice. In agreement with the AG, National Treasury, the relevant treasuries and implicated municipalities, the matter will be submitted for formal review and guidance to the relevant Supreme Court of Appeal. The outcome of such judgement will be implemented by the Municipality together with the appropriate consequence management requirements and relevant ‘just and equitable’ remedies allowed.”

The attached Memo is further submitted to respond and try to show the matter, which the Knysna CFO presented, at CFO forum to PT as to the complication and ambiguity that has been brought about by the circular.

1. Saldanha Bay Municipality: T26 of 2018/19

This tender is rates based tender and was awarded by Saldanha Municipality for a period of three years. (01 July 2018 to 30 June 2021). Even if the circular were to be accepted, it will not be applicable in this case for the following reasons:

Knysna used regulation 32 and approval was given on the 17th of August 2018 by Saldanha Municipality. The contract period (assuming the forfeited part) ends only in 2021 June. Therefore, Knysna Municipality is still within the assumed period taking into account-forfeited part. (Please take note of the emphasis assumed). Knysna has technically forfeited only one or two months. Again, emphasis being made of assumed the interpretation of the circular was correct which we disagree and was the first Municipality to highlight the complications regarding this circular. Question is, the forfeited period is in measures in quantity (if so how will this be done on rates based tender since there is no quantity) or measured in month (if measured in months left then Knysna is still within the 34 months of the 36 months. (see attachments)

2. City of Cape Town: T39 of 2017/18

This tender is rates based tender and was awarded by City of Cape Town Municipality for a period of two years and eight months. (01 November 2016 to 30 June 2019, under T176S/2015/16 and T 241G/201/17). Even if the circular were to be accepted, it will not be applicable in this case for the following reasons:

Knysna used regulation 32 and approval was given on the 15 of January 2019 by City of Cape Town Municipality. The contract period (assuming the forfeited part) ends only in 2019 June. Therefore, Knysna Municipality is still within the assumed period taking into account-forfeited part. (Please take note of the emphasis assumed). Knysna has technically forfeited only twenty six months and used last six months. Again, emphasis being made of assumed the interpretation of the circular was correct which we disagree and was the first Municipality to highlight the complications regarding this circular. Question is, the forfeited period is it measures in quantity (if so how will this be done on rates based tender since there is no quantity) or measured in month (if measured in months left then Knysna is still within the 6 months of the 32 months. (see attachments). It must be noted that community protest demanding subcontracting and employment of workers within a specific ward has led to delays in the completion of the project on time by just more than a month. Again the community protest and environment we operate in becomes a serious challenge if we were to accept the circular as there are unforeseen and justifiable delays. To be added here is that after the circular was issue we immediately stopped using the tender for installation and started our own specifications and tender process, which will be awarded by end of December 2019.

3. Mosselbay Municipality: T45 of 2017/18

This tender is rates based tender and was awarded by Mosselbay Municipality for a period of three years. (01 July 2017 to 30 June 2020). Even if the circular were to be accepted, it will not be applicable in this case for the following reasons: Knysna used regulation 32 and approval was given on the 23 October 2017 by Mosselbay Municipality. The contract period (assuming the forfeited part) ends only in 2020 June. Therefore, Knysna Municipality is still within the assumed period taking into account-forfeited part. (Please take note of the emphasis assumed). Knysna has technically forfeited only four months. Again, emphasis being made of assumed the interpretation of the circular was correct which we disagree and was the first Municipality to highlight the complications regarding this circular. Question is, the forfeited period is in measures in quantity (if so how will this be done on rates based tender since there is no quantity) or measured in month (if measured in months left then Knysna is still within the 32 months of the 36 months. (see attachments. To be added here is that after the circular was issue we immediately started our own specifications and tender process, which will be awarded long before this regulation 32 with Mosselbay ends in June 2020.

4. Bitou Municipality T49 of 2017/18

This tender is rates based tender and was awarded by Bitou Municipality for a period of three years. (01 July 2015 to 30 June 2018). Even if the circular were to be accepted, it will not be applicable in this case for the following reasons: Knysna used regulation 32 and approval was given on the 21 August 2017 by Bitou Municipality. The contract period (assuming the forfeited part) ends in 2019 June. Therefore, Knysna Municipality was still within the assumed period taking into account-forfeited part. (Please take note of the emphasis assumed). Again, emphasis being made of assumed the interpretation of the circular was correct which we disagree and was the first Municipality to highlight the complications regarding this circular. With these types of work the consulting engineer will finalise the work up until confirming that retention can be released and or pay and all conditions have been met. The amount as stated is in relation to the contract for professional services for planning and implementation of Human settlement projects. The fact that the building of houses would end in June 2018 means that the consultant did work up until June 2018 and the invoice could be in the new financial year. Question is, the forfeited period is in measures in quantity (if so how will this be done on rates based tender since there is no quantity) or measured in month (if measured in months left then Knysna was within the period before the contract ends in June 2018.

4. Bitou Municipality T5 of 2017/18

This is again a rates based tender and management argument on the application of the circular which has no force to Municipalities is stated above.

Auditor's conclusion

The audit finding is not based on MFMA Circular No 96 issued in July of 2019 by National Treasury to provide further elaboration to municipalities and municipal entities on the principles captured in regulation 32 of the Municipal Supply Chain Management Regulations 2005 (SCM Regulations) when procuring goods or services from contracts secured by other organs of state.

Circular 96 provides important principles for the effective implementation of regulation 32 of the municipal supply chain management regulations, and as a consequence section 110(2) of the MFMA.

However, the circular is not used to raise the non-compliance.

There have also been two court judgments which provide an understanding of regulation 32 and section 110(2). They were delivered in the High Court of South Africa KwaZulu-Natal division (Durban) on 6 July 2018 (KwaDukuza) and in the High Court of South Africa (Eastern Cape circuit

court, East London) on 24 November 2015 (Amathole) which were based on the interpretation of regulation 32.

In both judgements, the contracts between the supplier and the municipality were declared to be null and void ab initio. Part of the reasons for the decisions are that the original contract had expired at the time the municipality participated and the terms and conditions were different and therefore the conditions for the section 110(2) exemption were not met.

The court judgements (KwaDukuza and Amathole) provide a lens through which regulation 32 and section 110(2) can be interpreted. However, they are not the criteria we use to base and conclude a non-compliance on.

Section 110(2) provides for an exemption from competitive processes established in terms of municipal SCM policies when municipalities contract with other organs of state for the procurement of goods or services under a contract secured by that other organ of state, provided that the relevant supplier has agreed to such procurement.

The exclusion of Part 1 under Chapter 11 of the MFMA may not detract from or erode the constitutional imperatives of fairness, equity, competitiveness and cost-effectiveness. Regulations must be read subject to the empowering legislation. The regulation may not be used as an aid to interpret a provision of the statute. The regulations shall not be used as an aid to interpreting any of the statutory provisions, nor can the regulations be used to extend the meaning of the enactment.

A provision in a statute must be interpreted before the regulation is considered as stated in paragraph 26 of the Amathole judgement.

Regulation 32 must therefore be interpreted to mean that the municipality or municipal entity must conclude a contract with another organ of state as required by section 110(2) and procure within that contract only the goods or services that have been procured through the contract secured by another organ of state and not more.

The “section 110(2) contract” must be in writing as required by section 116 of the MFMA.

The municipality is not legislatively empowered to contract directly with the supplier, as the exemption provided by section 110(2) is applicable only if the municipality contracts (enters into a contract) with another organ of state.

The municipality procures under the contract through the other organ of state. The municipality cannot substitute itself in place of the other organ of state. A municipality or entity cannot conclude a contract with any supplier without a section 217(1) fair, equitable, transparent, competitive, and cost effective procurement process in terms of paragraph 50 of the Amathole judgement.

Non-compliance with regulation 32 is based on the fact that the municipality did not procure under a contract secured by another organ of state as required by MFMA section 110(2)(c). The case law (the 2 court judgments referred to above) assists in understanding the requirements of MFMA section 110(2)(c) and SCM regulation 32.

The evaluation at this stage is that the non-compliance does not result in material non-compliance to be reported in the audit report. The irregular expenditure is however required to be reported in the financial statements as non-compliance has been identified in relation to SCM reg32.

Audit has confirmed the irregular expenditure relating to the above has been appropriately disclosed in the Annual Financial Statements.

Local Content – COMAF 25

Audit Finding

Preferential Procurement Regulation 8 (2), 2017 issued in terms of the Preferential Procurement Policy Framework Act (Act no. 5 of 2000) states that-

“An organ of state must, in the case of a designated sector, advertise the invitation to tender with a specific condition that only locally produced goods or locally manufactured goods, meeting the stipulated minimum threshold for local production and content, will be considered.”

During the audit of supply chain management, the following awards made during the 2018/19 financial year were identified as not complying with the requirements of local production as the municipality failed to advertise the correct Local Content minimum threshold:

No	Description of award	Supplier	Award value	Expenditure	Local content item	Advertised Local Content threshold	Threshold per DTI
1	T01 of 2018/19 Electrification of various areas for 2018/19 to 2020/21 in Knysna	V.E Reticulation (PTY) LTD	R11 125 240.00	R2 175 740.29	Prepayment meters	90%	70%
2	T29 of 2018/19 Knysna Reverse Osmosis Plants - Operation & Maintenance for a three year period	Alveo Water	R6 672 078.20	R1 128 907.46	Valve Products and actuators	50% - 70%	70%
3	T40 of 2018/19 Upgrade of Hornlee Water Reticulation	Techni Civils t/a Ikhono Projects	R3 250 826.31	R2 674 946.70	Valve Products and actuators	50% - 70%	70%
Total			R 21 0481 44.51	R5 979 594.45			

As a result of the local production content requirements not being adhered to in the awarding of the above mentioned awards, this results in irregular expenditure of R5 979 594.45.

Internal control deficiency

Financial and Performance Management

Review and monitor compliance with applicable laws and regulations

Management did not put controls and processes in place to ensure that the Supply Chain Management unit is regularly updated and trained on circulars for local production and content issued by treasury for compliance with the regulations.

Recommendation

Management should reassess its approach and processes for local production and content tenders and ensure that advertisements comply with the requirements of the Preferential Procurement Regulations.

It is further recommended that management should examine the entire population of awards for local production and content to identify any possible non-compliance.



Management should also update the disclosure note for irregular expenditure as a result of the identified finding.

Management response

Management comment on the audit finding:

Management disagree with the finding.

Various sessions presented by Dti were attended by SCM staff over the past number of years and the information used in the advertisements were as per the presentations received from the Dti, **see attached the last two training presentation in our District**. KM used the presentations as the most relevant information to advertise bids and none of the bidders or potential bidder was affected, complained or objected on the thresholds indicated in the tender documents.

T1 of 18/19 – additional to the above it must be noted that the 70% **is a minimum** and nowhere in the document does it indicate that the advert or requirements cannot be above the Minimum. On the attached two training presentation by DTI it is very clear that KM used the correct percentage on the tender documents.

T29 of 18/19 – On the attached two training presentation by DTI it is very clear that KM used the correct percentage on the tender documents. The spending on the Valves in this tender has been calculated and it is only R **R80 761.29**. Even if management were to accept, the amount indicated as irregular expenditure is incorrect. The core focus of this tender is on the operation of the plant and very little emphasis on the maintenance thereof. This tender focused more on appointing experts to assist with operations than on maintaining the plant.

T40 of 18/19 – On the attached two training presentation by DTI it is very clear that KM used the correct percentage on the tender documents. As per the BOQ only 12 valves are specifically indicated and the amount for that is R120 229. The total amount for valves can only be and will only be limited to R166 971. Only that amount were to be in contradiction if management were to agree.

Auditor's conclusion

T01 of 2018/19

Management's response is noted. We accept management's response regarding T01 of 2018/19. Management advertised more than the minimum required level of local content per DTI and therefore, this finding is resolved and no further reporting is required.

T29 of 2018/19

Management response is noted and has been accepted per inspection of the additional documentation provided. The matter will however remain in the management report as an "other matter" as there is still a control deficiency that needs to be addressed relating to advertising that must meet the requirements of the regulations only.

T40 of 2018/19

Management response is noted and has been accepted per inspection of the additional documentation provided. The matter will however remain in the management report as an "other matter" as there is still a control deficiency that needs to be addressed relating to advertising requirements.

Commitments – Authorised capital expenditure misstated – COMAF 34

Audit Finding

The Municipal Finance Management Act no. 56 of 2003 (MFMA), section 122 (1) (a) states that:

“Every municipality and every municipal entity must for each financial year prepare annual financial statements which fairly presents the state of affairs of the municipality or entity, its performance against its budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results, and its financial position as at the end of the financial year.”

Paragraph 124 of the Standard of Generally Recognised Accounting Practice – Presentation of Financial Statements (GRAP 1), states that:

“Notes are normally presented in the following order, which assists users in understanding the financial statements and comparing them with financial statements of other entities:

(d) other disclosures, including:

(i) contingent liabilities (see GRAP 19) and unrecognised contractual commitments.”

Paragraph 86 of the Standard of Generally Recognised Accounting Practice – Property plant and equipment (GRAP 17), states that:

“The financial statements shall also disclose for each class of property, plant and equipment recognised in the financial statements:

(b) the amount of contractual commitments for the acquisition of property, plant and equipment.”

Paragraph 38 of the Standard of Generally Recognised Accounting Practice – Leases (GRAP 13), states that:

“Lessees shall, in addition to meeting the requirements of the Standard of GRAP on Financial Instruments (GRAP 104) make the following disclosures for finance leases:

(b) a reconciliation between the total of future minimum lease payments at the reporting date, and their present value. In addition, an entity shall disclose the total of future minimum lease payments at the reporting date, and their present value, for each of the following periods:

(i) not later than one year;

(ii) later than one year and not later than five years; and

(iii) later than five years.”

Paragraph 42 of the Standard of Generally Recognised Accounting Practice – Leases (GRAP 13), states that:

“Lessees shall, in addition to meeting the requirements of GRAP 104, make the following disclosures for operating leases:

(a) the total of future minimum lease payments under non-cancellable operating leases for each of the following periods:

(i) not later than one year;

(ii) later than one year and not later than five years; and

(iii) later than five years.”

The following issues were identified while auditing the commitments disclosed in note 42 of the Notes to the Annual Financial Statements for the year ended 30 June 2019:

Issue 1

During the audit of capital commitments, it was identified that capital commitments for certain tenders did not agree to the auditors recalculated commitment amount as at 30 June 2019. The differences identified are detailed below:

Auditor's recalculation:

No	Tender No	Contractor	Amount as per the contract (R)	Amounts Invoiced (R)	Auditors recalculated Commitment as at 30 June 2019 (R)	Commitments value included in note 42 of the AFS (R)	Difference (R)
1	T09 of 2016/17	MDL Electrical	2 293 855.39	2 335 693.10	0	278 799.02	278 799.02
2	T17 of 2016/17	RC Orban T/A Rudcor	7 618 835.53	8 475 475.46	0	958 472.71	958 472.71
3	T09 of 2017/18	B&V Contractors	18 998 061.50	17 583 338.54	1 414 722.96	5 178 389.63	3 763 666.67
4	T27 of 2017/18	MDL Engineering	2 480 438.70	2 406 620.32	73 818.38	424 047.89	350 229.51
5	T55 of 2017/18	Urhwebo E- Transand	8 532 769.49	7 960 504.81	572 264.68	1 189 924.04	617 659.36
6	T57 of 2017/18	HT Pelatona	15 708 316.62	8 095 052.84	7 613 263.78	9 413 644.55	1 800 380.77
7	T63 of 2017/18	MDL Engineering	5 400 000.00	4 912 426.44	487 573.56	1 198 708.36	711 134.80
8	T20 of 2018/19	Bukho Q Holdings JV Zwelo's Construction JV	29 913 527.19	4 866 930.12	25 046 597.07	9 411 260.64	-15 635 5336.43
9	T22 of 2018/19	MDL Engineering	18 888 507.73	2 626 598.17	16 261 909.56	18 527 440.43	2 265 530.87
10	T25 of 2018/19	Izazi Technologies	4 632 510.79	4 400 885.25	231 625.54	272 221.92	40 596.38
						Total	4 848 866.35

The finding identified has led to a factual misstatement of R4 848 866.35 and the understatement of capital commitments.



Issue 2

The following tenders were found to have commitment balances outstanding at year end, but were not included in the schedule of commitments used for AFS disclosure purposes:

Project/ Tender Number	Total approved project value/ Total contract value (R)	Actual amount per invoices (R)	Misstatement amount (Understated) (R)
53 of 2016/17	3 441 072.59	3 138 053.89	303 018.70
54 of 201718	2 409 098.70	2 101 982.33	307 116.37
60 of 201718	10 743 689.80	10 532 428.23	211 261.57
36 of 201718	1 614 204.79	506 298.76	1 107 906.03
70 OF 201718	14 340 564.89	2 021 491.83	12 319 073.06
Totals	32 548 630.77	18 300 255.04	14 248 375.73

The identified finding has led to a factual misstatement of R14 248 375.73, which is projected to R26 670 036.64 and the understatement of capital commitments.

Internal control deficiency

Financial and performance management

Prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information

Management did not adequately review the commitments schedule against the tenders and actual amounts invoiced, to ensure that the information taken into account in the compilation of the commitment schedule was valid, accurate and complete, prior to this being disclosed in the financial statements.

Recommendation

Management should thoroughly scrutinize the tender register to identify all tenders which may impact on the commitments disclosure note and ensure that the tender amounts and the amounts invoiced in the commitment schedule are accurate and all recorded for reporting purposes.

It is recommended that management adjust the financial statements to accurately account for the commitments disclosure at year end.

Management response

Management comment on the audit finding:

Issue 1:

Please refer to the responses below indicating the disagreement and agreements per item in the finding.

The items per issue 1 of COMAF34 were assessed by management and are addressed per item 1 to 10.

Item 1 - T09 of 2016/17:

Management agrees that the total commitment excluding VAT remaining is Rnil as per the auditor's recalculation.

Item 2 - T17 of 2016/17:

Management disagrees.

The BAC recommended and approved the following amounts including VAT:

1. R 8 685 472.50 – See document 1. *T17_20162017 - Tender*, the tender contract amount approved.
2. R 1 302 820.00 – See document 2. *T17_20162017 - BAC minute Extension 1*, for the amount approved.
3. R 766 408.41 – See document 3. *T17_20162017 - BAC minute Extension 2*, for the amount approved.

This amounts to R 10 754 700.91 including VAT. The approved total commitment amount is consequently R 9 433 948.17 excluding VAT.

The commitment of R 958 472.71 as at year end as per the register and financial statements is consequently correct.

Item 3 - T09 of 2017/18:

Management disagrees.

The BAC recommended and approved the following amounts including VAT:

1. R 21 657 790.11 – See document 4. *T09_20172018 tender*, for the amount approved.
2. R4 331 558.02 – See document 5. *T09_20172018 BAC minute extension 1*, for the amount approved.

This amounts to R 25 989 348.13 including VAT and R 22 797 673.80 excluding VAT.

Management agrees with the amount invoiced of R17 583 338.54 excluding VAT.

The total commitment remaining, excluding VAT, is consequently R 5 214 335.26.

Item 4 - T27 of 2017/18:

Management disagrees.

The BAC recommended and approved the following amounts including VAT:

1. R 2 702 300.12 – See document 6. *T27_20172018 BAC minute*, for the amount approved.
2. R 540 460.02 – See document 7. *T27_20172018 BAC minute extension 1*, for the amount approved.

This amounts to R 3 242 760.14 including VAT and R 2 844 526.44 excluding VAT.

Management agrees with the amount invoiced of R2 406 620.32 excluding VAT.

The total commitment remaining, excluding VAT, is consequently R 437 906.12.

Item 5 - T55 of 2017/18:

Management disagrees.

The BAC recommended and approved the following amounts:

1. R 7 458 714.59 excluding VAT– See document 8. *T55_20172018 Urhwebo BAC minute* for the amount approved.
2. R 1 945 471.40 including VAT (at 15%) – See document 9. *T55_201718 BAC minute Extension 1*, for the amount approved.

This is a total amount of R 10 448 406.03 including VAT and an amount of R 9 150 428.85 excluding VAT.

Management does not agree with the amount invoiced of R 7 960 504.81 excluding VAT. The total amount invoiced was R 9 715 602.65 excluding VAT. See attached the invoice for an amount of R 1 755 097.84 to be included in the amount invoiced. See document *P1 - Invoice INVUT1321_EFT43421*.

The total commitment remaining excluding VAT is Rnil.

Item 6 - T57 of 2017/18:

Management disagrees

The BAC recommended and approved the following amounts excluding VAT:

1. R 15 846 108.87 – See document 10. *T57_20172018 tender*, the tender contracted amount approved.

Management agrees with the amount invoiced of R 8 095 052.84 excluding VAT.

The total commitment remaining excluding VAT is R 7 751 056.03.

Item 7 - T63 of 2017/18:

Management agrees.

Item 8 - T20 of 2018/19:

Management disagrees

Paragraph 86 of the Standard of Generally Recognised Accounting Practice – Property plant and equipment (GRAP 17), states that:

*“The financial statements shall also disclose for each class of property, plant and equipment recognised in the financial statements:
(b) the amount of contractual commitments for the acquisition of property, plant and equipment.”*

This contract is a dual contract that includes capital expenditure and operating expenditure. The contracted amount that is capital expenditure was included in the capital commitment register, while the operating expenditure was not included, as per the requirements of GRAP.

The Capital expenditure recommended and approved excluding VAT is:

1. R10 352 386.70 – See documents 11. *T20_20182019 Tender bill of quantities and split and 12. T20_20182019 - Calculation of Split of Capital expenditure and operational expenditure*, for the amount approved.

Management does not agree with the amount invoiced of R 4 866 930.12 excluding VAT. The amounts invoiced as per the finding is for invoices from July 2019 (after year end). No invoices where invoiced during the 2018/19 financial year. The total amount invoiced is therefore Rnil at 30 June 2019.

The total commitment remaining excluding VAT is R 10 352 386.70.

Item 9 - T22 of 2018/19:

Management disagrees.

The BAC recommended and approved the following amounts including VAT:

1. R 23 893 962.28 – See document 13. *T22_20182019 - BAC Minute*, for the amount approved.

This is an amount of R 20 777 358.50 excluding VAT.

Management agrees with the amount invoiced of R 2 626 598.17 excluding VAT.

The total commitment remaining, excluding VAT, is R18 150 760.33.

Item 10 - T25 of 2018/19:

Management agrees.

Issue 1 summary of recalculated differences:

The recalculated difference due to the evaluation and responses to the finding is summarised below:

No	Tender No	Contractor	Amount as per the contract (R)	Amounts Invoiced (R)	Knysna recalculated Commitment as at 30 June 2019 (R)	Commitments value included in note 42 of the AFS (R)	Difference (R)
1	T09 of 2016/17	MDL Electrical	2 293 855.39	2 335 693.10	-	278 799.02	278 799.02
2	T17 of 2016/17	RC Orban T/A Rudcor	9 433 948.17	8 475 475.46	958 472.71	958 472.71	0.00
3	T09 of 2017/18	B&V Contractors	22 797 673.80	17 583 338.54	5 214 335.26	5 178 389.63	- 35 945.63
4	T27 of 2017/18	MDL Engineering	2 844 526.44	2 406 620.32	437 906.12	424 047.89	- 13 858.23
5	T55 of 2017/18	Urhwebo E-Transand	9 150 428.85	9 715 602.65	-	1 189 924.04	1 189 924.04
6	T57 of 2017/18	HT Pelatona	15 846 108.87	8 095 052.84	7 751 056.03	9 413 644.55	1 662 588.52
7	T63 of 2017/18	MDL Engineering	5 400 000.00	4 912 426.44	487 573.56	1 198 708.36	711 134.80
8	T20 of 2018/19	Bukho Q Holdings JV Zwelo's Construction JV	10 352 386.70	-	10 352 386.70	9 411 260.64	- 941 126.06
9	T22 of 2018/19	MDL Engineering	20 777 358.50	2 626 598.17	18 150 760.33	18 527 440.43	376 680.10
10	T25 of 2018/19	Izazi Technologies	4 632 510.79	4 400 885.26	231 625.53	272 221.92	40 596.39
					43 584 116.23	46 852 909.19	3 268 792.96

Issue 2:

The assessment of issue 2 of COMAF34 by the Auditor General where assessed by management and are addressed per tender number.

Tender 53 of 2016/17:

Management disagrees.

This tender was completed and no remaining commitment exist at year end.

A document of completion issued by the engineers were received. See document *14. 53 of 20162017- Document of Completion.*

Tender 54 of 201718:

Management disagrees.

This tender was completed and no remaining commitment exist at year end.

A document of completion issued by the engineers were received. See document *15. 54 of 20172018 - Document of Completion.*

Tender 60 of 201718:

Management disagrees.

This tender was completed and no remaining commitment exist at year end.

A document of completion issued by the engineers were received. See document *16. 60 of 20172018 - Document of Completion.*

Tender 36 of 201718:

Management disagrees.

This tender was completed and no remaining commitment exist at year end.

A document of completion by the engineers where received. See document 17. 36 of 20172018 - *Document of Completion*.

Tender 70 OF 201718:

Management disagrees.

Tender contract 70 of 20172018 is awarded for the repairs and maintenance of various water and sewer pump stations and facilities for a period of three years.

This is part of contracted operating expenditure and not capital expenditure.

It was consequently correctly not included in the capital commitments disclosure.

Issue 2 summary:

We disagree with the extrapolated misstatements as none of these tenders should be part of the commitment register and was correctly treated in the AFS disclosure.

Management comment on the root cause identified within the audit finding:

Management take note and will continue to strengthen review controls relating to the commitment register.

Management comment on the recommendation:

Management take note of the recommendation.

Remedial action:

What actions will be taken:

Management will continue to strengthen review controls relating to the commitment register to ensure increased accuracy.

By whom:

By when:

If the above findings affects an amount (s) disclosed in the financial statements:

YES

Please give an indication of whether the correcting journal entry shall be processed:

N/A

If yes, please indicate the accounting entry:

N/a

If no, please provide the reason why such a conclusion:

N/a

Auditor's conclusion

Issue 1:

Management's comments are note. Upon further inspection of the supporting evidence we agree with management's response and the total misstatement of R3 268 792.96. The final adjusted financial statements was inspected and the adjustment was accurately processed. This matter will remain in the management report as an "other important matter" as there is an internal control deficiency that must be addressed.

Issue 2:

Management's comment is noted. Upon further inspection of the supporting documentation, we agree with management's response. Therefore, this finding is resolved and no further reporting is required.

Supply Chain Management Deviations – COMAF 36

Audit finding

Regulation 36 (1) (a) of the Municipal Supply Chain Management Regulations states that: “a supply chain management policy may allow the accounting officer to dispense with the official procurement processes established by the policy and to procure any required goods or services through any convenient process, which may include direct negotiations, but only

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- (i) in an emergency;
- (ii) if such goods or services are produced or available from a single provider only;
- (iii) for the acquisition of special works of art or historical objects where specifications are difficult to compile;
- (iv) acquisition of animals for zoos; or
- (v) in any other exceptional case where it is impractical or impossible to follow the official procurement processes”

Regulation 13 (b) of the Municipal Supply Chain Management Regulation states that: “a supply chain management policy must state that the municipality may not consider a written quotation or bid unless the provider who submitted the quotation or bid has authorised the municipality to obtain a tax clearance certificate from the South African Revenue Services that the provider’s tax matters are in order.”

Regulation 43, Prohibition on awards to persons whose tax matters are not in order, of the Municipal Supply Chain Management Regulations states the following

- 1) “The supply chain management policy of the municipality or municipal entity must, irrespective of the procurement process followed, state that the municipality or municipal entity may not make any award above R15 000 to a person whose tax matters have not been declared by the South African Revenue Services to be in order.
- 2) Before making an award to a person, a municipality or municipal entity must first check with SARS whether that person’s tax matters are in order.
- 3) If SARS does not respond within seven days such person’s tax matters may for purposes of sub regulation (1) be presumed to be in order.”

Section 62(1)(a) of the MFMA states that “the accounting officer of a municipality is responsible for managing the financial administration of the municipality, and must for this purpose take all reasonable steps to ensure that the resources of the municipality are used effectively, efficiently and economically.”

Section 95(a) of the Municipal Finance Management Act states that: “the accounting officer of a municipal entity is responsible for managing the financial administration of the entity, and must for this purpose take all reasonable steps to ensure that the resources of the entity are used effectively, efficiently, economically and transparently.”

Section 117 of the Municipal Finance Management Act states: “that no councillor of any municipality may be a member of a municipal bid committee or any other committee evaluating or approving tenders, quotations, contracts or other bids, nor attend any such meeting as an observer.”

Issue 1

1. Regulation 36 evaluation of justification for deviations

During the audit of procurement and contract management, the following deviations were evaluated and found to be in contravention of Regulation 36 and the municipality's Supply Chain Management Policy:

No.	Supplier	Deviation Reference	Expenditure	Reason for classification as irregular expenditure
1.	Noble Spectatus Fund 4	9862	R1 812 987.45	<p>>Background The Municipal Council resolved to extend the lease over the Customer Care Building in the Old Standard Bank Building on 2 July 2018 for a year commencing 1 August 2018. The current Office Accommodation lease for the Customer Care Building in the Old Standard Bank Building, Erf 711, Knysna expires on 31 July 2018. The ownership of the property changed from Albatros Property Trust to Noble Spectatus Fund 4 (Pty) Ltd.</p> <p>The Community Services (Vehicle License department) and Income Sections department of the Municipality are using the offices in the Customer Care Building situated at Erf 711, Knysna.</p> <p>>Furnish and motivate reasons for required deviation No alternative is in place as a request for proposals could not be advertised due to the current organisational review, which will result in wholesale changes in the composition of the organisation. Only after the process has been completed a request for proposal can be advertised. Enough money is budgeted for the leasing of this space for this financial year.</p> <p>>Auditor's view: The auditor is not in agreement with the reasons provided by the municipality justifying impracticality. Management knew already at the beginning of the 2018 financial year that the intentions were in place to restructure the Municipality and to centralize all departments into one building. Furthermore, management also knew that the lease was coming to an end in the 2018 financial year and should have implemented proper planning already from inception of the 2018 financial year. Thus had adequate planning taken place from inception it which would have enabled management to carry out a proper test of the market for suitable premises without impacting the municipal operations.</p> <p>Furthermore, upon inspecting the supporting evidence provided to the auditors regarding this deviation (as auditee's proof of testing the market (Minutes of the BEC as signed by the BEC members on 20/09/2019)), it was noted that the auditee advertised a tender - T10 of 2019/20: Rental of Office Space for a period of three (3) years on 01 August 2019. The tender was advertised in the following media streams: The Knysna Plett Herald, The Edge, Municipal Notice Board, The Municipal Website and on E-Tender Portal. The test conducted for suitable premises was conducted after the lapse of the lease which does not justify the deviation taking place as there was sufficient time to implement proper procurement process.</p>
2.	Albatros Property Trust	9863	R3 004 765.43	<p>>Background The Technical Services Department, Planning & Development Department and the Public Participation Unit is using the offices in the Old Main Building situated at Erf 985, Knysna. The Municipal Council on 2 July 2018 resolved to extend the current lease agreement as from 1 July 2018 for another two years.</p>

				<p>>Furnish and motivate reasons for required deviations: No alternative is in place as a request for proposals could not be advertised due to the current organisational review, which will result in wholesale changes in the composition of the organisation. Only after the process has been completed a request for proposal can be advertised. Enough Money is budgeted for the leasing of this space for this financial year.</p> <p>>Auditor's view: The auditor is not in agreement with the reasons provided by the municipality justifying impracticality. Management knew already at the beginning of the 2018 financial year that the intentions were in place to restructure the Municipality and to centralize all departments into one building. Furthermore, management also knew that the lease was coming to an end in the 2018 financial year and should have implemented proper planning already from inception of the 2018 financial year. Thus had adequate planning taken place from inception it which would have enabled management to carry out a proper test of the market for suitable premises without impacting the municipal operations.</p> <p>Furthermore, upon inspection of supporting evidence provided to auditors regarding this deviation as the auditee's proof of testing the market (Minutes of the BEC as signed by the BEC members on 20/09/2019), it was noted that the auditee advertised a tender - T10 of 2019/20: Rental of Office Space for a period of three (3) years on 01 August 2019 in the following media streams: The Knysna Plett Herald, The Edge, Municipal Notice Board, the Municipal Website and on E-Tender Portal. This test conducted for suitable premises in the market was therefore conducted after the lease expired which does not justify the deviation taking place as there was sufficient time to implement proper procurement process.</p>
3.	De Swardt Vogel Myambo Attorneys	9944	R616 494.97	<p>>Background The Municipal Council on 17 July 2018 resolved that an independent investigator be appointed to conduct an investigation based on allegations of misconduct against a Senior Manager.</p> <p>De Swardt Vogel Myambo Attorneys were appointed to conduct the investigation on behalf of Knysna Municipality. De Swardt Vogel Myambo Attorneys subsequently conducted the investigation and submitted the enclosed invoice for services rendered.</p> <p>The firm is not on Council's approved panel of attorneys and the payment could therefore not be effected through normal SCM procurement processes.</p> <p>>Furnish and motivate reasons for required deviation: This was an exceptional case as Council resolved that De Swardt Vogel Myambo Attorneys be appointed to conduct above-mentioned investigation.</p> <p>>Auditor's view: The auditor is not satisfied with the reasons provided by the municipality to justify the exceptional case.</p> <p>There is no (documented) valid reason as to why Myambo Attorneys were appointed as the independent investigator - the firm is not on the Council's approved panel of attorneys and there is no specific reason cited (specialized skills, etc.) for the appointment of Myambo Attorneys.</p>
4.	RC Orban t/a Rudcor	9950	R929 749.86	<p>>Provided to audit as support for the deviation was the following: 1). A memorandum from Manager: Protection Services to Director: Community Services regarding: construction of new pump station,</p>

				<p>white location multipurpose centre: outstanding payments: Rudcor contractor, which stated the following:</p> <p>"In view of the Legal action instituted against Knysna Municipality for money not paid for work completed during the first phase of property, I attached a copy of the report from the Consulting Engineers indicating the reason for the expenditure. After consultation with the Chief Financial Officer vote no 9/103-8-7 was allocated for the payment of the invoice.</p> <p>Community and Technical Services have own funding Capital money that will be adjusted to compensate the expenditure. Recommendation: That the amount of R905 422,96 vat included be paid to Rudcor Contractors from vote no 9/103-8-7."</p> <p>The memorandum is signed by S Langlands (Manager: Protection Services) on 2018-10-11.</p> <p>2). An official routing form. Noted is the comments made by Manager: Legal Services: "Rudcore has commenced action proceedings in the HC for payment after considering all relevant factors. KM is liable for payment of the invoice for services rendered.</p> <p>>Auditor's view: The auditor is not satisfied with the reasons provided by the municipality. There is no clear valid reason for the deviation in the memorandum and official routing forms noted above.</p> <p>Further per inspection of communication from Element Consulting Engineers (Hannes Lourens, Technical Director), to the Municipal Manager (for Mr. S Langlands' attention) dated 27 July 2018, an amount of R905 422, 96 was payable to Rudcor. (Reference is made to contract no T17/2016/17: construction of civil works, PH1 upgrading of sportfield on erf re/214 White Location Knysna, and payment certificate No.3 for work completed).</p> <p>Based on the above, the auditor is of the view that had the work been performed under an already awarded tender, a "deviation" would not be necessary to facilitate payments.</p> <p>The above reasons noted in the memorandum and official routing forms as well as inquiries made is not reflective of any circumstance that allows for a deviation.</p>
5.	Albatros Property Trust	10038	R427 830.85	<p>>Background Council extended the lease until 31 July 2019. This extension is due to no space being available closer to proximity of the Main Building.</p> <p>>Furnish and motivate reasons for required deviation: The reason for deviation is that it is impractical to find a space in Knysna CBD.</p> <p>>Auditor's view: The auditor is not satisfied with the reasons provided by the municipality. Management knew that the current lease was coming to an end and should have implemented proper planning which would have enabled it to carry out a proper testing of the market without impacting the municipal operations.</p> <p>Furthermore, upon inspection of further supporting evidence provided to auditors regarding this deviation as the auditee's proof of testing the market (Minutes of the BEC as signed by the BEC members on 20/09/2019), it is noted that the auditee advertised a tender - T10 of 2019/20: Rental of Office Space for a period of three (3) years on 01 August 2019 in the following media streams: The</p>

				Knysna Plett Herald, The Edge, Municipal Notice Board, the Municipal Website and on E-Tender Portal. This testing of the market, for suitable premises is therefore conducted after the lapse of the lease which does not justify the reasons to deviate.
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The reasons for the above deviations are not in line with regulation 36 and therefore results to non-compliance and possible irregular expenditure amounting to R6 791 829.

Issue 2

2. Regulation 13(b) & 43 Provider's tax matters

D order 9862 NOBLE SPECTATUS FUND 4:

Tax Clearance Certificate for NOBLE SPECTATUS FUND 4 (PTY) LTD (Tax Clearance Certificate Number: 0700/2/2019/A003126060) provided stated that the taxpayer has complied with the requirements as set out in the Tax Administration Act (Approved date 2019-06-19, Expiry date 2020-06-19). The date that the deviation was requested/applied for was however on 17/07/2018 - the date of the tax clearance falls outside of the date of the deviation.

The above is not in line with regulation 13(b) and regulation 43 and therefore results in irregular expenditure of R1 812 987,45.

Internal control deficiency

Financial and performance management

Review and monitor compliance with applicable laws and regulations.

Management did not adequately review the reasons, details and/or circumstances presented to deviate before approving them to ensure that they were in line with SCM regulations and the SCM policy of the municipality.

Management did not review that the tax documents to ensure that they are valid and relevant for the period in which the deviation took place.

Management did not make use of the panel of attorneys in place for which a competitive procurement process was followed.

Recommendation

It is recommended that management communicate the supply chain management policy to all members of staff and when approving deviations ensure that they are in line with the policy and SCM regulations.

Management response

Management comment on the audit finding:

Management response is dealt with separately for each matter.

Issue 1. Matter 1, 2 and 5 dealt with together.

Management disagree with the finding. It is a undisputed fact that there is no sufficient space to accommodate the needs of Knysna Municipality, for the staff that are scattered in different rented buildings. Whether the market is and was tested during the year under review or after the year under review will have same effect and the fact remains that there is no space that is suitable for

the needs of the Municipality. The tender that was recently done to test the market proves that there is no one building that can accommodate all the staff that are scattered all over. The results of that tender process is that still two building would have to be rented and have staff still scattered all over. In view of this, the BAC did not award the tender as the same status core will remain and does not resolve the problem.

AG to note that these rented building serviced before MPAC for investigation and eventually to Council. MPAC and Council resolved on this expenditure because Council and MPAC are aware that there is no space available in the Knysna area. The argument that the market was tested after the year under review will is incorrect as the outcome would be the same. The Municipality under current competing needs is assessing the options to build on the house next to the main building, close the Community hall behind finance, and convert this into offices.

Issue 1. Matter 3

Management disagree in relation to point 3 above: De Swardt Vogel Myambo Attorneys.

Attached is the tender for the panel of service providers to provide legal services. In that tender the scope of work for such investigation is not included. Therefore, it is wrong for AG to assume that there is a panel and one of the panelist service provider could be used. An exceptional case arose for investigating the Municipal Manager and Previous Mayor conduct. The regulation has strict timeframes for such investigations and the regulations have been provided to the AG. It was an exceptional case to have a service provider that has expertise/experience in such investigations. Knysna Municipality considered a service provider that have conducted/done such investigations in order to be within the strict periods envisaged by the regulations. **De Swardt Vogel Myambo Attorneys**, to the knowledge of the Municipality did such investigation in Knysna previously and in Bitou Municipality.

Issue 1. Matter 4

Management disagree in relation to point: RC Orban t/a Rudcor. Attached closure documentation indicate correctly that there were variations orders for this work. Management incorrectly treated variation orders as deviations.

Issue 2

Management disagree in relation to Regulation 13(b) & 43 Provider's tax matters.

Attached is a valid tax clearance certificate of Noble Spectatus Fund that is valid for the period to which the deviations request falls.

Management comment on the root cause identified within the audit finding:

Management disagree

Management comment on the recommendation:

Management disagree on the recommendations

Remedial action:

What actions will be taken: None	By whom: N/A	By when: N/A
If the above findings affects an amount (s) disclosed in the financial statements:	YES	
Please give an indication of whether the correcting journal entry shall be processed:		NO
If yes. please indicate the accounting entry: N/A Correction of the disclosure note on deviations.		
If no. please provide the reason why such a conclusion: N/A		

Auditor's conclusion

Managements responses are noted.

Issue 1 Matter 1,2,3 and 5

Upon further inspection of supporting documentation the finding is resolved. No further reporting is required from management.

Issue 1 Matter 4

Inspected the updated annual financial statements and confirmed that the adjustments were processed. The matter will however remain in the management report as an "other matter" as there is still a control deficiency that needs to be addressed regarding the documentation around deviations.

Issue 2

The auditors inspected the tax clearance certificate subsequently provided and confirmed that the award was made within the validity period of the tax clearance certificate. As such the finding is resolved.

Impairment Allowance – COMAF 12

Audit Finding

The Municipal Finance Management Act no. 56 of 2003 (MFMA), section 122 (1), states that:

“Every municipality and every municipal entity must for each financial year prepare annual financial statements which -

- (a) fairly presents the state of affairs of the municipality or entity, its performance against its budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results, and its financial position as at the end of the financial year.”*

Paragraph 17 of the Standard of Generally Recognised Accounting Practice (GRAP 1) – Presentation of Financial Statements states that:

“Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful presentation of the effect of the transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, revenue and expenses. The application of Standards of GRAP with additional disclosures, when necessary, is presumed to result in financial statements that achieve a fair presentation.”

Issue 1: Accuracy

During the audit of Allowance for Impairment, it was identified that the allowance for impairment for traffic fines was incorrectly calculated due to incorrect inputs being used to determine the average payment ratio for handwritten fines. Details of the finding are as follows:

Allowance for impairment	Amount disclosed per note 6 of the Annual Financial Statements	Auditor's calculation	Difference
Fines	R119 989 907	R119 793 654	R196 253

Consequently, allowance for impairments are overstated and receivables from non-exchange transactions are understated by R196 253

Internal control deficiency

Financial and Performance Management

Prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information

Management did not adequately review the allowance for impairment calculation to ensure that the handwritten fines impairment allowance is accurately calculated per the payment ratio basis.

Recommendation

Management should strengthen its review processes of the financial statements to ensure that the figures reported are accurate.

Management should adjust the Annual Financial Statements to accurately account for the above misstatements reported on.



Management response

Management comment on the audit finding:

We agree with the finding that the allowance for impairment is overstated by R196 253.

The calculation was revisited and it was due to an incorrect input cell used in the Handwritten Fines provision calculation.

Management comment on the root cause identified within the audit finding:

A review process is in place for traffic fines due to the quantitatively material nature thereof. Due to the nature and insignificance of this amount in relation to the total impairment it will be highly unlikely that a review process will identify it. The review process mainly addresses the risk of material error being made in the calculation.

Management comment on the recommendation:

Management take note of the recommendation to strengthen the review process. However, take note that the purpose of the review is to ensure that material errors are not made.

Due to the insignificance of the amount and the nature of the impairment estimation, this will not be corrected in the financial statements.

Remedial action:

What actions will be taken:	By whom:	By when:	
Reconsider controls over the fines process in general to strengthen the recognition process.	Director Community Services		
If the above findings affects an amount (s) disclosed in the financial statements:	YES		
Please give an indication of whether the correcting journal entry shall be processed:		NO	
If yes, please indicate the accounting entry:			
If no, please provide the reason why such a conclusion:			
Due to the insignificance of the amount and the nature of the impairment estimation, this will not be corrected in the financial statements.			

Auditor's conclusion

Managements comments are noted. The finding will however be included in the summary of uncorrected misstatements. The finding will remain in the management report as an "other important matter."

Inventory Disclosure Misstated – COMAF 24

Audit finding

The Municipal Finance Management Act no. 56 of 2003 (MFMA), section 122 (1), states that:

“Every municipality and every municipal entity must for each financial year prepare annual financial statements which –

- (a) fairly presents the state of affairs of the municipality or entity, its performance against its budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results, and its financial position as at the end of the financial year.”*

Paragraph 47 (d) of the Standard of Generally Recognised Accounting Practice (GRAP) 12 states that:

“The financial statements shall disclose the amount of inventories recognized as an expense during the period.”

During the audit of inventory, the following was identified:

The amount of inventory recognized as an expense during the year, disclosed in note 3 of the Notes to the Annual Financial Statements for the year ended 30 June 2019, does not agree to the amount of inventory consumed as per note 38 as well as the Statement of Financial Performance. The difference is highlighted below:

Financial year	Amount as per note 3 (R)	Amount as per note 38 and the Statement of Financial Performance (R)	Difference (R)
2017/2018	13 986 889	49 309 630	- 35 322 741
2018/2019	23 638 655	43 089 810	- 19 451 155

The identified finding is material and has led to the factual understatement of inventories recognised as an expense during the year to the amount of R19 451 155 (2018: R35 322 741).

Internal control deficiency

Financial and performance management

Management did not prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information.

Management did not adequately review the inventory disclosure to ensure that all disclosures are accurate and in terms of GRAP 12.

Recommendation

Management should strengthen its review processes of the financial statements to ensure that the figures reported are in terms of GRAP 12.

Management should investigate the cause of the misstatement and make the appropriate adjustments.

Management response

Management comment on the audit finding:

Management disagrees with the finding

As quoted in the finding, paragraph 47 (d) of the Standard of Generally Recognised Accounting Practice (GRAP) 12 states that:



"The financial statements shall disclose the amount of inventories recognized as an expense during the period."

The amount of R23 638 655 as disclosed per note 3 is all the inventories recognised as inventories in the warehouses that was issued out of the warehouses and expensed during the year. Consequently, the disclosure "Inventories recognised as an expense during the year – warehouse inventory" in note 3 to the financial statements.

Paragraph 46 of GRAP 12 - Inventories state that:

"Some inventories may be allocated to other asset accounts, for example, inventory used as a component of self-constructed property, plant or equipment. Inventories allocated to another asset in this way are recognised as an expense during the useful life of that asset"

At Knysna Municipality this is also the case as certain inventory items were expensed to Capital suspense accounts (Property, plant and Equipment) additions during the year. The total value of these items amounted to R 2 899 140. This is warehouse inventory used for construction of municipal property, plant and equipment.

It is consequently clear from this that the finding is fundamentally incorrect in assuming that the note named "Inventory consumed" is to balance with the disclosure of inventory expensed during the year. This is clearly not the intention of the GRAP nor the disclosure as in the financial statements.

In addition, there are also items purchased directly, like fuel that is recognised as inventories consumed in the financial statements. This is not warehouse inventory items as it is not purchased and kept in stock in the warehouses, except for trivial emergency generator fuel, etc. Consequently, as it is never recognised as inventory it can't be part of the inventory expensed disclosure.

Fuel purchases are allocated to inventory consumed per the nature of the transaction in mSCOA. There is no other place to allocate this expense and fuel is treated like this for all municipalities as inventories consumed due to this.

Materials purchased specifically by the municipality and used in housing projects and community housing disaster assistance are also not warehouse items in inventory as it is directly purchased and used in the housing projects when required. Consequently, it is correctly allocated as materials and supplies under inventory consumed, but is not part of inventories expensed disclosure as in note 3 as it was never part of recognised inventory.

In conclusion, based on the above we disagree as the assumption that the note named "Inventory consumed" is to balance with the disclosure of inventory expensed during the year is incorrect and will result in inaccurate disclosure.

Management comment on the root cause identified within the audit finding:

Management disagrees with the finding.

Management comment on the recommendation:

Management disagrees with the finding.

<u>Remedial action:</u>			
<u>What actions will be taken:</u>	<u>By whom:</u>		<u>By when:</u>
None			
If the above findings affects an amount (s) disclosed in the financial statements:	YES		
Please give an indication of whether the correcting journal entry shall be processed:		NO	
If yes, please indicate the accounting entry:			
N/a			
If no, please provide the reason why such a conclusion:			
N/a			

Auditor's conclusion

Management's response is noted.

The auditors are however in disagreement with management.

As per Paragraph 47 (d) of the Standard of Generally Recognised Accounting Practice (GRAP) 12:

"The financial statements shall disclose the amount of inventories recognised as an expense during the period."

The requirement is that all inventories recognised as an expense during the year should be disclosed. The inventory consumed as presented in the Statement of Financial Performance is the inventory recognised as an expense for the year. This amount correctly excludes the inventory capitalized to other assets as mentioned in managements response. However, this amount also includes other items that management deems to be inventory, but was not included as warehouse inventory. The requirement as per GRAP 12 is that all inventory recognised as an expense be disclosed and not only inventory items that was included as warehouse inventory. Consequently, the inventory consumed as presented in the Statement of Financial Performance should agree to the inventory recognised as an expense disclosure.

Subsequent to the above response, management agreed to adjust the annual financial statements. The auditors inspected the updated annual financial statements and confirmed that the necessary adjustments were made by management. The finding will however remain in the management report as an "other important matter."

Financial Instruments and Statutory Receivables Misstated – COMAF 19

Audit finding

The Municipal Finance Management Act no. 56 of 2003 (MFMA), section 122 (1), states that:

“Every municipality and every municipal entity must for each financial year prepare annual financial statements which –

- (a) fairly presents the state of affairs of the municipality or entity, its performance against its budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results, and its financial position as at the end of the financial year.”*

Paragraph 13 of the Standard of Generally Recognised Accounting Practice (GRAP 104) – Financial Instruments defines a financial instrument as:

“A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or a residual interest of another entity.”

Paragraph 13 of the Standard of Generally Recognised Accounting Practice (GRAP 104) – Financial Instruments also defines a financial asset and a financial liability:

“A financial asset is:

- (a) cash;*
- (b) a residual interest of another entity; or*
- (c) a contractual right to:*
 - (i) receive cash or another financial asset from another entity; or*
 - (ii) exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity.”*

“A financial liability is any liability that is a contractual obligation to:

- (a) deliver cash or another financial asset to another entity; or*
- (b) exchange financial assets or financial liabilities under conditions that are potentially unfavourable to the entity.”*

Paragraph 16 of the Standard of Generally Recognised Accounting Practice (GRAP 104) – Financial Instruments states that:

“In this Standard, ‘contract’ and ‘contractual’ refer to an agreement between two or more parties that has clear economic consequences that the parties have little, if any, discretion to avoid, usually because the agreement is enforceable by law. Contracts, and thus financial instruments, may take a variety of forms and need not be in writing.”

Paragraph 106 of the Standard of Generally Recognised Accounting Practice (GRAP 104) – Financial Instruments states that:

“The carrying amounts of each of the categories of financial instruments, as defined in paragraph 14, shall be disclosed in the notes.”

Paragraph 5 of the Standard of Generally Recognised Accounting Practice (GRAP 108) – Statutory Receivables defines a statutory receivable as:



“Statutory receivables are receivables that:

(a) arise from legislation, supporting regulations, or similar means; and

(b) require settlement by another entity in cash or another financial asset.”

Paragraph 35 of the Standard of Generally Recognised Accounting Practice (GRAP 108) – Statutory Receivables states that:

“The carrying amount of statutory receivables shall be disclosed separately in the notes to the financial statements, clearly distinguishing statutory receivables from receivables which are financial assets and other receivables.”

Issue 1: Financial Instruments (disclosure)

During the audit of the financial instruments as per note 41 of the Notes to the Annual Financial Statements the following was identified:

The unpaid conditional grants and receipts and the unspent conditional grants and receipts was not disclosed as a financial instrument.

For the unpaid conditional grants and receipts, an agreement exists between the municipality and the transferring department that has clear economic consequences, which the transferring department has little discretion to avoid. A contract therefore exists between the municipality and the transferring department. The unpaid conditional grants and receipts is also a right to receive cash. Therefore, the unpaid conditional grants and receipts meets the definition of a financial asset.

The identified finding is a factual misstatement and has led to the understatement of financial assets to the amount of R30 775 924 (2018: R14 981 801).

Similarly, for the unspent conditional grants and receipts, an agreement exists between the municipality and the transferring department that has clear economic consequences, which the municipality has little discretion to avoid. A contract therefore exists between the municipality and the transferring department. The unspent conditional grants and receipts is an obligation to deliver cash or another financial asset to another entity. Therefore, the unspent conditional grants and receipts meets the definition of a financial liability.

The identified finding is a factual misstatement and has led to the understatement of financial liabilities to the amount of R32 585 851 (2018: R10 314 802).

Issue 2: Statutory receivables (disclosure)

During the audit of statutory receivables, we identified that the comparative figure (2017/18) for VAT receivable per note 53 does not agree to the comparative figure (2017/18) for VAT receivable per Note 7 of the annual financial statement. Details below

Detail	Disclosure Note 53	Disclosure Note 7	Difference
2017/18 VAT Receivable	R17 452 161	R27 346 515	R9 894 354

The identified finding is a factual misstatement and has led to the understatement of the comparative figure for statutory receivables to the amount of R9 894 353.

Internal control deficiency

Financial and performance management

Management did not prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information.

Management did not adequately review the financial instruments and statutory receivables disclosure to ensure that all disclosures are accurate.



Management did not disclose financial instruments in terms of GRAP 104.

Recommendation

Management should strengthen its review processes of the financial statements to ensure that the figures reported are accurate and complete.

Management should investigate the cause of the misstatement and make the appropriate adjustments.

Management should put in place additional controls to ensure that figures disclosed are accurate and complete.

Management response

Management comment on the audit finding:

Issue 1:

Management disagrees with the finding as it does not comply with the definition of a financial instrument.

The nature of unspent conditional grants is deferred revenue still to be recognised when the expenditure is incurred. Such assets and liabilities are associated with the future delivery of goods or services. They do not give rise to a contractual obligation to pay cash or another financial asset. These unspent conditional grants will be realised / settled by way of future expenditure as per the grant conditions. The settlement of this line item is consequently not a settlement of cash or another financial instrument. Based on this it is clearly not a financial instrument.

Also refer to GRAP 104 application guidance:

AG2.9 Assets (such as prepaid expenses) for which the future economic benefit is the receipt of goods or services, rather than the right to receive cash or another financial asset, are not financial assets. Similarly, most obligations arising from non-exchange revenue transactions with conditions and warranty obligations are not financial liabilities because the outflow of economic benefits associated with them is the delivery of goods and services rather than a contractual obligation to pay cash or another financial asset.

Issue 2:

Management agrees with the finding. This is due to the restatement on VAT as disclosed in note 45.5. Although the statement of financial position and -performance were correctly updated this incorrectly did not update in this note 53 only. The amount in note 53 is still prior to the restatement as per the previous year signed financial statements. This is a financial statement formula disclosure error where this note only was not updated with the restatement. The figures presented and the presentation and disclosure of the correction of prior year error was however correctly presented and disclosed throughout the financial statements. This note 53 is only additional disclosure that does not result in a misstatement of the financial statements.

Management comment on the root cause identified within the audit finding:

Issue 1:

Management disagrees as the disclosure is in accordance with the definitions of GRAP 104.

Issue 2:			
The financial statements were reviewed on various levels, including the audit committee and internal audit. As stated above this is only disclosure anomaly in this note due to the correction of the prior year error adjustment of VAT. There is no misstatement in the financial statements relating to the correction of error.			
<u>Management comment on the recommendation:</u>			
Management take note of the recommendation.			
<u>Remedial action:</u>			
<u>What actions will be taken:</u>	<u>By whom:</u>	<u>By when:</u>	
Correction of the disclosure of note 53, Statutory receivables.	CFO	15 November 2019	
If the above findings affects an amount (s) disclosed in the financial statements:	YES		
Please give an indication of whether the correcting journal entry shall be processed:		NO	
If yes, please indicate the accounting entry:			
N/a			
If no, please provide the reason why such a conclusion:			
No misstatement in the financial statements and treatment of the correction of prior year error.			

Auditor's conclusion

Issue 1:

Management's response is noted.

Unpaid

Inspected the updated AFS and confirmed that the financial instrument disclosure has been amended for the unpaid conditional grants and receipts. The finding will however remain in the management report as an "other important matter" for the control deficiency identified to be addressed.

Unspent

The auditors are in agreement with management.

As per GRAP 104, paragraph 3 (g): "This Standard does not apply to the following instruments, except where indicated otherwise: Contractual rights and obligations arising from non-exchange revenue transactions to which the Standard of GRAP on Revenue from Non-Exchange Transactions (Taxes and Transfer) (GRAP 23) applies. However, receivables and payables recognised by an entity as a result of contractual non-exchange revenue transactions are subject to the subsequent measurement, derecognition, presentation and disclosure requirements of this Standard."

Therefore, the auditors are in agreement that the unspent conditional grants are not financial instruments. The finding on unspent conditional grants is therefore resolved.

Issue 2:

Management's response is noted.

The auditors inspected the updated AFS and confirmed that the necessary amendments were made. The finding will however remain in the management report as an "other important matter" for the control deficiency identified to be addressed.

Revenue from exchange transactions – Electricity misstated – COMAF 5

Audit finding

The Municipal Finance Management Act no. 56 of 2003 (MFMA), section 122 (1) (a) states that *“Every municipality and every municipal entity must for each financial year prepare annual financial statements which fairly presents the state of affairs of the municipality or entity, its performance against its budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results, and its financial position as at the end of the financial year.”*

Paragraph 17 of the Generally Recognised Accounting Practice 1 (GRAP 1) states that *“Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, revenue and expenses set out in the Framework for the Preparation and Presentation of Financial Statements. The application of Standards of GRAP with additional disclosures when necessary is presumed to result in financial statements that achieve a fair presentation.”*

During the audit of revenue from exchange transactions: Sale of electricity, it was noted that the revenue from the sale of pre-paid electricity as per the Ontech reports, does not agree to the revenue from the sale of pre-paid electricity as per the general ledger.

The difference identified is further detailed below:

Month	Amounts as per the Ontech Reports (R)	Amount as per the General ledger (9/238-45-65):	Difference
July 2018	9 482 410.46		
August 2018	9 931 864.74		
September 2018	9 189 214.61		
October 2018	9 030 730.11		
November 2018	8 891 934.40		
December 2018	9 632 248.48		
January 2019	9 115 093.26		
February 2019	8 053 644.56		
March 2019	8 770 953.11		
April 2019	9 116 163.08		
May 2019	9 548 519.87		
June 2019	10 086 770.49		
Total (Including VAT):	110 849 547.17		
Total (Excluding VAT):	96 390 910.58		
Reversal of revenue due to unused pre-paid electricity as at 30 June 2019:	-3 797 004.55		
Recognition of revenue due to unused pre-paid electricity as at 30 June 2018:	3 158 723.50		
Total after adjustments:	95 752 629.53	90 973 256.96	4 779 372.57

This has led to the understatement of revenue from exchange transactions of R4 779 372.57.

Internal control deficiency

Financial and performance management

Management did not prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information.

Management did not perform a reconciliation between the sale of pre-paid electricity as per the Ontech reports and the general ledger, to ensure that it is accurately reported in the financial statements.

Recommendation

Management should strengthen its review processes of the financial statements to ensure that the figures reported are accurate.

Management should adjust the financial statements in order to reflect the correct figures in the Statement of Financial Performance.

Management should perform an annual reconciliation (in addition to the monthly reconciliation) to reconcile the pre-paid electricity sales as per the Ontech reports, to the revenue recognised in the general ledger and financial statements.

Management response

Management comment on the audit finding:

The difference was investigated and established to be due to following:

At 30 June 2018 revenue amounting to R 2 421 737.90 on the Ontec report was not yet received at year end. The reconciliation was performed and the journal (RV000055) was correctly created to recognise the pre-paid electricity revenue and receivable. Refer to journal RV000055 with the reconciliation attached.

The standard operating procedure is to do and approve the reconciliation, process the journal at year end (RV000055) and then reverse the accrual journal in the following financial year (journal RV000056).

The problem came in with the capturing of the two journals. Journal RV000055 was erroneously not captured onto the system and journal RV000056 were incorrectly captured in the 2018/2019 financial year instead of in the following financial year (July 2019) as intended and indicated on the journal created.

Refer to the journals attached as evidence.

We consequently agree with the finding that electricity revenue and receivables is understated by R 4 843 475.80 (R 2 421 737.90 x 2) as only the next year reversal journal (RV000056) was incorrectly captured in the current financial year.

<u>Management comment on the root cause identified within the audit finding:</u>			
We disagree that reconciliations were not performed. An accurate reconciliation was performed and appropriate journals were created. The root cause was the inaccurate capturing of the journals as explained in the management comment on the finding.			
<u>Management comment on the recommendation:</u>			
We disagree that the review process for the financial statements should be strengthened. Financial statement level review will not pick up on this as it is not material on a financial statement review level. The reconciliation and journal were also accurately performed at year end.			
We agree that the financial statements should be adjusted to record for the income accurately and completely as initially intended with the journal.			
We take note of the recommendation to do an additional annual reconciliation to ensure completeness and accuracy, however the reconciliation was accurate, the root cause was the capturing of the journals, not the performance of the reconciliation and journals.			
<u>Remedial action:</u>			
<u>What actions will be taken:</u>	<u>By whom:</u>	<u>By when:</u>	
The financial statements will be corrected to account for the revenue as intended with the reconciliation and journals created. This is to be done by reversing journal RV000056, capturing journal RV000055 at 30 June 2019 (current financial year) and capturing journal RV000056 at 01 July 2019 (next financial year) as intended.			
If the above findings affects an amount (s) disclosed in the financial statements:	YES		
Please give an indication of whether the correcting journal entry shall be processed:	YES		
If yes, please indicate the accounting entry:			
<u>As at 30 June 2019 (2018/2019 current financial year):</u>			
Dt 29-26-44-6600-25 (Actaris Prepaid Income Owing)	R 2 421 737.90		
Ct 9/238-45-65 (Electricity Sales – Prepayment meters)		R 2 421 737.90	
<u>(Reversal of journal RV000056 captured in incorrect financial period)</u>			
Dt 29-26-44-6600-25 (Actaris Prepaid Income Owing)	R 2 421 737.90		
Ct 9/238-45-65 (Electricity Sales – Prepayment meters)		R 2 421 737.90	
<u>(Capturing of journal RV000055 as intended)</u>			
<u>As at 01 July 2019 (2019/2020 next financial year):</u>			
Dt 9/238-45-65 (Electricity Sales – Prepayment meters)	R 2 421 737.90		
Ct 29-26-44-6600-25 (Actaris Prepaid Income Owing)		R 2 421 737.90	
<u>(Capturing of journal RV000056 as intended in the 2019/2020 financial year)</u>			
If no, please provide the reason why such a conclusion:			

Auditor's conclusion

Management's response is noted. After assessing management's response, we agree with the root cause as stated by management. We also note a difference of R64 103 between management's response and the original finding (R4 843 475.80 - R4 779 372.57). This amount is however trivial and would therefore **not** be taken to overs and unders.

We inspected the updated Annual Financial Statements (AFS) and confirmed that the AFS were updated. This matter will remain in the management report as an "other important matter" as there is an internal control deficiency that must be addressed.

IT Repeat Findings – COMAF 6

1. Weaknesses in the management of user accounts for PROMUN

Audit finding

As previously reported, the following weaknesses were identified in the management of user accounts for PROMUN:

- The system administrators responsible for adding, removing and amending user access had access to transact on the financial application PROMUN.
- The system administrator activities for PROMUN were not reviewed as required by the IT User Access Management Policy.
- User activity logs and user logins were not reviewed on a periodic basis by management to ensure that inappropriate activities on PROMUN are detected. This is required by the IT User Access Management Policy.

Unauthorised activity of system administrators may not be detected in a timely manner which could result in the integrity and availability of data on the system being compromised. Without regular access and logon violation reviews, suspicious user activity or attempts to gain unauthorised access to the system may not be identified in a timely manner, or at all. Inadequate password controls increase the risk of unauthorised users gaining access to the application systems and effecting changes that could compromise the integrity and availability of the data on the system.

Management has indicated that the CFO reviewed and signed off on the Promun Administrator activities and user access reviews were performed however, no evidence for the above has been provided.

Upon further inspections it was identified that reviews were performed for the 2019/20 financial year which is outside the audit period.

Internal control deficiency

The control weaknesses could not be addressed due to limited resources (personnel to perform the control activities) and the inability to achieve the planned implementation of the IT User Access Management Policy.

Recommendation

- Users with system administrator access should have limited access to the front end of the business applications to restrict them from processing transactions. Management should consider centralising the system administrator processes for PROMUN applications in order to be able to isolate responsibility and accountability for activities performed by system administrator accounts.
- The audit trails of system administrator activities (New user creation, password resets and amendment of access) should be reviewed on a periodic basis. The system generated audit trails should be reviewed and matched back to the relevant access requests and approval. The independent person reviewing these audit trails should ideally be the person to whom the system administrator reports. Evidence of this review should be maintained for audit purposes.

- The audit trails of logon and access violations should be monitored on a periodic basis to ensure that inappropriate activities on the municipal applications are detected.

Management response

<u>Management comment on the audit finding:</u>			
Management accepts the finding.			
<u>Management comment on the root cause identified within the audit finding:</u>			
Management accepts the root cause of the finding.			
<u>Management comment on the recommendation:</u>			
Management agrees with the recommendation.			
<u>Remedial action:</u>			
<u>What actions will be taken:</u> Promun to be replaced by a new ERP / financial system to following the completion of the tender process for T50 2018/19 and the implementation of the new system.	<u>By whom:</u> CFO / Snr Manager: ICT	<u>By when:</u> July 2021	
Administration of the ERP / financial system to be an IT department function following the implementation of the new organogram and placement.	Snr Manager: ICT	July 2020	
IT to endeavour to implement the requirements of Council's IT policies	Snr Manager: ICT	July 2020	
If the above findings affects an amount (s) disclosed in the financial statements:		NO	
Please give an indication of whether the correcting journal entry shall be processed:			N/A
If yes, please indicate the accounting entry:			
N/A			
If no, please provide the reason why such a conclusion:			
The finding does not have a direct impact on the accuracy, integrity or completeness of financial information.			

Auditor's Conclusion

Management's comments are noted and will be followed up during the 2019/20 regulatory audit for implementation of audit's recommendations.

2. The Disaster Recovery (DR) site is within 100 meters of Knysna Municipality

Audit finding

As previously reported, the Disaster Recovery (DR) site is located within 100 meters of the Knysna Municipality, which is the main production site where the data centre is located.

Furthermore, the current disaster recovery site does not contain the following physical and environmental controls:

- No record of third-party access for maintenance work was kept and reviewed by the IT Manager.
- The datacentre did not have any smoke sensors, water detectors, temperature and humidity monitoring system, raised flooring and generators.

Having a DR site within such close proximity to the main production site also increases the risk of a single disaster event (e.g. fire) destroying both the DR site and production site, meaning that there could be no failover facility being available to recover IT systems. Poor physical access and environment controls could result in a loss of data as well as possible financial losses through destruction or theft of equipment.

It has however been noted the processes are currently in place to move the DR site to a location further outside of the immediate Municipal offices and is budgeted to begin during the 2019/2020 financial year.

Internal control deficiency:

The DR plan has been approved in May 2019 which resulted in the DR site only being budgeted for in the 2019/2020 financial year.

Recommendation

Management should ensure that the new DR site should be moved as soon as possible.

Management should also include the risks currently experienced in their risk acceptance register until such time that the DR site has been moved.

Management response

<u>Management comment on the audit finding:</u> Management accepts the finding and appreciates the acknowledgement of action already taken to address the finding.		
<u>Management comment on the root cause identified within the audit finding:</u> Management accepts the root cause of the finding but wishes to highlight that management has previously committed to the implementation of the new IT DR site by June 2021.		
<u>Management comment on the recommendation:</u> Management agrees with the recommendation and is in the process of implementing a solution in line with the recommendation.		
<u>Remedial action:</u>		
<u>What actions will be taken:</u> Implement a new IT DR solution	<u>By whom:</u> Snr Manager: ICT	<u>By when:</u> June 2021
If the above findings affects an amount (s) disclosed in the financial statements:		NO

Please give an indication of whether the correcting journal entry shall be processed:			N/A
If yes, please indicate the accounting entry: N/A			
If no, please provide the reason why such a conclusion: The finding does not have a direct impact on the accuracy, integrity or completeness of financial information.			

Auditor's Conclusion

Management's comments are noted and will be followed up during the 2019/20 regulatory audit for implementation of audit's recommendations.

3. Inadequate monitoring of the firewall

Audit finding

As previously reported, the following weaknesses were identified in the monitoring of the firewall:

- The firewall rules configuration was not reviewed every quarter by management to ensure that dormant rules and other vulnerabilities were identified and removed in a timely manner. This is required by Paragraph 13.6 of the IT Security Controls Policy.
- Firewall real-time alerts were not implemented to ensure that invalid or unauthorised attempts to access the network are identified, investigated and resolved on a timely basis. This is required by Paragraph 13.8 of the IT Security Controls Policy.
- The firewall logs were not exported into SYSLOG or SIEM services continuously to allow for analysis of the firewall for malicious activity.

If regular reviews of the firewall rules configuration settings are not performed, management may not be aware of existing firewall vulnerabilities within the rule configurations and underlying operating system of the firewall, which increases the risk of firewall breach attempts being successful.

Invalid or unauthorised attempts to access the network may not be detected, investigated and resolved timeously if firewall real-time alerts are not implemented. This may lead to the integrity of financial information and data being compromised if this control weakness is exploited to carry out malicious activities.

Internal control deficiency:

The firewall is outdated and is a Linux based open source firewall that does not have the features available to allow for real-time alerting and only has limited storage space for the retention of logs. Furthermore, due to the delay in the procurement of the fibre lines this has impacted the replacement of the firewall.

Recommendation

Management should prioritise the procurement of a new firewall to ensure this provision of adequate network security to the municipality. Once the new firewall has been procured the following should be implemented:

- Management should implement a formal process to review the firewall rules configuration on a periodic basis. In addition, management should implement real-time firewall alerts and monitor the network for malicious activities on a continuous basis.
- The firewall should be configured to alert the appropriate IT or security personnel immediately when there are any suspected invalid or unauthorised attempt to access the network, using a pre-determined threshold to flag such instances on the firewall.

Management response

Management comment on the audit finding:

Management did review the firewall ruleset during the period under review but not in line with the frequency as required by Council's policies. The policies have subsequently been reviewed and approved by Council to require less frequent reviews as the frequency was found to be impractical.

Management does not accept that exporting firewall logs into SYSLOG or SIEM services to allow for continuously analysis of the firewall for malicious activity will be an effective control.



<p>Management has ensured that there is limited public facing infrastructure and have closed all unnecessary incoming ports. In addition, outgoing network traffic is routed via proxy servers before the firewall. Therefore, internal machines are not able to connect to external command and control centres. All other traffic would exist on allowed ports and the review of this traffic would unlikely be an effective control.</p> <p>The primary attack vectors that have been identified by management are malicious emails and infected files via user downloads or USB devices. Management has implemented a layered security approach for these attack vectors through the implementation of Mimecast, Windows Defender and USB Disk Security.</p> <p>Management does however accept that implementation of a modern firewall solution would be in the best interest of protecting Council's IT network.</p>			
<p><u>Management comment on the root cause identified within the audit finding:</u> Management accepts the root cause of the finding.</p>			
<p><u>Management comment on the recommendation:</u> Management agrees with the recommendation.</p>			
<p><u>Remedial action:</u></p>			
<p><u>What actions will be taken:</u> Bi-annual review of the firewall ruleset</p>	<p><u>By whom:</u> Snr Manager: ICT</p>	<p><u>By when:</u> June 2020</p>	
<p>Procure firewall and related services subject to budget allocation</p>	<p>Snr Manager: ICT / CFO</p>	<p>June 2021</p>	
<p>If the above findings affects an amount (s) disclosed in the financial statements:</p>		<p>NO</p>	
<p>Please give an indication of whether the correcting journal entry shall be processed:</p>			<p>N/A</p>
<p>If yes, please indicate the accounting entry: N/A</p>			
<p>If no, please provide the reason why such a conclusion: The finding does not have a direct impact on the accuracy, integrity or completeness of financial information.</p>			

Auditor's conclusion

Management's comments are noted and will be followed up during the 2019/20 regulatory audit for implementation of audit's recommendations.

APR not consistent with SDBIP – COMAF 7

Audit Finding

In terms of Section 41 (1) of the Municipal Systems Act no. 32 of 2000 (MSA), the Annual Report must (a) set appropriate key performance indicators as a yardstick for measuring performance, including outcomes and impact, with regard to the municipality's development priorities and objectives set out in its integrated development plan.

During the audit of the 2018/19 Annual Performance Report (APR) we identified that the indicators within Strategic Objective (SO)1 and SO 2 per the approved 2018/19 Service Delivery Budget and Implementation Plan (SDBIP) does not agree to the indicators in SO1 and SO 2 as per the 2018/19 APR.

Please see below for the detail:

Indicators:	Classification as per SDBIP:	Incorrect classification as per APR:
TL 37	SO 6 - To encourage the involvement of communities in the matters of local government, through the promotion of open channels of communication	SO 1 - To improve and maintain current basic service delivery through specific infrastructural development projects
TL 52	SO 4 - To grow the revenue base of the municipality	SO 1 - To improve and maintain current basic service delivery through specific infrastructural development projects
TL 53	SO 4 - To grow the revenue base of the municipality	SO 1 - To improve and maintain current basic service delivery through specific infrastructural development projects
TL 54	SO 4 - To grow the revenue base of the municipality	SO 1 - To improve and maintain current basic service delivery through specific infrastructural development projects
TL 55	SO 3 - To create an enabling environment for social development and economic growth	SO 1 - To improve and maintain current basic service delivery through specific infrastructural development projects
TL 39	SO 6 - To encourage the involvement of communities in the matters of local government, through the promotion of open channels of communication	SO 2 - To promote a safe and healthy environment through the protection of our natural resources
TL 48	SO 6 - To encourage the involvement of communities in the matters of local government, through the promotion of open channels of communication	SO 2 - To promote a safe and healthy environment through the protection of our natural resources
TL 49	SO 6 - To encourage the involvement of communities in the matters of local government, through the promotion of open channels of communication	SO 2 - To promote a safe and healthy environment through the protection of our natural resources
TL 51	SO 4 - To grow the revenue base of the municipality	SO 2 - To promote a safe and healthy environment through the protection of our natural resources
TL 47	SO 6 - To encourage the involvement of communities in the matters of local government, through the promotion of open channels of communication	SO 2 - To promote a safe and healthy environment through the protection of our natural resources

Internal control deficiency

Financial and performance management

Prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information.



Management did not thoroughly review the SDBIP and the APR to ensure that these were consistent and accurately reported on in the 2018/19 financial year.

Recommendation

Management should make sure that adequate reviews are performed between the SDBIP and the APR to ensure that these are consistently and accurately reported on in the 2018/19 financial year.

Management is also requested to adjust the APR to ensure the above mentioned indicators are reported within the Strategic Focus Area and Strategic Objective that is consistent with the SDBIP.

Management is further requested to revisit the APR to identify any further inconsistencies between the APR and SDBIP and adjust accordingly.

Management response

Management comment on the audit finding:

Management agrees in respect to TL37, TL52, TL53, TL54, TL39, TL48, TL49, TL51 and TL47.

Management disagrees partly with the finding relating to TL55 we agree that it is incorrectly allocated. However, it should be SO4 and not SO3 as per the approved amended 2018/2019 SDBIP.

Management has undertaken a full reconciliation as recommended of all priorities allocation in regards to the approved Strategic Objectives and have discovered the following additional inconsistencies between the APR and SDBIP;

Indicators:	Classification as per SDBIP:	Incorrect classification as per APR:
TL31	SO3	SO6
TL35	SO6	SO3
TL44	SO6	SO3

Management comment on the root cause identified within the audit finding:

Management agrees with the root cause identified.

Management comment on the recommendation:

To improve processes and ensure improved outcomes the organogram was reviewed and approved by the Council on October 2018. The amended structure makes provision for the dissolution of the Performance, Internal Audit and Risk Management (PIARM) and the creation of an integrated IDP and institutional performance focusing on the IDP, SDBIP, APR and AR process. In addition, Council is currently in the process of procuring an ERP system. The intention is to strive for maximum integration thereby reducing manual processes such as the manual updating of the SDBIP and APR.

Remedial action:

What actions will be taken:

By whom:

By when:

25 October 2019

TL31, 35, 37, 39, 44, 48, 49, 51, 52, 53, 54, 55 and 57 will be amended to reflect correctly in the APR where after it will resubmitted to the Auditor General as per the audit finding recommendations.	Chief Audit Executive		
If the above findings affects an amount (s) disclosed in the financial statements:	YES	NO X	
Please give an indication of whether the correcting journal entry shall be processed:	YES	NO	N/A X
If yes, please indicate the accounting entry:			
N/A			
If no, please provide the reason why such a conclusion:			
N/A			

Auditor's conclusion

Managements comments are noted. We received the adjusted APR and the amendments were found to have been made correctly. This matter will remain in the management report as an "other important matter" as there is an internal control deficiency that must be addressed.

Performance Agreements signed late – COMAF 8

The Municipal System Act (MSA) 57(2)(a) states that:

“The performance agreement referred to in subsection (1) (b) must—

i) be concluded within 60 days after a person has been appointed as the municipal manager or as a manager directly accountable to the municipal manager, failing which the appointment lapses: Provided that, upon good cause shown by such person to the satisfaction of the municipality, the appointment shall not lapse; and

ii) be concluded annually, thereafter, within one month after the beginning of each financial year of the municipality”

Based on the audit work performed we identified that the performance agreement of the Director of planning and development (Marlene Boyce) was concluded on the 30th of September 2018.

The director of planning and development acted as the municipal manager and therefore was unable to sign off on her own performance agreement.

This resulted in non-compliance with MSA 57(2)(a)(ii) as it was not concluded within one month after the beginning of the 2018/19 financial year.

Internal control deficiency

Financial and Performance Management

Review and monitor compliance with applicable laws and regulations

Management did not ensure the existence of a contingency plan where they needed to comply with section 57(2)(a) of the MSA in the event of the absence of the municipal manager.

Recommendation

It is recommended that management implement controls to adequately track and monitor the signing of performance agreements for managers directly accountable to the municipal manager to ensure that these are signed within one month after the beginning of each financial year.

Furthermore, a contingency plan should also be in place to address what happens in the absence of a party to the agreement

Management response

Management comment on the audit finding:

Management agrees with the finding only as far as it relates to compliance to MSA subsection 57(2)(a)(ii).

Management comment on the root cause identified within the audit finding:

Management submits the following in reply to the AGs finding.

Circumstances resulting in noncompliance to subsection 57(2)(a)(ii) of the MSA.



Until 6 July 2018, a full-time Municipal Manager was in office the incumbent resigned with immediate effect thereby creating a vacancy. Prior to 6 July, there was no requirement for an acting MM and no expectation of noncompliance with MSA subsection 57(2)(a)(ii). As a result of the resignation, there were only two full-time directors the Director Planning and Development and the Chief Finance Officer. Both individuals were encumbered with additional acting responsibilities the Director Planning and Development was appointed as acting MM for the period 7 July 2018 to 6 August 2018 and the CFO was appointed the acting Director Corporate Services.

Legislation

A basic legal principle is that a contract is an agreement between **two or more** parties entered into with the intention of creating a legal obligation. In this instance, the acting MM cannot sign on behalf of the employer (MM) and as an employee (Director Planning and Development). This is supported by the MSA Section 57(2)(c) *“in the case of a manager directly reporting accountable to the municipal manager, be entered into with the municipal manager”* therefore only the MM or acting MM may sign the performance agreement as employer with a director.

The appointment of an acting MM is legislated by section 54A(1) “The municipal council must appoint–“ (b) “an acting municipal manager under circumstances and for a period prescribed.” Managements understanding and interpretation of “an” is singular. The Director Planning and Development was the (acting) MM for the period between the resignation of the previous MM and the appointment of a temporary external MM starting 7 August 2018, covering the compliance period relating to subsection 57(2)(a)(ii) of the MSA. Therefore, we contend that she was de facto the MM with all the responsibilities and accountabilities relating to the position thus superseding her position of Director Planning and development.

Accordingly, during this period, she could only ever have signed the performance agreement as an employer and not as an employee. In other words, was she out of the office for a day that would allow for the signing of the performance agreement by an alternative acting MM she would still have been the MM at the time of the signing of the agreement therefore still the MM (employer) as the alternative acting MM would have been acting on her behalf.

Additional concerns and comments

Management endeavours to address unintended consequences as far as possible as well as attaining intended outcomes. Although compliance to legislation is important to the municipality, consideration always needs to be given to what the impact of blind adherence could result in.

The appointment of MM’s and acting MM’s requiring Council approval it has implications, not only legislative i.e. who was accountable and when but has operational implications as well. Even with the best intentions changes in the MM position leads to instability and delayed processes and should be avoided if at all possible. It causes confusion within the institution as well with the community. There could also be a temptation to backdate documentation to prevent an audit finding/s thereby flaunting sound governance principles.

Management also would like to highlight that by the end of the 2018/2019 financial year seven section 57(2) performance agreements were in place of which only one that of the Director Planning and development was non-compliant to the 30-day requirement of 57(2)(ii). Therefore, only 14% (1 of 7) were non-compliant.

Management is of the opinion that the root cause does not lie with the current controls or lack of a contingency plan and is rather rooted in the convoluted appointment processes for Municipal Managers and Directors and the lack of competent and capacitated individuals.

<u>Management comment on the recommendation:</u>			
There are controls currently in place as approved in Councils Performance Management Framework of 2012. The framework is currently under review as approved in the 2019/2020 SDBIP TL75, "Performance Management Policy Framework", "A complete review will commence in the 2019/2020 financial year throughout 2020/2021." Management will as far as practicable consider and implement the AG's recommendation as part of the review process.			
<u>Remedial action:</u>			
<u>What actions will be taken:</u>	<u>By whom:</u>		<u>By when:</u>
Review of the Performance Management Policy Framework.	Director Corporate Services and Manager IDP & IPM		June 2021
If the above findings affects an amount (s) disclosed in the financial statements:	YES		NO X
Please give an indication of whether the correcting journal entry shall be processed:	YES	NO	N/A X
If yes, please indicate the accounting entry:			
N/A			
If no, please provide the reason why such a conclusion:			
N/A			

Auditor's conclusion

Management's comments are noted, and after taking these into account, we have assessed that this is not material non-compliance. This matter will however remain in the management report as an "other important matter" as there is still an internal control deficiency that must be addressed.

Related Parties Misstated – COMAF 9

Audit Finding

The MFMA section 122 (1) (a) states that *“Every municipality and every municipal entity must for each financial year prepare annual financial statements which fairly presents the state of affairs of the municipality or entity, its performance against its budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results, and its financial position as at the end of the financial year.”*

Paragraph 2 of Generally Recognised Accounting Practice (GRAP) 20 - *Related Party Disclosures* states that *“An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in:*

- a) identifying related party relationships and transactions*
- b) identifying outstanding balances, including commitments, between an entity and its related parties;*
- c) identifying the circumstances in which disclosure of the items in (a) and (b) is required; and*
- d) determining the disclosures to be made about those items.”*

GRAP 20 further states that *“A related party is a person or an entity with the ability to control or jointly control the other party, or exercise significant influence over the other party, or vice versa, or an entity that is subject to common control, or joint control. As a minimum, the following are regarded as related parties of the reporting entity:*

A related party is a person or an entity with the ability to control or jointly control the other party, or exercise significant influence over the other party, or vice versa, or an entity that is subject to common control, or joint control. As a minimum, the following are regarded as related parties of the reporting entity:

- a) A person or a close member of that person’s family is related to the reporting entity if that person:*
 - (i) has control or joint control over the reporting entity;*
 - (ii) has significant influence over the reporting entity; or*
 - (iii) Is a member of the management of the entity or its controlling entity”.*

During the audit of related parties, the following issues were identified:

Issue 1

The below supplier was found to have delivered goods and or services in the 2017/18 financial year but was however accounted for in the 2018/19 financial year.

Staff member	Relationship	Entity
Mr. A Bans (Superintendent–Traffic)	Son	Tolo & Miles

Details of the goods and services found to be rendered in the 2017/18 financial year is listed below.

Invoice No.	Invoice date	Amount
348	2018/06/30	R14 000

Related party transactions were therefore found to be overstated by R14 000 in the 2018/19 financial year and understated in the 2017/18 financial year as a result of the above.



Issue 2

The following supplier was found to have provided a declaration of interest for the 2018/19 financial year but the declaration did not disclose the fact that the supplier's spouse is an employee of Knysna municipality, resulting in a possible incorrect/false declaration being made by the supplier.

Details as follows:

A - Information on person with interest					
Name of person	Position	Name of spouse/partner/associate	Relationship to person in service of the auditee	Supplier name	Total rand-value of award
Eleno Damane	Director	Eric Mfundisi Damane	Spouse (Husband)	E4D Construction PTY LTD	R213 340

Related party transactions were therefore found to be understated by R213 340 in the 2018/19 financial year.

Issue 3

Per inspection of the CIPC records of "It's about time investment", Mr MJ Kalani and Perino Pama (Director in company, Mosdell Pama & Cox) were business partners for the period 2003 to 2012.

The company was however deregistered on the 24th May 2012. Furthermore, per inspection of the CSD reports we identified that the following municipal official was found to no longer have a business interest with the below supplier who received awards from the municipality.

Details as per AFS Note 44:

Name of person	Position	Relationship to person in service of the auditee	Supplier name	Amount
Mr MJ Kalani	Not detailed	Business partner	Mosdell Pama & Cox	R1 093 734

Related party transactions were therefore found to be overstated by R1 093 734 in the 2018/19 financial year. The prior year comparatives were also overstated by R272 312 as a consequence of this finding.

Internal control deficiency

Financial and Performance Management

Prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information

Management did not adequately review the related party disclosure note against CSD reports to ensure that the transactions are accounted for in the correct financial period to which it relates.

Recommendation

Management should assess the related party disclosures and transactions and ensure that they are accounted for in terms of GRAP requirements.



Management should validate all related party disclosures made against the relevant supplier / employee declarations made and against the CSD report to confirm the accuracy thereof prior to the AFS reporting thereof.

Management should further adjust the Annual Financial Statements to accurately account for the above misstatements reported on.

Management response

Management comment on the audit finding:

Issue 1 –

Management agrees with this finding.

To be amended.

Issue 2 –

Management partially agree with the finding.

It must please be noted that the supplier did declare the related party, see attached declaration, but the employee did not declare the relationship. Therefor there is no false declaration by the supplier as this can be seen from the declaration form. The employee has no interest in the company as can be seen from the Windeed information. The employee has however submitted a declaration form. Management therefor disagree with the finding as it relate to false declaration but agrees with the finding as it relate to related parties disclosure to be understated.

To be amended.

Issue 3 –

Management agree with the finding; however, management is of the view that the disclosure was accurate and correct at the time of finalization of the AFS. The confirmation by the legal firm was only received after the fact . Management got to knows of this fact after Conclusion of the AFS. Agreed, this matter will be corrected in the financial statements.

To be amended.

Management comment on the root cause identified within the audit finding:

Employees may not understand the declaration forms or what they are declaring and an awareness campaign to be held with them, especially with general labour staff.

Management comment on the recommendation:

Management agree with the recommendation.

Remedial action:

What actions will be taken:	By whom:	By when:
AFS to be adjusted as per comments of management above	CFO	31 October 2019
If the above findings affects an amount (s) disclosed in the financial statements:	YES	
Please give an indication of whether the correcting journal entry shall be processed:		N/A
If yes, please indicate the accounting entry:		
If no, please provide the reason why such a conclusion:		

Auditor's conclusion

Issue 1

Management's response is noted.

The auditors inspected the adjusted annual financial statements (AFS) and confirmed that the necessary adjustments were made. The matter will however remain in the management report as an "other important matter" as there is an internal control deficiency that must be addressed.

Issue 2

Management's response is noted.

The auditors inspected the adjusted AFS and confirmed that the necessary adjustments were made. The matter will however remain in the management report as an "other important matter" as there is an internal control deficiency that must be addressed.

Issue 3

Management's response is noted.

The auditors inspected the adjusted AFS and confirmed that the necessary adjustments were made. The matter will however remain in the management report as an "other important matter" as there is an internal control deficiency that must be addressed.

Sale of Electricity and non-compliance – COMAF 10

Audit finding

The Municipal Finance Management Act no. 56 of 2003 (MFMA), section 122 (1), states that:

“Every municipality and every municipal entity must for each financial year prepare annual financial statements which -

- (b) fairly presents the state of affairs of the municipality or entity, its performance against its budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results, and its financial position as at the end of the financial year.”*

Paragraph 17 of the Standard of Generally Recognised Accounting Practice (GRAP 1) – Presentation of Financial Statements states that:

“Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful presentation of the effect of the transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, revenue and expenses. The application of Standards of GRAP with additional disclosures, when necessary, is presumed to result in financial statements that achieve a fair presentation.”

Section 74(1) of the Municipal Systems Act no. 32 of 2000 (MSA) states that:

“A municipal council must adopt and implement a tariff policy on the levying of fees for municipal services provided by the municipality itself or by way of service delivery agreements, and which complies with the provisions of this Act, the Municipal Finance Management Act and any other applicable legislation.”

Section 15 (2) of the Electricity Regulations Act no. 4 of 2006 states that:

“A licensee may not charge a customer any other tariff and make use of provisions in agreements other than that determined or approved by the Regulator as part of its licensing conditions.”

Paragraph 15 of the Standard of Generally Recognised Accounting Practice – Revenue from exchange transactions (GRAP 9) states that:

“Revenue shall be measured at the fair value of the consideration received or receivable.”

Paragraph 12 of the Standard of Generally Recognised Accounting Practice – Revenue from exchange transactions (GRAP 9) states that:

“Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction.”

Paragraph 8B of the Interpretation of the Standards of Generally Recognised Accounting Practice – Applying the Probability Test on Initial Recognition of Revenue (IGRAP 1) states that:

“On initial recognition of revenue, an entity should consider the revenue it is entitled to, following its obligation to collect all revenue due to it in terms of legislation or similar means.”

Therefore, based on the afore-mentioned paragraphs, customers should be levied tariffs that are approved by the regulator, the National Energy Regulator of South Africa (NERSA). The initial amount of revenue recognized from the sale of electricity should therefore be determined in accordance with the tariffs approved by NERSA, as this is the fair value of the transaction and the amount that the municipality is legally entitled to.

Issue 1: Accuracy and Non-Compliance

During the audit of revenue from exchange transactions: Sale of electricity, we identified that the municipality charged tariffs which were lower than the NERSA approved tariffs.

Furthermore, we also identified that the municipality charged tariffs which were higher than NERSA approved tariffs which therefore has led to non-compliance of Section 15 (2) of the Electricity Regulations Act no. 4 of 2006 and consequently non-compliance of Section 74(1) of the Municipal Systems Act no. 32 of 2000.

The following differences arose from the recalculation:

Information as per the general ledger				Auditor's Recalculation				
No.	Date	Description	Amount	Tariff category per NERSA approved tariffs	Auditor's recalculated amount (Excludes basic charge)	Basic charge	Total	Difference
1	24/06/2019	01312520933	434.79	Domestic Prepaid 60A	301.24	121.52	422.76	12.03
2	03/06/2019	84625402379	1652.3	Domestic Prepaid 60A	1560.25	125.44	1685.69	-33.39
3	03/06/2019	84625145507	465.69	Domestic Prepaid 60A	328.23	125.44	453.67	12.02
4	17/05/2019	RANGS D M P O BOX 3065 KNYSNA	2608.70	Domestic Prepaid 60A	2614.22	90.16	2704.38	-95.68
			869.57	Domestic Prepaid 60A	524.40	333.20	857.60	11.97
5	02/05/2019	04149064315	1739.14	Domestic Three Phase 60A Prepaid	1569.85	203.40	1773.25	-34.11
6	18/04/2019	KHAYALETHU - A.PRINGLE 298	234.79	Domestic Prepaid Meters Electrification Scheme	43.55	0	43.55	191.24
7	10/04/2019	banking shift 270 mbaadjies	521.74	Domestic Prepaid 60A	368.61	141.12	509.73	12.01
8	06/03/2019	O'DEA OI PO BOX 3724 KNYSNA	434.79	Domestic Prepaid Meter One Phase 30A	348.31	74.52	422.83	11.96
9	25/02/2019	04168684993	1115.48	Domestic Three Phase 60A Prepaid	629.04	474.60	1103.64	11.84
10	22/02/2019	84625607886	227.10	Domestic Prepaid 60A	101.39	113.68	215.07	12.03
11	31/01/2019	SLABBERT EMA POSBUS 295 KNYSNA	260.87	Domestic Prepaid Meter One Phase 30A	184.75	64.17	248.92	11.95
12	22/01/2019	01620547644	510.87	Domestic All-inclusive Energy Charge 60A Prepaid	496.86	0	496.86	14.01
13	21/11/2018	01311361990	1577.59	Domestic Prepaid 60A	1464.19	141.12	1605.31	-27.72



Information as per the general ledger				Auditor's Recalculation				
No.	Date	Description	Amount	Tariff category per NERSA approved tariffs	Auditor's recalculated amount (Excludes basic charge)	Basic charge	Total	Difference
14	24/10/2018	GOOSEN AM PO BOX 2244 KNYRNA	521.74	Domestic Prepaid 60A	396.17	113.68	509.85	11.89
15	10/10/2018	84625605104	86.96	Domestic Prepaid Meter One Phase 30A	68.39	18.63	87.02	-0.06
16	01/10/2018	01313627406	391.21	Domestic Prepaid 60A	328.23	50.96	379.19	12.02
17	11/09/2018	01312679630	695.66	Domestic Prepaid 60A	574.03	109.76	683.79	11.87
18	03/09/2018	01314491299	1304.35	Domestic Prepaid 60A	1307.22	15.68	1322.90	-18.55
19	31/08/2018	01314741545	383.37	Domestic Prepaid 60A	328.23	43.12	371.35	12.02
20	20/08/2018	01312520719 X2 BLACK BAGS	1565.22	Domestic Prepaid 60A	1463.61	129.36	1592.97	-27.75
21	03/07/2018	01026044923	718.87	Domestic Prepaid 60A	629.04	82.32	711.36	7.51
22	MUN050.P	30/06/2019	1814.09	Domestic Phase Credit Meters 60A	1306.65	206.67	1513.32	300.77
23	852259	31/07/2018	1867.03	Commercial One Phase Credit Meter 30A	1714.02	233.59	1947.61	-80.58
24	671364	31/07/2018	782.03	Commercial One Phase Credit Meter 30A	585.03	233.59	818.62	-36.59
25	138337	31/07/2018	693.18	Commercial One Phase Credit Meter 30A	484.10	233.59	717.69	-24.51
26	RC133857,	25/02/2019	1115.48	Domestic Three Phase 60A Prepaid	629.04	474.60	1103.64	11.84
							TOTAL:	290.04

This identified finding has led to a factual misstatement of R290.04, which is projected to a misstatement of R575 949.08.

The misstatement identified has resulted in the overstatement of revenue from exchange transactions for the 2018/19 financial year and Non-Compliance to the Electricity Regulations Act no. 4 of 2006 and the Municipal Systems Act no. 32 of 2000.



Issue 2: Cut-off

During the audit of revenue from exchange transactions: Sale of electricity, it was identified that the following transaction related to the 2017/2018 financial year, but was erroneously recorded in the 2018/2019 financial year:

Information as per the general ledger				
Number	Reference	Date	Description	Amount
1	2515	31/08/2018	STALE CHE 2515 MOSALA NP	275.00

This identified finding has led to a factual misstatement of R275.00, which is projected to a misstatement of R546 015.60.

The misstatement identified has resulted in the overstatement of revenue from exchange transactions: Sale of electricity for the 2018/19 financial year.

The combined effect of issue 1 and 2 is a factual misstatement of R565.04, which is projected to a combined misstatement of R1 121 964.68.

Issue 3: Classification

During the audit of revenue from exchange transactions: Sale of electricity, it was identified that the following transactions relating to the purchase of electricity was erroneously recorded as revenue and included in revenue from exchange transactions: Sale of electricity:

Information as per the general ledger					
No.	Reference	Date	Description	Amount (R)	Misstatement (R)
1	660973220483	18/06/2019	ACC#3833 ESKOM JUNE 2019	-12 793.16	-12 793.16
2	660973220483	18/06/2019	ACC#3833 Eskom- 2018-2019	-13 876.10	-13 876.10
3	660027053992	14/05/2019	ACC#3833 Eskom- 2018-2019	-26 565.69	-26 565.69
4	660519983677	12/04/2019	ACC#3833 Eskom- 2018-2019	-26 565.69	-26 565.69
5	660998014227	13/03/2019	ACC#3833 Eskom- 2018-2019	-27 083.38	-27 083.38
6	660518518293	16/02/2019	ACC#3833 Eskom- 2018-2019	-27 134.91	-27 134.91
7	660963459502	17/01/2019	ACC#3833 Eskom- 2018-2019	-26 462.11	-26 462.11
8	660498158828	11/12/2018	ACC#3833 Eskom- 2018-2019	-53 234.94	-53 234.94
9	660745179801	15/10/2018	ACC#3833 Eskom- 2018-2019	-26 565.69	-26 565.69
10	660773184013	13/09/2018	ACC#3833 Eskom- 2018-2019	-26 669.26	-26 669.26
11	660779362875	16/08/2018	ACC#3833 Eskom- 2018-2019	-26 824.61	-26 824.61
12	660776598447	13/07/2018	ACC#3833 Eskom- 2018-2019	-25 543.85	-25 543.85
TOTAL:					-319 319.39

This identified finding has led to a factual misstatement of R319 319.39. The misstatement identified has resulted in the understatement of revenue from exchange transactions: Sale of electricity for the 2019 financial year.

Internal control deficiency**Financial and performance management**

Management did not prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information.

Management did not adequately review the detailed accounts for revenue from the sale of electricity to ensure that it is in terms of GRAP 9 and IGRAP 1.

Further management did not ensure that the tariffs as on the system are per the NERSA approved tariffs.

Recommendation

Management should strengthen its review processes of the financial statements to ensure that the figures reported are accurate and complete.

Management should examine the population to which the misstatement relates to understand the cause of the misstatement and to make the appropriate adjustments.

Management should put in place controls to ensure the accuracy of revenue from the sale of electricity.

Management should account for revenue from the sale of electricity in terms of GRAP 9 and IGRAP 1.

Management should ensure compliance with all applicable legislation.

Management response**Management comment on the audit finding:****Issue 1: Accuracy and Non-Compliance****Management response**

Management agree in so far as to non-compliance with section 15(2) of Electricity Regulations Act no 4 of 2006 and section 74(1) of the MSA no 32 of 2000.

However management want to state the following regarding this non-compliance that Knysna Municipality could not have avoided. Council in terms of MFMA approved its draft budget and tariffs, which included electricity tariffs in March 2017. The electricity tariffs were in terms of the budget circular issued by NT. This circular provided a guide in terms of electricity tariffs, which Municipality must use while awaiting NERSA approval. Public participation was done in terms of the MSA no 32 of 2000.

After public consultation, Council approved the budget and tariffs. NERSA approval letter was only received after the budget was approved (see NERSA letter date 29-06-2019). On August 15, 2018, Knysna Municipality wrote to NERSA advising them of the above in terms of legislation (see-attached letter). NERSA responded with the attached letter dated 13-09-2018. Clearly, from the correspondence NERSA did not come back rejecting the Council approved tariffs and equally did not adjust their approval letter. NERSA proposed a reduction in the number of tariffs that KM had for its different customers and we appointed a consultant to assist us in developing the cost of supply study for the municipality and the following process of which affects the 1st block of the Domestic Prepaid Tariffs was followed:

Eliminating Block 1 (0-50 kWh) and combine block 1 and 2 to be one tier as 0-350kWh as 1st block:

Previously KM was selling Block 1 below our cost from Eskom, so this has been increased to the same cost as Block 2 in order to ensure cost reflective tariffs and the maximum impact per customer is R14 per month. This also follows a consultation with NERSA that KM had a number of tariffs of which we needed to reduce.

Knysna Municipality did everything to comply with all applicable legislation but could not comply with section 15(2) of Electricity Regulations Act no 4 of 2006 and section 74(1) of the MSA no 32 of 2000 because of the reasons stated above.

Tariff category per NERSA approved tariffs	Council Approved Tariffs				NERSA approved Tariffs			
	Block 1 : 1 - 50kWh	Block 2 : 51 - 350kWh	Block 3 : 351 - 600kWh	Block 4 : > 600kWh	Block 1 : 1 - 50kWh	Block 2 : 51 - 350kWh	Block 3 : 351 - 600kWh	Block 4 : > 600kWh
Domestic Prepaid 60A	1,1342	1,1342	1,6273	1,8077	0,8936	1,1342	1,6273	1,9212
Domestic Prepaid Meters Electrification Scheme	1,1342	1,1342	1,6273	1,8077	0,8936	1,1342	1,6273	1,9212
Domestic All-inclusive Energy Charge 60A Prepaid	1,4597	1,4597	1,6599	1,8439	1,11789	1,4597	1,6599	1,9485
Domestic Prepaid Meter One Phase 30A	1,1342	1,1342	1,6273	1,8077	0,8936	1,1342	1,6273	1,9212
Domestic Three Phase 60A Prepaid	1,1342	1,1342	1,6273	1,8077	0,8936	1,1342	1,6273	1,9212

Knysna Municipality disagree as far as the factual misstatement and overstatement of revenue from exchange transactions. Management took the three Commercial 30 amp credit meter.

All three customer's sample the consumption falls within two financial years as depicted on table below and AG incorrectly used 2018-19 flat rate to calculate the total consumption. AG should have subtracted the 2017-18 consumption from the 2018-19 and apply separate consumption rate applicable to the two financial years.

No.	Date	Description	Amount	Tariff category per NERSA approved tariffs	Auditor's recalculated amount (Excludes basic charge)	Basic charge	Total	Difference	Total consumption	18-19 flat consumption rate	17-18 flat consumption rate	
23	852259	31/07/2018	1 867,03	Commercial One Phase Credit Meter 30A	1714,02	233,59	1947,6	- 80,58	1002	1,6827	1,601	Rate in a rand approved by Council
									1002	357,86	644,14	Units
										602,17	1 031,27	
											1 633,44	
										1,7106	1,601	Rate in a rand approved by NERSA
									1002	1002		Units
										1 714,02		
										80,58		
24	671364	31/07/2018	782,03	Commercial One Phase	585,03	233,59	818,62	-36,59				
25	138337	31/07/2018	693,18	Commercial One Phase	484,1	233,59	717,69	-24,51				

The rate in a rand tariff is below than the NERSA approved and is as well within NERSA benchmark for this category. (1, 7106 vs 1, 6827).

Issue 2: Cut-off**Management response**

The cheque was paid to the debtor on 23/02/2018 but the cheque however did not get banked by the debtor within six months. There were no contact details of the debtor except for the postal address. A cheque older than 6 months becomes stale which, means that the cheque can no longer be banked (not valid) and such a cheque should be reversed.

On issue and posting of the cheque to the debtor the payment is correctly recognised in the general ledger by crediting bank with the payment. This will then be a reconciling item on the bank reconciliation until the cheque is banked by the debtor. This is normal bank reconciliation accounting procedure. At 30 June 2018 this cheque was not yet banked but the payment was made and still correctly recorded in the general ledger as the cheque was still valid (only 4 months had passed from issue/payment date).

However, in August 2018 the cheque became stale as the cheque was not banked within the required 6 months. Only on 23/08/2018 the event took place where the cheque became stale and the payment was no longer valid. Consequently, only at this date (during 2018/2019 year) can this payment be reversed in the GL as this is the date the cheque and payment is no longer valid.

23 August 2018 is the earliest date at which the payment can be reversed and the bank general ledger can be debited.

Management thus disagrees with the cut-off issue.

Management also disagrees with the projected amount as the total amount of stale cheques recognised in this vote amounts to R 3 379 for the year. Please refer to the population attached.

Issue 3: Classification**Management response**

Management agrees with the finding. After investigation it was discovered that an incorrect MSCOA code was linked on the accounting system for these electricity purchases. This resulted in erroneously being recorded as revenue instead of expenditure. The total transactions for the year amounts R 319 319.39 as stated in the finding. This does not have an effect on the surplus for the year and is regarded as immaterial.

Management comment on the root cause identified within the audit finding:**Issue 1:**

As stated, the root cause is due to approval by NERSA, which always fall outside of MFMA legislative processes. Our letter to NERSA clearly indicate why we cannot not change approved tariffs and or implement NERSA tariffs.

Issue 2: Cut-off

Management disagrees with the finding as the accounting treatment in the previous and current years is correct as explained in the response above.

Issue 3: Classification

There is a thorough financial statement review process in place which includes the audit committee, internal audit and provincial treasury review in addition to compilation controls. This classification misstatement is immaterial and will not be identified on a financial statement review level.

The incorrect MSCOA code for sale of electricity was used for the purchase of these specific electricity transactions. This resulted in the classification misstatement.

Management comment on the recommendation:**Issue 1:**

Management disagree with the recommendation as stated above.

Issue 2: Cut-off

Management disagrees with the recommendation of the finding as this was correctly accounted for.

Issue 3: Classification

We take note of the recommendations and will evaluate the current controls in place for improvement.

The population was revisited as recommended and responded on above.

Remedial action:**What actions will be taken:****By whom:****By when:**

Issue 2: No actions will be taken

Issue 3: Correction will be made.

CFO

30 November
2019

If the above findings affect an amount (s) disclosed in the financial statements:

YES

Please give an indication of whether the correcting journal entry shall be processed:

YES

If yes, please indicate the accounting entry:

If no, please provide the reason why such a conclusion:

Issue 3:

Dt 9/238-1-1 Bulk Purchases – Electricity R 319 319.39

Ct 9/238-57-77 Electricity rebate (revenue vote) R 319 319.39

Auditor's conclusion**Issue 1****Compliance:**

Management's response is noted. Audit takes cognisance of the reasons for the non-compliance, however, the finding will remain in the management report as an "other important matter".

Accuracy:

Management's response is noted.

26 sample items were misstated. Management's response only provides reasons for three of the misstated sample items. Management therefore failed to provide audit with evidence that the population was investigated and corrected.

Furthermore, the sample items for which management provided reasons is still misstated, because as per management's explanation, a portion of the consumption relates to the 2017/2018 financial year. That portion of the transaction is therefore recorded in the incorrect accounting period.

The projected misstatement of R575 949.08 therefore remains. The misstatement identified will be included in the summary of uncorrected misstatements and assessed in aggregate with other uncorrected misstatements. The finding will therefore remain in the management report as an "other important matter".

Issue 2

Management's response is noted. The auditors inspected the additional supporting documentation provided by management and confirmed that a cheque was paid to a debtor in February 2018 to refund the debtor for an erroneous electricity connection fee charged. As per management's response, the cheque became stale in August 2018. Management correctly recorded the stale cheque as an increase in bank (debit), however, the stale cheque was erroneously recorded as an increase in revenue (credit). The cheque becoming stale does not affect revenue. The municipality does however still have the obligation to repay the debtor for the erroneous charge. The correct contra account would therefore have been a liability and not revenue.

The transaction was therefore classified incorrectly and the misstatement therefore remains. The misstatement identified will be included in the summary of uncorrected misstatements and assessed in aggregate with other uncorrected misstatements. The finding will therefore remain in the management report as an "other important matter".

Issue 3

Management's response is noted. Audit inspected the updated AFS and confirmed the adjustment as per management's response was not made. The finding will therefore remain in the management report as an "other important matter."

Parking fines – Completeness – COMAF 11

Audit finding

The Municipal Finance Management Act no. 56 of 2003 (MFMA), section 122 (1), states that:

“Every municipality and every municipal entity must for each financial year prepare annual financial statements which -

- (c) fairly presents the state of affairs of the municipality or entity, its performance against its budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results, and its financial position as at the end of the financial year.”*

Paragraph 90 of the Standard of Generally Recognised Accounting Practice: Revenue from Non-Exchange Transactions (Taxes and Transfers) (GRAP 23) states that:

“Fines normally require an entity to transfer a fixed amount of cash to government and do not impose on the government any obligation that may be recognized as a liability. As such, fines are recognized as revenue when the receivable meets the definition of an asset and satisfies the criteria for recognition as an asset set out in paragraph 30. As noted in paragraph 11, where an entity collects fines in the capacity of an agent, the fine will not be revenue of the collecting entity. Assets arising from fines are measured at the best estimate of the inflow of resources to the entity.”

Paragraph 30 of GRAP 23 states that:

“Other than services in-kind not recognized in terms of paragraph 99, an inflow of resources from a non-exchange transaction that meets the definition of an asset shall be recognized as an asset when, and only when:

- a) it is probable that the future economic benefits or service potential associated with the asset will flow to the entity; and*
- b) the fair value of the asset can be measured reliably.”*

Paragraph 7 of iGRAP 1 states that:

“In the public sector, entities are required to provide goods or services and to levy taxes, fines, license fees and other types of non-exchange revenue in accordance with their legislative mandate. At the time of invoicing, there may be uncertainty as to whether the revenue will ultimately be collected based on the entity’s exposure to credit risk. Nevertheless, entities often continue to provide goods or services and levy taxes, fines, license fees or other types of non-exchange revenue, despite non-payment as they are required in terms of their legislative mandate to undertake these functions and collect the revenue due to them.”

Paragraph 9 of iGRAP 1 states that:

“At the time of initial recognition of exchange and non-exchange revenue it is not appropriate to assume that revenue will not be collected as the entity has an obligation to collect all revenue and this would be contrary to normal business principles. Accordingly, the Board concluded that the full amount of exchange and non-exchange revenue should be recognised at the initial transaction date.”

The Accounting Policy, Paragraph 1.24 Revenue from non-exchange transactions: Fines states that:

“Fine Revenue constitutes both spot fines and summonses. Fine revenue is recognised when the offence occurs to the extent that the municipality expects legal entitlement.”

Therefore, based on the application of the afore-mentioned paragraphs, traffic fines should be recognised in the accounting period that the offence occurs, as it is probable that future economic benefits will flow to the entity and the fair value of the asset can be measured reliably at the date of the offence.

During the testing of traffic fines, it was identified that the following parking fines were not recorded in the 2019 financial year:

Notice number	Date of offence	Amount (R)
11/0001501/657/0003470	06-11-2018	500.00
11/0001751/657/0003720	20-12-2018	500.00
11/0001801/657/0003770	24-01-2019	500.00
11/0002052/657/0004021	16-06-2019	800.00
11/0002005/657/0003974	09-04-2019	500.00
11/0002401/657/0004370	12-06-2019	300.00
11/0002403/657/0004372	14-06-2019	1 000.00
11/0001401/657/0003370	23-07-2018	500.00
11/0001403/657/0003372	23-07-2018	500.00
11/0001301/657/0003270	30-07-2018	500.00
		5 600.00

This identified finding has led to a factual misstatement of R5 600.00, which is projected to a misstatement of R420 700.

The misstatement identified has resulted in the understatement of revenue from non-exchange transactions: Fines, penalties and forfeits for the 2019 financial year.

Internal control deficiency

Financial and performance management

Management did not prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information.

Management did not account for traffic fines issued in terms of GRAP 23 and iGRAP 1.

Furthermore, management did not ensure that a reconciliation between the fines register and the annual financial statement is performed in order to ensure that all fines are accounted for in the annual financial statements.

Recommendation

Management should strengthen its review processes of the financial statements to ensure that the figures reported are accurate and complete.

Management should examine the population to which the misstatement relates to understand the cause of the misstatement and to make the appropriate adjustments.

Management should do appropriate reconciliations between the fines register and annual financial statements.

Management responseManagement comment on the audit finding:

Management notes and agrees with the finding.

The total revenue understatement of R 420 700 is immaterial. These fines will also have to be evaluated for recoverability and a consequent debt impairment in the income statement to accurately account for these fines in the financial statements as a whole. The average recoverability of handwritten fines in general was calculated as 26.5%. Consequently, only R 111 486 (R 420 700 x 26.5%) is recoverable.

The net effect of the misstatement on the surplus for the year after the debt impairment only amounts to R 111 486.

Management comment on the root cause identified within the audit finding:

Controls and review processes are implemented and in place to ensure the completeness and accuracy of the fines recognised. Greater care will however be implemented regarding the accuracy of the report received and used in the future.

Management comment on the recommendation:

As communicated with the service provider, reports will include these parking fines from the next financial year.

The fines reports are evaluated and reconciled in order to ensure accurate and complete recognition of fines.

Greater care will however be implemented regarding the accuracy of the report received and used in the future.

Remedial action:What actions will be taken:

Service provider to include these fines in the reports for the next financial year to ensure that these revenue are recognised in the financial statements.

By whom:By when:

If the above findings affects an amount (s) disclosed in the financial statements:

YES

Please give an indication of whether the correcting journal entry shall be processed:

NO

If yes, please indicate the accounting entry:

N/a

If no, please provide the reason why such a conclusion:

The effect on surplus for the year is immaterial and insignificant.

Auditor's conclusion

Management's comments are noted. As management did not provide us with an updated listing and did not amend the annual financial statements, the amount of R420 700 will be included in the summary of uncorrected misstatements. This matter will remain in the management report as an "other important matter".

Finance Costs Misstated – COMAF 13

Audit Finding

The Municipal Finance Management Act no. 56 of 2003 (MFMA), section 122 (1) (a) states that:

“Every municipality and every municipal entity must for each financial year prepare annual financial statements which fairly presents the state of affairs of the municipality or entity, its performance against its budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results, and its financial position as at the end of the financial year.”

Paragraph 17 of the Generally Recognised Accounting Practice - Presentation of Financial Statements (GRAP 1) states that:

“Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, revenue and expenses set out in the Framework for the Preparation and Presentation of Financial Statements. The application of Standards of GRAP, with additional disclosures when necessary, is presumed to result in financial statements that achieve a fair presentation.”

Paragraph 31 of the Generally Recognised Accounting Practice - Presentation of Financial Statements (GRAP 1) states that:

“An entity shall prepare its financial statements, except for cash flow information, using the accrual basis of accounting”

Paragraph 32 of the Generally Recognised Accounting Practice - Presentation of Financial Statements (GRAP 1) states that:

“When the accrual basis of accounting is used, items are recognised as assets, liabilities, net assets, revenue and expenses (the elements of financial statements) when they satisfy the definitions and recognition criteria for those elements in the Framework for the Preparation and Presentation of Financial Statements.”

Therefore, based on the afore-mentioned, entities must account for transactions on the accrual basis of accounting and not only when payments are made or received.

During the audit of finance costs, it was identified that the interest as reflected in the annual financial statements and the loan register did not agree to the interest as per the third party confirmations. Interest was accounted for on actual interest payments made to third parties and not on the accrual basis of accounting.

Details of the issue is highlighted below:

Loan Facilities	Interest per third party confirmations:	Interest per note 33 of the Annual Financial Statements: Annuity loans	Difference
City of Tswane - Knysna Municipality	R58 440		
DBSA	R2 167 587		

ABSA	R5 019 083		
Standard bank - INCA	R1 104 221		
Nedbank	R3 902 366		
Standard bank	R2 893 091		
TOTAL:	R15 144 788	R14 088 782	R1 056 006

The identified finding has led to a factual misstatement of R1 056 006, which has resulted in the understatement of finance cost for annuity loans as per note 33 of the annual financial statements.

Internal control deficiency

Financial and Performance Management

Management did not prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information.

Management did not perform regular reconciliations during the year of the schedules obtained from the various third party loan facilities to the loan register.

Furthermore, management did not perform adequate reviews to ensure that finance costs are correctly accounted for as per GRAP 1.

Recommendation

Management should strengthen its review processes of the financial statements to ensure that the figures reported are accurate.

Management should adjust the financial statements in order to reflect the correct figures in the Statement of Financial Performance.

Management should obtain, on a quarterly basis, the third party schedules from the various loan facilities and perform reconciliations of the interest schedules obtained to the loan register. This will enable management to identify discrepancies timeously and provide sufficient time to investigate differences and maintain accurate record of information.

Management response

Management comment on the audit finding:

Management agree with the finding.

The loans are due for payment 30 June, however 30 June 2019 was on a Sunday, hence payment was only processed by the bank on 01 July 2019.

This was identified and due to this anomaly this year the shortfall in the short portion was subsequently corrected, but it was erroneously neglected to adjust for the accrued interest portion as well.

Management comment on the root cause identified within the audit finding:

Loan reconciliations and registers are prepared. Due to the payment being due on 30 June 2019 but only being processed by the bank on 1 July 2019, as explained above, the accrued interest

was incorrectly not recognised. If the payment went through on 30 June 2019 as intended the interest portion would have been recognised accurately in the current financial year.

Management comment on the recommendation:

It is agreed that the financial statement should be corrected as recommended.

Reconciliation and registers are performed and the error occurred due to the date anomaly as indicated above.

Remedial action:

What actions will be taken:	By whom:	By when:
The financial statements will be corrected.	CFO	30 November 2019

If the above findings affects an amount (s) disclosed in the financial statements:	YES	
--	-----	--

Please give an indication of whether the correcting journal entry shall be processed:	YES		
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If yes, please indicate the accounting entry:

		Dr	Cr
33-39-50-28-7708	Interest - Annuity Loans	26 268.81	
35-72-50-28-7708	Interest - Annuity Loans	82 020.82	
35-76-50-28-7708	Interest - Annuity Loans	186 425.28	
35-88-50-28-7708	Interest - Annuity Loans	104 783.48	
35-89-50-28-7708	Interest - Annuity Loans	185 916.83	
35-90-50-28-7708	Interest - Annuity Loans	34 202.75	
35-93-50-28-7708	Interest - Annuity Loans	278 806.55	
35-73-50-28-7708	Interest - Annuity Loans	123 031.24	
33-60-50-28-7708	Interest - Annuity Loans	34 550.25	
01-07-26-07-9956	Accrued Interest on Ext Loans		(1 056 006.01)

If no, please provide the reason why such a conclusion:

Auditor's conclusion

Management's response is noted.

The auditors inspected the adjusted annual financial statements and confirmed that the necessary corrections were made. The finding will however remain in the management report as an "other important matter" as there is an internal control deficiency that must be addressed.

Sewerage and Sanitation misstated – COMAF 14**Audit finding**

The Municipal Finance Management Act no. 56 of 2003 (MFMA), section 122 (1), states that:

“Every municipality and every municipal entity must for each financial year prepare annual financial statements which -

- (d) fairly presents the state of affairs of the municipality or entity, its performance against its budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results, and its financial position as at the end of the financial year.”*

Paragraph 17 of the Standard of Generally Recognised Accounting Practice (GRAP 1) – Presentation of Financial Statements states that:

“Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful presentation of the effect of the transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, revenue and expenses. The application of Standards of GRAP with additional disclosures, when necessary, is presumed to result in financial statements that achieve a fair presentation.”

Paragraph 21 of the Standard of Generally Recognised Accounting Practice – Revenue from exchange transactions (GRAP 9) states that:

“The recognition of revenue by reference to the stage of completion of a transaction is often referred to as the percentage of completion method. Under this method, revenue is recognised in the reporting periods in which the services are rendered. For example, an entity providing property valuations services would recognize revenue as the individual valuations are completed.”

Therefore, based on the afore-mentioned paragraphs, revenue should be recognised in the accounting period that the service is rendered.

Issue 1: Cut-off

During the audit of revenue from exchange transactions: sewerage and sanitation charges, it was identified that the following transactions as listed below related to the prior financial years, but were erroneously recorded in the 2018/2019 financial year:

Information as per the general ledger					Auditor Comments
No.	Reference	Date	Description	Amount (R)	
1	mun038.p	27/05/2019	Update Daily Transac	-4 588.59	Inspected the dates as per the general ledger and account statements and confirmed that the transaction was recorded in the 2018/19 financial year. However, the transaction relates to the reversal of availability fees for both the 2015/2016 and 2016/2017 financial years. The transaction is therefore recorded in the incorrect financial period.
2	mun038.p	27/03/2019	Update Daily Transac	-2 519.30	Inspected the dates as per the general ledger and account statements and confirmed that the transaction was recorded in the 2018/19 financial year. However, the transaction relates to the reversal of availability fees for the 2017/18 financial year. The transaction is therefore recorded in the incorrect financial period.

Information as per the general ledger					Auditor Comments
No.	Reference	Date	Description	Amount (R)	
3	mun038.p	18/12/2018	Update Daily Transac	-3 463.16	Inspected the dates as per the general ledger and account statements and confirmed that the transaction was recorded in the 2018/19 financial year. However, the transaction relates to the reversal of basic fees relating to the 2017/18 financial year. The transaction is therefore recorded in the incorrect financial period.
TOTAL:				-10 571.05	

These identified findings have led to a factual misstatement of R10 571.05, which is projected to a misstatement of R11 708 302.54.

The misstatements identified have resulted in the understatement of revenue from exchange transactions: Sewerage and sanitation charges for the 2018/19 financial year.

Similarly, the following transactions also related to prior financial years, but were erroneously recorded in the 2018/2019 financial year:

Information as per the general ledger					Auditor Comments
No.	Reference	Date	Description	Amount (R)	
1	mun038.p	31/08/2018	Update Daily Transac	463.01	Inspected the dates as per the general ledger and account statements and confirmed that the transaction was recorded in the 2018/19 financial year. However, the transaction relates to the charging of basic fees relating to the 2017/18 financial year. The transaction is therefore recorded in the incorrect financial period.
2	mun038.p	31/07/2018	Update Daily Transac	857.89	
3	mun038.p	28/09/2018	Update Daily Transac	2 179.10	Inspected the dates as per the general ledger and account statements and confirmed that the transaction was recorded in the 2018/19 financial year. However, the transaction relates to the charging of availability fees for the 2015/2016 financial year. The transaction is therefore recorded in the incorrect financial period.
TOTAL:				3 500.00	

These identified findings have led to a factual misstatement of R3 500.00, which is projected to a misstatement of R7 295 355.62.

The misstatement identified has resulted in the overstatement of revenue from exchange transactions: Sewerage and sanitation charges for the 2018/19 financial year.

The combined effect of the identified finding is the projected understatement of revenue from exchange transactions: Sewerage and sanitation charges for the 2018/19 financial year by R4 412 946.92.

Issue 2: Classification

During the audit of revenue from exchange transactions: Sewerage and sanitation charges, it was identified that the following transaction relating to rentals was erroneously recorded as revenue from exchange transactions: Sewerage and sanitation charges:

Information as per the general ledger					Auditor Comments
No.	Reference	Date	Description	Amount (R)	
1	MH055.P	30/09/2018	Rent/Installment Rai	106.08	Inspected the statement of account and confirmed that the transaction related to rental. The transaction is therefore not sewerage and sanitation services and is classified incorrectly.
TOTAL:				106.08	

This identified finding has led to a factual misstatement of R106.08, which is projected to a misstatement of R221 111.51. The misstatement identified has resulted in the overstatement of revenue from exchange transactions: Sewerage and sanitation charges for the 2018/2019 financial year.

Internal control deficiency

Financial and performance management

Management did not prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information.

Management did not account for revenue from sewerage and sanitation charges in terms of GRAP 9.

Furthermore, management did not adequately review the detailed accounts for revenue from sewerage and sanitation charges to ensure that all transactions relate to sewerage and sanitation and that they are recorded in the correct accounting period.

Recommendation

Management should strengthen its review processes of the financial statements to ensure that the figures reported are accurate and complete.

Management should examine the population to which the misstatement relates to understand the cause of the misstatement and to make the appropriate adjustments.

Management should put in place controls to ensure that transactions are recorded in the correct financial period and are classified appropriately.

Management should account for revenue from sewerage and sanitation charges in terms of GRAP 9.

Management response

Management comment on the audit finding:

Issue 1:

The total value of the population of refuse and sewer prior year adjustments amounts to R 64 763.42. Refer to the 4 attachments for the total population relating to sewerage and refuse as per the table below:

Refuse detailed transactions 1	R 58 100.45
Refuse detailed transactions 2	R 13 616.64
Sewer detailed transactions 1	(R 6 873.01)
Sewer detailed transactions 2	(R 80.66)
	<u>R 64 763.42</u>

The transactions as indicated in the finding are marked in yellow in the attached population. Refer to the reference below:

Information as per the general ledger					
No.	Reference	Date	Description	Amount (R)	Reference to attachment
1	mun038.p	27/05/2019	Update Daily Transac	-4 588.59	Sewer detailed transactions 2 – Comaf reference A1
2	mun038.p	27/03/2019	Update Daily Transac	-2 519.30	Sewer detailed transactions 1 – Comaf reference A2
3	mun038.p	18/12/2018	Update Daily Transac	-3 463.16	Sewer detailed transactions 1 – Comaf reference A3
TOTAL:				<u>-10 571.05</u>	

Information as per the general ledger					
No.	Reference	Date	Description	Amount (R)	Reference to attachment
1	mun038.p	31/08/2018	Update Daily Transac	463.01	Sewer detailed transactions 1 – Comaf reference B1
2	mun038.p	31/07/2018	Update Daily Transac	857.89	Sewer detailed transactions 1 – Comaf reference B2
3	mun038.p	28/09/2018	Update Daily Transac	2 179.10	Sewer detailed transactions 2 – Comaf reference B3
TOTAL:				<u>3 500.00</u>	

We consequently disagree with the extrapolated misstatement due to revisiting the entire population amount of R 64 763.42.

These adjustments are not due to failure to use or misuse of prior year information when prior year financial statements were issued and is not regarded as a prior period error per GRAP 3 par 4.

This amount is immaterial and clearly indicated in the trial balance as prior year adjustments to service charges. As per GRAP3 par 44 an entity shall correct material prior year errors.

As this is immaterial and not due to misuse of prior year information it is not regarded as a prior period error and consequently retrospective restatement per GRAP 3 was not required.

Issue 2:

We agree that rental revenue was incorrectly recognised as part of revenue from exchange transactions: Sewerage and sanitation charges. The R 106.08 transaction in the finding is part of the total September debit raising of R 2 649.60. It was identified that the total population of these incorrect classifications of rental charges amounted to R 33 856 for the year.

Refer to the attachment (9_246_28_43.x/sx) for the entire population including all 12 months raisings incorrectly to vote 9/246/28/43.

Management comment on the root cause identified within the audit finding:

The root cause was due to incorrect linking of the revenue vote to the specific monthly debit raising on the system. This resulted in the classification misstatement between different revenue types.

Management comment on the recommendation:

We take note of the recommendations and will evaluate the current controls in place for improvement.

The population was revisited as recommended. The total population values are R 64 763.42 for issue 1 and R 33 856 for issue 2.

The linking of the debit raising as identified in issue 2 will be corrected on the system to ensure accurate classification going forward.

Remedial action:**What actions will be taken:**

The linking of this debit raising as identified in issue 2 will be corrected on the system to ensure accurate classification.

By whom:

CFO

By when:

30 November 2019

If the above findings affects an amount (s) disclosed in the financial statements:

YES

Please give an indication of whether the correcting journal entry shall be processed:

NO

If yes, please indicate the accounting entry:

N/a

If no, please provide the reason why such a conclusion:

This is regarded as immaterial and does not affect the surplus for the year.

Issue 1 is not regarded as a GRAP 3 prior year error.

Issue 2 is an insignificant classification difference between two different revenue types only.

Auditor's conclusion**Issue 1**

Management's response is noted. Management agreed with the finding, but disagreed with the amount of the misstatement. A projected misstatement was reported to management, which is merely the auditor's best estimate of the misstatement. The onus rests on management to

investigate and correct the population. As management agrees with the finding, but did not correct the population, no retesting will be performed by audit to determine if the population was corrected. Audit assessed the additional information provided by management and audit could not distinguish between the misstated items and the correct items by scrutinizing the listing. The projected misstatement of R4 412 946.92 therefore remains and the misstatement identified will be included in the summary of uncorrected misstatements and assessed in aggregate with other uncorrected misstatements. The finding will therefore remain in the management report.

Issue 2

Management's response is noted.

The auditors inspected the general ledger and confirmed that the total amount of items with description "Rent" amounts to R33 856. The auditors are therefore in agreement with management that the total population of incorrect classifications of rental charges amounts to R 33 856. Management subsequently decided not to adjust the annual financial statements. The amount is trivial and will therefore not be included on the schedule of uncorrected misstatements. The finding will remain in the management report as an "other important matter" to highlight the internal control deficiency identified.

Contingent Liabilities Misstated – COMAF 15

Audit Finding

In terms of GRAP 19 - Provisions, Contingent Liabilities and Contingent Assets; a contingent liability is:

- a) a possible obligation that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
- b) a present obligation that arises from past events but is not recognised because:
 - i. it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; or
 - ii. the amount of the obligation cannot be measured with sufficient reliability.

During the audit we identified that the following pending legal case which was disclosed in the 2017/18 financial year has not been disclosed in the 2018/19 financial even though the case is still pending.

Details	Amount
<i>RDH Gebert & 8 others / Yo-Art Properties (Pty) Ltd vs the Knysna Municipality (High court & Regional court Matter).</i>	R2 946 332

Contingent liabilities were consequently found to be understated by R2 946 332 at year end.

Internal control deficiency

Financial and performance management

Prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information

Management did not adequately review the legal confirmations as received from the attorneys to ensure that all contingent liabilities were accounted for in the AFS.

Recommendation

It is recommended that management should examine all legal confirmations and correspondence so that the financials are amended to accurately account for the contingent liabilities at year end.

Going forward review procedures should be developed that ensure all legal confirmations have been taken into account at year end and that the total of such agrees to that as reflected in the annual financial statements.

Management response

Management comment on audit finding

Management agrees with the finding. Amendment will be made on note 43.

Management comment on internal control deficiencies

Management disagree with the mentioned internal control deficiency. As can be seen from the email this was an error from the Attorneys whom were requested to confirm and they did not include this matter.

Management comment on recommendation Management did not examine legal confirmation and interacted with the responsible attorneys to get clarity on all matters. Management will use this findings to have a workshop with all attorneys in order for them to understand auditing of this area and their responsibility.		
Remedial action		
What actions will be taken: Communication and or workshop with the attorneys of Council to make them understand the audit of this area and their responsibility.	By whom: Manager Legal services and CFO	By when: 30 March 2020
If the above finding affects an amount(s) disclosed in the financial statements:		
Please give an indication of whether a correcting journal entry shall be processed	Yes	No X
If yes, please indicate the accounting entry: N/A		
If no, please provide the reason why such a conclusion has been reached: N/A		

Auditor's conclusion

Management's comments are noted. We agree with management's response to the root cause after inspecting the email from the attorney. The auditors inspected the updated AFS and confirmed that the necessary amendments were made. The finding will however remain in the management report as an "other important matter" for the internal control deficiency to be addressed.

Overtime – COMAF 16

Audit Finding

Section 122 (1) (a) of the Municipal Finance Management Act 56 of 2003, requires that every municipality and every municipal entity must for each financial year prepare annual financial statements which fairly presents the state of affairs of the municipality or entity, its performance against its budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results, and its financial position as at the end of the financial year.

Para 31 of GRAP 1 – *Presentation of Financial statements*; states that an entity shall prepare its financial statements, except for cash flow information, using the accrual basis of accounting.

During the audit of overtime, we have identified that overtime worked in June 2019 was not accounted for in the 2018-19 financial year.

Details of overtime tested include:

No	Employee no	Employee name	ITEM CODE	Month overtime was worked	Hours claimed	Amount paid per payroll (R)
1	20711	MZ Mpayipheli	Basic overtime	Jun-19	4,00	348,80
2	20713	King WR	Basic overtime	Jun-19	13,00	2 723,42
3	3511131	Royi M	Basic overtime	Jun-19	15,00	1 370,60
4	3511202	T.S Kalo	Sunday Overtime	Jun-19	20,00	2 436,63
SUM						6 879,45

Based on the sample items selected for testing, overtime payable for the 2018-19 financial year is understated by a projected misstatement amount of R3 160 659. Further follow up and enquiry with management, revealed that this issue is only related to the June period as the payroll system closes and the payment is made in July which falls in the new year.

This finding was also reported on in the 2017-18 financial year where the overtime payable was understated by an amount of R1 817 365.

Consequently, employee cost: overtime in the 2018-19 financial year is understated by R1 343 294.

Internal control deficiency

Financial and performance management

Prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information

Management did not recognise the overtime in terms of accrual accounting due to these claims being only recorded by payroll when the employee submits an overtime payment claim.

Recommendation

It is recommended that management investigate the population for overtime to ensure that overtime worked is recorded in the correct reporting period. This process should be included as part of the review of the annual financial statements going forward.

Management response**Management comment on the audit finding:**

Management agrees that the overtime value was misstatement. The total understatement for 2018/2019 however amounts to R 577 741.72.

The overstated amount relating to 2017/2018 amounts to R 1 823 612.20 (recognised in July 2018), and understated value relating to 2018/2019 amounts to R1 245 870.48 (recognised in July 2019), totalling an understatement in 2018/2019 of R 577 741.72. (See attached excel of overtime paid for July 2018 and July 2019)

The overtime worked by permanent staff for June was only processed for payment in July, which has led to a misstatement. Casual workers should be excluded from the population as they are paid overtime in the same month that overtime is worked. Casual workers receive their wages and overtime money on the last day of the month.

We disagree with the extrapolated amount in the finding as the total misstatements can't be greater than the total population as explained and attached.

Management comment on the root cause identified within the audit finding:

Management agrees with the root cause that overtime is not accurately accrued for. However, due to the practical nature of the overtime at Knysna and the rolling effect over the years the net effect in a year has always been regarded as immaterial.

Management comment on the recommendation:

Noted and agreed. The total population is attached to this finding. We will revisit the controls in place and determine how this will be practically implemented on the system to ensure accurate accrual of overtime in the future.

Remedial action:

What actions will be taken:	By whom:	By when:
We will revisit the controls in place and determine how this will be practically implemented on the system to ensure accurate accrual of overtime in the future.		
If the above findings affects an amount (s) disclosed in the financial statements:	YES	
Please give an indication of whether the correcting journal entry shall be processed:		NO
If yes, please indicate the accounting entry:		
N/A		
If no, please provide the reason why such a conclusion:		
The net effect in the year is regarded as immaterial.		

Auditor's conclusion

Management's comments are noted. Management has not updated the annual financial statements and therefore the difference will be included in the schedules of uncorrected misstatements. The finding will however remain in the management report as an "other important matter".

Grants Revenue Misstated – COMAF 17

Audit finding

The Municipal Finance Management Act no. 56 of 2003 (MFMA), section 122 (1), states that:

“Every municipality and every municipal entity must for each financial year prepare annual financial statements which -

- (e) fairly presents the state of affairs of the municipality or entity, its performance against its budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results, and its financial position as at the end of the financial year.”*

Paragraph 17 of the Standard of Generally Recognised Accounting Practice (GRAP 1) – Presentation of Financial Statements states that:

“Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful presentation of the effect of the transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, revenue and expenses. The application of Standards of GRAP with additional disclosures, when necessary, is presumed to result in financial statements that achieve a fair presentation.”

Paragraph 44 of the Standard of Generally Recognised Accounting Practice (GRAP 23) – Revenue from non-exchange transactions states that:

An inflow of resources from a non-exchange transaction recognised as an asset shall be recognised as revenue, except to the extent that a liability is also recognised in respect of the same inflow.

Paragraph 45 of the Standard of Generally Recognised Accounting Practice (GRAP 23) – Revenue from non-exchange transactions states that:

“As an entity satisfies a present obligation recognised as a liability in respect of an inflow of resources from a non-exchange transaction recognised as an asset, it shall reduce the carrying amount of the liability recognised and recognise an amount of revenue equal to that reduction.”

Issue 1: Accuracy of grants

During the audit of revenue from non-exchange transactions: government grants and subsidies, we identified that the following transactions relating to capital grants were misstated:

No.	Account	Description	Date	Amount (R)	Auditor's recalculated amount (R)	Difference (R)
1	357850838786	010727081131C APX M10	30/04/2019	110 961.74	110 960.56	1.18
2	357850838786	010727081131 CAPXM12	30/06/2019	597 060.70	575 249.55	21 811.15
3	335150838718	01-07-27-0869- 27OPEXM02	31/08/2018	791 421.64	753 537.89	37 883.75
4	335150838718	010727086927 CAPEX M05	30/11/2018	528 525.97	531 995.51	-3 469.54
TOTAL:						56 226.54

The identified finding has led to a factual misstatement of R56 226.54, which is projected to a misstatement of R301 713.18

The misstatement identified has resulted in the overstatement of revenue from non-exchange transaction: government grants and subsidies and an understatement of unspent conditional grants and receipts for the 2018/19 financial year.

Furthermore, the following transactions relating to operating grants were also misstated:

No.	Account	Description	Date	Amount (R)	Auditor's recalculated amount (R)	Difference (R)
1	335150838793	010727086931 CAPX M09	31/03/2019	102 655.68	105 498.8	- 2 843.12
2	357650838784	100727080227 CAPXM12	30/06/2019	51 425.72	62 070.44	-10 644.72
3	347050828768	010727080330 OPEXM12	30/06/2019	23 289.59	26 424.9	- .3 135.31
TOTAL:						-16 623.15

This identified finding has led to a factual misstatement of R16 623.15, which is projected to a misstatement of R312 002.55.

The misstatement identified has resulted in the understatement of revenue from non-exchange transaction: government grants and subsidies and an overstatement of unspent conditional grants and receipts for the 2018/19 financial year.

Issue 2: Incorrect disclosure (conditional grants)

During the audit of revenue from non-exchange transactions: government grants and subsidies, it was identified that the following revenue transactions relating to capital expenditure was erroneously disclosed as revenue from operating expenditure:

No	Account	Item	Date	Reference	Description	Amount (R)
1	335150838793	VAT Capex Grant: WCPA	28/02/2019	AM2345	010727086931 CAPX M08	19 509.95
2	335150838793	VAT Capex Grant: WCPA	31/03/2019	AM2354	010727086931 CAPX M09	102 655.68
3	335150838793	VAT Capex Grant: WCPA	31/03/2019	AM002358	010727086931 CAPXM09	8 465.38
4	357650838784	VAT Grant Capex:INEP	31/10/2018	AM2313	100727080131 CAPEX M04	34 422.00
5	357650838784	VAT Grant Capex:INEP	31/12/2018	AM002330	100727080131 CAPXM06	2 840.48
6	357650838784	VAT Grant Capex:INEP	28/02/2019	AM2345	100727080131 CAPX M08	10 743.36
7	357650838784	VAT Grant Capex:INEP	31/03/2019	AM2354	100727080131 CAPX M09	29 784.9
8	357650838784	VAT Grant Capex:INEP	30/04/2019	AM002360	100727080131CAPX M10	2 775.00
9	357650838784	VAT Grant Capex:INEP	31/05/2019	AM002364	100727080131 CAPXM11	101 651.34
10	357650838784	VAT Grant Capex:INEP	30/06/2019	AM002376	100727080131 CAPXM12	2 650.50
11	357650838784	VAT Grant Capex:INEP	30/06/2019	AM002390	100727080227 CAPXM12	51 425.72
12	347050828768	Vat on Operating Grant-NatGov	30/06/2019	AM002377	010727080330 OPEXM12	23 289.59
TOTAL:						390 213.90

This identified finding has led to a factual misstatement of R390 213.90, which is projected to a misstatement of R7 323 992.03. The misstatement identified has resulted in the inaccurate disclosure of note 8 and note 25 of the annual financial statements for the year ended 30 June 2019.

Internal control deficiency

Financial and performance management

Management did not prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information.

Management did not adequately review the detailed accounts for revenue from government grants and subsidies to ensure that all transactions are recorded accurately.

Recommendation

Management should strengthen its review processes of the financial statements to ensure that the figures reported are accurate and complete.

Management should examine the population to which the misstatement relates to understand the cause of the misstatement and to make the appropriate adjustments.

Management should put in place controls to ensure that transactions are recorded and disclosed accurately.

Management response

Management comment on the audit finding:

Issue 1:

First Table:

1 – VAT was calculated on the full amount as per the vote for that month thus the total $739,744.9 \times 0.15 = 110,961.74$ which is the vat on this amount – the difference with the AG is due to rounding.

2 - VAT on full amount for that month in the vote – not on individual transactions. We agree with the finding.

3 – We disagree with number 3. On this order an invoice was processed (IN100827) without taking into account the retention portion. This was subsequently identified and corrected by including it with the next invoice (IN100841).

Invoice	Retention amount Included in expenditure	Retention as per invoice	Invoice amount	Amount recorded as revenue
IN100827	0.00	37,883.75	757,674.92	719,791.17
IN100841	75,560.64	37,676.89	753,537.90	791,421.64
	75,560.64	75,560.64	1,511,212.82	1,511,212.82

Overall the correct amount was recorded as revenue.
Refer to the attached invoices.

4 – We agree with the finding and the amount was incorrectly captured.

The total selection misstatement for issue 1 table 1 is consequently R 18 342.79 (Nr's 1,2 and 4 agreed with the finding).

Second Table:

1 – We disagree as the total amount of R 703 325.31 (invoice IN100995) was split into two votes. An amount of R 18,954.12 was allocated to vote 9/151-8-13 which does not relate to grants as it was own funded. The remaining R 684,371.19 was allocated to vote 9/251-3-3 which is a grant vote for which revenue must be recognised.

As the 18,954 do not relate to grant expenditure the Vat portion on this amount of R 2,843.12 was correctly not recognised as revenue.

2 – We agree with the finding.

3 – Only R 155 263.93 of the total amount of R 176 166.00 of the invoice was recognised against the FMG grant. Revenue on the VAT portion can consequently only be recognised on the portion relating to grant expenditure of R 155 263.93. The remaining R 20 902.07 (R 176 166.00 - R 155 263.93) was recognised in account 346750147220. The revenue recognised relating to the VAT on grant expenditure was consequently correct (R 155 263.93 * 0.15 = R 23 289.59)

The total selection misstatement for issue 1 table 2 is consequently R 10 644.72 (Nr 2 in the table).

Issue 2:

Management agrees with the finding that revenue on capital expenditure are incorrectly allocated to the revenue on operating expenditure.

However, Management does not agree with the factual amount and projection of the misstatement.

The last item in the table number 12 relates to the operating expenditure as this is VAT on the National Grant - Local Government Finance Management Grant which relates specifically to operating expenditure thus the vat on this item cannot be included in the factual misstatement.

These items are limited to the VAT on the capital expenditure that is incorrectly allocated thus the total capital expenditure incorrectly allocated to operating expenditure is:

9/213-14-32	VAT Grant Capex:MIG	(485,839.52)
9/218-57-79	VAT Capex Grant: WCPA	(841,999.07)
9/238-53-73	VAT Grant Capex:INEP	(761,306.79)
9/246-36-51	VAT Grant Capex:MIG	14,740.63
9/251-61-76	VAT Grant Capex:MIG	(120,357.72)
9/251-214-198	VAT Grant Capex:MIG	(855,573.30)
Total		(3,050,335.77)

This however has no effect on the Transfer Revenue – Government Grant and subsidies line in the statement of financial performance.

Management comment on the root cause identified within the audit finding:

Management agrees that controls can be strengthened relating to the review of grant revenue account details.

Management comment on the recommendation:

We take note of the recommendations and controls will be evaluated to ensure increased review over detail of votes.

The full population was examined as responded on above.

Remedial action:

What actions will be taken:

Evaluation of improvement over the current grant revenue recognition process.

By whom:

By when:

If the above findings affects an amount (s) disclosed in the financial statements:

YES

Please give an indication of whether the correcting journal entry shall be processed:

NO

N/A

If yes, please indicate the accounting entry:

N/a

If no, please provide the reason why such a conclusion:

No journal required as this has no monetary effect on the Transfer Revenue – Government Grant and subsidies line as presented in the statement of financial performance. This only relates to disclosure in the note to the mentioned line item.

Auditor's conclusion

Managements response is noted.

Issue 1:

Management agrees with the misstatement identified in issue 1, sample items 1,2 and 4 of table 1.

For sample item 3 of issue 1 in the first table, audit only considered the retention of Invoice 100841 amounting to R37 676.89 in the recalculation of revenue from non-exchange transactions: government grants and subsidies. Invoice 100827 is dated 29/06/2018 and consequently relates to the 2017/2018 financial year and not the 2018/2019 financial year. The retention of R37 883.75 relating to Invoice 100827 should consequently not be recorded as revenue from non-exchange transactions: government grants and subsidies, as the expenditure does not relate to the 2018/2019 financial year. The projected misstatement of R301 713.18 identified will be included in the summary of uncorrected misstatements and assessed in aggregate with the other uncorrected misstatements. The finding will therefore remain in the management report.

Management agrees with the misstatement identified in issue 1, sample item 2 of table 2.

For sample item 1 of table 2, audit recalculated the revenue by recalculating the VAT on the invoice amount and applicable retention. Management did not provide audit with reasons for recording the invoice in separate vote accounts. Furthermore, the expenditure was incurred in accordance with the grant conditions and audit did not identify a reason as to why the revenue cannot be recognised on the full invoice amount, nor was a reason provided by management. Consequently, sample item 1 of table 2 is still misstated.

Similarly, for sample item 3 of table 2, audit recalculated the revenue by recalculating the VAT on the invoice amount. Management did not provide audit with reasons for only recording a portion of the invoice as revenue. Furthermore, the expenditure was incurred in accordance with the grant conditions and audit did not identify a reason as to why the revenue cannot be recognised on the full invoice amount, nor was a reason provided by management. Consequently, sample item 3 of table 2 is still misstated. The projected misstatement of R312 002.55 identified will be included in the summary of uncorrected misstatements and assessed in aggregate with the other uncorrected misstatements. The finding will therefore remain in the management report.

Issue 2:

Management agrees with the misstatement identified, with the exception of the amount of the misstatement.

Audit is in agreement with management that sample item 12 of Issue 2 relates to operating expenditure and is not erroneously disclosed. The factual misstatement identified is therefore R366 924.31, which is projected to a misstatement of R6 886 865.70. A projected misstatement was reported to management, which is merely the auditor's best estimate of the misstatement. The onus rests on management to investigate and correct the population. As management agrees with the finding, but did not correct the population, no further audit work will be performed. The projected misstatement of R6 886 865.70 therefore remains and the misstatement identified will be included in the summary of uncorrected misstatements and assessed in aggregate with the other uncorrected misstatements. The finding will therefore remain in the management report.

Cash Flow Statement Misstated – COMAF 18

Audit Finding

The Municipal Finance Management Act no. 56 of 2003 (MFMA), section 122 (1), states that:

“Every municipality and every municipal entity must for each financial year prepare annual financial statements which -

- (a) fairly presents the state of affairs of the municipality or entity, its performance against its budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results, and its financial position as at the end of the financial year.”*

Paragraph 12 of the Standard of Generally Recognised Accounting Practice (GRAP 2) states that:
“.12 An entity presents its cash flows from operating, investing and financing activities in a manner which is most appropriate to its activities. Classification by activity provides information that allows users to assess the impact of those activities on the financial position of the entity and the amount of its cash and cash equivalents. This information may also be used to evaluate the relationships among those activities.

.13 A single transaction may include cash flows that are classified differently. For example, when the cash repayment of a loan includes both interest and capital, the interest element may be classified as an operating activity and the capital element is classified as a financing activity.”

Issue 1

During the audit cash flow statements, it was identified that the prior period adjustments made to receivables from exchange transactions per note 45.3 were not taken into account when preparing the cash flow statement for the 2018/19 financial year.

Line item	Amount per AFS	Amount per audit recalculation	Difference
Sale of goods and services	344 198 184	344 421 113	(222 929)
Total	334 198 184	344 421 113	(222 929)

This consequently resulted in receipts (sale of goods and services) being understated and payments (suppliers) being overstated by R222 929 in the 2017/18 and 2018/19 financial years.

Issue 2

Furthermore, it was identified that the employee benefit finance cost was erroneously allocated to the supplier's line item in the cash flow statement instead of employee cost line item. Details below

Line item	Amount per Municipality's calculation	Amount per audit recalculation	Difference
Employee cost	5 948	(9 769 319)	(9 763 371)
Suppliers	(10 675 819)	(900 550)	9 775 269

The above therefore resulted in employee cost per the cash flow statement being understated by R9 763 371 and Suppliers being overstated by R9 775 269.

This will not affect the total cash outflow from operating activities, however, the individual line items are materially misstated.

Internal control deficiency**Financial and Performance Management**

Prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information

Management did not adequately review the cash flow statement calculation for accuracy of formulas used.

Recommendation

Management should amend the Annual Financial Statements to accurately account for the above misstatements reported on therein.

Formulas used within the cash flow statement recalculation sheet should be adequately reviewed by management during the AFS review process to confirm the accuracy thereof.

Management response**Management comment on the audit finding:****Issue 1**

We agree with the finding.

Issue 2

We agree with the finding. As stated in the finding this will not affect the total cash outflow from operating activities. The cash-flow statement does not contain a material misstatement per the 3 major classification lines as required by GRAP 2 and consequently this disclosure difference should not have a material impact on the users of the AFS. This actuarial finance cost was erroneously only included in the suppliers line instead of the employee cost line under the payments sub-heading.

Extract from GRAP 2:**“Presentation of a cash flow statement**

.11 The cash flow statement shall report cash flows during the period classified by operating, investing and financing activities.”

Management comment on the root cause identified within the audit finding:

Management take note of the root cause. Financial Statement review procedures are in place and this was not a calculation error and did not result in a calculation misstatement on the Cash-flow statement. This actuarial finance cost was erroneously only included in the suppliers line instead of the employee cost line under the payments sub-heading.

Management comment on the recommendation:

Management take note of the recommendation and will amend the financial statements accordingly.

Remedial action:

What actions will be taken:

By whom:

By when:

CFO

Correction of disclosure within the operating activities cash-flow disclosure.		15 November 2019	
If the above findings affects an amount (s) disclosed in the financial statements:	YES		
Please give an indication of whether the correcting journal entry shall be processed:		NO	
If yes, please indicate the accounting entry:			
N/a			
If no, please provide the reason why such a conclusion:			
No misstatement, only disclosure lines to be amended within the operating activities cash-flow line item.			

Auditor's conclusion

Management's comment is noted.

The auditors inspected the updated AFS and confirmed that the necessary amendments were made. The finding will however remain in the management report as an "other important matter" for the internal control deficiency to be addressed.

Disclosure note 47 and Budget Statement Misstated – COMAF 21**Audit Finding**

The Municipal Finance Management Act no. 56 of 2003 (MFMA), section 122 (1) (a) states that:

“Every municipality and every municipal entity must for each financial year prepare annual financial statements which fairly presents the state of affairs of the municipality or entity, its performance against its budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results, and its financial position as at the end of the financial year.”

The Municipal Finance Management Act no. 56 of 2003 (MFMA), section (1) defines unauthorised expenditure as:

- (a) “overspending of the total amount appropriated in the municipality’s approved budget;
- (b) overspending of the total amount appropriated for a vote in the approved budget;
- (c) expenditure from a vote unrelated to the department or functional area covered by the vote;
- (d) expenditure of money appropriated for a specific purpose, otherwise than for that specific purpose;
- (e) spending of an allocation referred to in paragraph (b), (c) or (d) of the definition of “allocation” otherwise than in accordance with any conditions of the allocation; or
- (f) a grant by the municipality otherwise than in accordance with this Act;”

Paragraph 17 of the Generally Recognised Accounting Practice - Presentation of Financial Statements (GRAP 1) states that:

“Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, revenue and expenses set out in the Framework for the Preparation and Presentation of Financial Statements. The application of Standards of GRAP, with additional disclosures when necessary, is presumed to result in financial statements that achieve a fair presentation.”

During the audit of the unauthorised expenditure, it was identified that the total actual operating expenditure per the disclosure note 47 does not agree to the total expenditure per the Statement of Financial Performance.

Details below:

Details	Statement of Financial Performance(SOFP)	Note 47 : Budget Comparison by Municipal Vote – Operating Expenditure	Difference
Total expenditure	R 883 480 368	R 875 206 485	R8 273 883

Furthermore, we also identified that the total expenditure per the Statement of Financial Position does not agree to the actual total expenditure recorded on the Statement of Comparison of budget and actual amounts.

Details below:

Details	Statement of Financial Performance(SOFP)	Statement of Comparison of Budget and Actual Amounts	Difference
Total expenditure	R 883 480 368	R 874 489 508	R8 990 860

Consequently, the total operating expenditure per note 47 is understated by R8 273 883 and total expenditure per the Statement of Comparison of budget and actual amounts are also understated by R8 990 860.

Internal control deficiency

Financial and Performance Management

Management did not prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information.

Furthermore, management did not perform adequate reviews to ensure that disclosure is complete and accurate.

Recommendation

Management should strengthen its review processes of the financial statements to ensure that the figures reported are accurate.

Management should amend both the statement of comparison of budget and actual amounts and note 47 to reflect the correct expenditure amounts.

Management response

Management comment on the audit finding:

Management disagrees with the finding based on the following:

As per GRAP 24

“38 An entity shall explain in notes to the financial statements the budgetary basis and classification basis adopted in the approved budget.

.41 GRAP 1 requires entities to present, in notes to the financial statements, information about the basis of preparation of the financial statements and the significant accounting policies adopted. Disclosure of the budgetary basis and classification basis adopted for the preparation and presentation of approved budgets will assist users to understand better the relationship between the budget and accounting information disclosed in the financial statements.”

Reconciliation of actual amounts on a comparable basis and actual amounts in the financial statements

.49 For some entities adopting the same basis of accounting for preparation of both the budget documents and the financial statements, only the identification of differences between actual amounts in the budget and the equivalent amounts in the financial statements will be required. This will occur where the budget is prepared for the same period, encompasses the same entities and adopts the same presentation format as the financial statements. In these cases, a reconciliation is not required. For other entities adopting the same basis of accounting for the budget and the financial statements, there may be a difference in presentation format, reporting entity or reporting period – for example, the approved budget may adopt a different classification or presentation format to the financial statements, may include only non-commercial activities of the entity, or may be a multi-year budget. A reconciliation would be necessary where there are presentation, timing

or entity differences between the budget and the financial statements prepared on the same accounting basis.

.46 ...The reconciliation shall be disclosed on the face of the statement of comparison of budget and actual amounts or in the notes to the financial statements."

This presentation differences as referred to in GRAP 24 was disclosed in note 54 on pages 104 – 105 in the financial statements under the heading: "Differences between budget and actual amounts basis of preparation and presentation.

As disclosed in note 54 the employee related cost, actuarial gains and losses and loss on disposal of assets are aggregated in the budgeted statements, but disclosed separately in the statement of financial performance.

Consequently, based on this implementation of GRAP 24 the differences as raised in the findings is explained as follows:

Statement of Financial Performance (SOF) vs Statement of Comparison of Budget and Actual Amounts:

This is reconciled to the note disclosure:

SOF – Total expenditure	883 480 368
Statement of Comparison of Budget and Actual Amounts	874 489 508
Difference as included in the finding	8 990 860
Actuarial gains/losses (separate on SOFP as explained in note 54)	(9 508 014)
Profit/loss on disposal of assets and liabilities (separate on SOFP as explained in note 54)	491 249
Remaining difference regarded as trivial	(25 905)

SOF vs Note 47 : Budget Comparison by Municipal Vote – Operating Expenditure:

SOF – Total expenditure	883 480 368
Budget Comparison by Municipal Vote – Operating Expenditure	875 206 485
Difference as included in the finding	8 273 883
Actuarial gains/losses (separate on SOFP as explained in note 54)	(9 508 014)
Profit/loss on disposal of assets and liabilities (separate on SOFP as explained in note 54)	491 249
Remaining difference	(742 882)

This difference is immaterial.

Management comment on the root cause identified within the audit finding:

Management disagree as the disclosure is complete and accurate as per the requirements of GRAP 24.

Management comment on the recommendation:

Management disagree as the disclosure is complete and accurate as per the requirements of GRAP 24. The actual R 742 882 difference on note 47 can be corrected on the AFS, although it will have no impact as it will not result in unauthorised expenditure.

Remedial action:			
What actions will be taken:	By whom:		By when:
None			
If the above findings affects an amount (s) disclosed in the financial statements:	YES		
Please give an indication of whether the correcting journal entry shall be processed:			N/A
If yes, please indicate the accounting entry:			
N/a			
If no, please provide the reason why such a conclusion:			
N/a			

Auditor's conclusion**Statement of Financial Performance (SOFP) vs Statement of Comparison of Budget and Actual Amounts:**

Management's comment is noted. Upon further inspection of the annual financial statements we agree with management's response. The finding will therefore be resolved as the remaining difference is trivial. Therefore, no further reporting is required.

SOFP vs Note 4: Budget Comparison by Municipal Vote – Operating Expenditure:

Management's responses are noted. Upon further inspection of the annual financial statements and related supporting documentation we agree with managements difference of R742 882. the amount of R742 882 will be included in the summary of uncorrected misstatements. This matter will remain in the management report as an "other important matter"

Expenditure Management – 30 day payments – COMAF 29**Audit finding**

The Municipal Finance Management Act (MFMA) Section 65(2)(e) states that:

“The accounting officer must for the purpose of subsection (1) take all reasonable steps to ensure_
(e) that all money owing by the municipality be paid within 30 days of receiving the relevant
invoice or statement, unless prescribed otherwise for certain categories of expenditure;”

During the audit of expenditure management, we identified that the following invoice were not settled within 30 days of receipt of the invoice:

Invoice reference	Supplier	Amount	Date invoice received	Date payment made	Number of days
PRF017304	Environmental Systems Research	R125 796.43	19/06/2019	22/07/2019	33

Furthermore, we could not confirm the date of receipt of the below invoices and were unable to assess whether or not the invoices were settled within 30days.

Invoice reference	Supplier	Amount	Invoice date	Date payment made	Number of days
MJ115	Steven Van Lier	R1 750	01/04/2019	24/07/2019	114
MJ120	Tyres and treads	R20 382.60	03/06/2019	02/08/2019	60

The above resulted in non-compliance with Section 65 (2) (e) of the MFMA, however not material non-compliance.

Internal control deficiency**Financial and performance management**

Review and monitor compliance with applicable laws and regulations

Management did not have adequate controls in place to ensure that all invoices are settled within 30 days.

Recommendation

It is recommended that management implement controls to adequately track and monitor the payment of suppliers/creditors to prevent non-compliance with the MFMA.

Management response

Management comment on the audit finding:

Management do not agree with findings. Payments were made within 30 days of receipt of approved invoice or statement and is not disputed.

Invoice reference	Supplier	Amount	Date invoice received	Date payment made	Number of days
PRF017304	Environmental Systems Research	R125 796.43	19/06/2019	22/07/2019	33

Payment is normally made after receipt of invoice and statement. However statement for the month of June was not received and payment made base on statement date, which would have been 30 June 2019. There payment was made within 30 days of statement. **(See attach documents). This is one of the suppliers where we always reconcile the invoice with statements before any payment is made.**

Invoice reference	Supplier	Amount	Invoice date	Date payment made	Number of days
MJ115	Steven Van Lier	R1 750	01/04/2019	24/07/2019	114

Payment made within 30days of receipt of invoice after approval of invoice by delegated official. **(See attachment).**

Invoice reference	Supplier	Amount	Invoice date	Date payment made	Number of days
MJ120	Tyres and treads	R20 382.60	03/06/2019	02/08/2019	60

Payment delayed due to Tax clearance certificate. Payment made with 30 days of receipt of tax clearance certificate. **(See Attachment). Payment on expired Tax certificate would have been wasteful and irregular expenditure.**

Management comment on the root cause identified within the audit finding:

Management disagree with the root cause and want to highlight that the legislation must be read in its entirety as there could be more subsection of the legislation affected or affecting a separate incident. i.e. payment within 30 days read with requirement to pay suppliers with valid Tax certificate.

Management comment on the recommendation:

Management note the recommendation but however disagree

Remedial action:

What actions will be taken: Ensure that all invoices and statements are stamped (Received Stamp). Once all supporting documents are received and invoices authorise for payment.

By whom:

Accountant:
Expenditure

By when:

With immediate effect.

If the above findings affects an amount (s) disclosed in the financial statements:

NO

Please give an indication of whether the correcting journal entry shall be processed:

N/A

If yes, please indicate the accounting entry:
N/A
If no, please provide the reason why such a conclusion:
N/A

Auditor's conclusion

Management's response has been noted and assessed as follows per matter reported on as follows:

Environmental Systems Research

Matter has been resolved per further inspection of the evidence presented. No interest was also noted in respect of the payment period in excess of 30 days per inspection of the supplier's statement in this regard. Matter will therefore not be reported on any further.

Steven Van Lier

A one-page attachment, being the actual suppliers invoice dated 1 April 2019, was submitted by management as part of this response. However, it is still not clear to audit what the actual date of receipt of this invoice was as there is no detail of such thereon. The invoice is therefore still considered to be subject to late payment and will therefore remain as a finding in the management report as an "other important matter".

Tyres and treads

Managements response regarding the outstanding tax clearance certificate being the reason for withholding payment is noted, but this was however found not to be documented on the payment file prior to audit follow up thereof. Management should also ensure that awards in excess of R30,000 are not made to suppliers that do not have valid tax clearance certificates to prevent irregular expenditure, even though this is not a finding herein. The finding pertaining to the late payment for this matter is therefore considered to be resolved, but this will still be included in the management report as an internal control deficiency needs to be addressed.

No material non-compliance is noted as a result of the one late payment made to Steven Van Lier.

Unjustifiable Deviation – COMAF 27

Section 217 of the Constitution of the republic of South Africa 1996 states:

“Procurement. — (1) When an organ of state in the national, provincial or local sphere of government, or any other institution identified in national legislation, contracts for goods or services, it must do so in accordance with a system which is fair, equitable, transparent, competitive and cost effective.”

In terms of paragraph 22(1)(b)(i) of the municipal supply chain management regulations, states:

“The closure date for the submission of bids, which may not be less than 30 days in the case of transactions over R10 million (VAT included), or which are of a long term nature, or 14 days in any other case, from the date on which the advertisement is placed in a newspaper, subject to sub-regulation (2); and a statement that bids may only be submitted on the bid documentation provided by the municipality or municipal entity.”

In terms of paragraph 22(2) of the municipal supply chain management regulations, states:

“A supply chain management policy may allow the accounting officer to determine a closure date for the submission of bids which is less than the 30 or 14 days requirement, but only if such shorter period can be justified on the grounds of urgency or emergency or any exceptional case where it is impractical or impossible to follow the official procurement process.”

It was identified the following tender was advertised for less than 14 days:

Tender number and description	Required number of days	Advertised number of days	Date published	Closing date
T59 of 2018/19 Supply and delivery of One (1) Major 4X4 Fire Fighting Vehicle, One (1) Light 4X4 Fire Fighting Vehicle and One (1) 4X4 Double Cab Bakkie	14	7	7 March 2019	15 March 2019

The deviation was approved in line with the Procurement Policy, however, the reasons documented for the deviation does not appear to be reasonable to justify a case of emergency.

Management’s reason for deviating from the required advertisement period was due to the length of time it would take for the vehicles to undergo a modification process in order to get them ready for operations before financial year end.

The financial year end should not have had an impact on operational requirements of the fire department and therefore the requirements of the procurement being an emergency is not justifiable as there wasn’t any need for an immediate action.

The above non-compliance results in irregular expenditure to an amount of R 1 612 322,17.

Internal control deficiency**Financial and performance management***Review and monitor compliance with applicable laws and regulations*

Management did not adequately plan the procurement of the fire vehicles to ensure they were timeously initiated to be concluded when management required it.

Management did not appropriately review the request for deviation to ensure it constitutes a valid emergency before approving it.

Recommendation

It is recommended that management disclose irregular expenditure in the financial statements to the amount of R1 612 322.17.

Management should further plan all the procurement needs of the municipality to ensure it is initiated timeously so that it can be finalized when management requires it to be.

Management responseManagement comment on the audit finding:

Management disagree with the audit finding.

The AG quoted correctly regulation 22. In terms of SCM regulation 22 (2) SCM policy may (**note the use of the word “MAY”**) allow the MM to determine a closing date for the submission of bids which is less than the 30 or 14 days requirement, but (**note the use of the word “but”**) only if such shortened period can be justified on the grounds of urgency or (**note again the use of the word “or between urgency, emergency”**) emergency or any exceptional case where it is impractical or impossible to follow the official procurement process.

The above process should not be confused and can never be seen in the same light as a deviation in terms of regulation 36, as a SCM process was followed, the advertising of the bid was shortened for justifiable reasons. It is also nowhere stated that this procurement was a matter of emergency. It was rather a case of urgency, which is justifiable in terms of regulation 22.

A contextual background is hereby given in order to assist the AG in making an informed decision in this regard. Provincial Government through Extraordinary Gazette number 8005 dated 22 November 2018 made additional allocation to Knysna Municipality. Knysna Municipality had to in terms of the legislation accept/ through adjustments budget this allocation and have it in Knysna approved Municipal budget. An adjustments budget was tabled in January 2019 and approved by Council. Only after this approval, that Knysna Municipality can do a procurement process. No procurement process could be done without an approved budget.

The parties concerned, with certain conditions attached only signed the Memorandum of Understanding on 7th and 18th of January 2019. As the financial year for Knysna municipality already commenced there was limited, time to spend the funding allocated to KM. The funds were paid over to KM 30 days after the signing of the MOU. In terms of the MOU, the municipality had 8 months from receipt of funds until implementation. Tender processes usually take between 30 to 120 days especially if appeals are received and implementation could take 3 months or longer as per the motivation from the specialists in the fire department received. Therefore, the Fire department opted to request urgency to advertise the tender for a shortened period. In terms of their motivation and the MOU, it was a valid reason and the MM approved the request.

A full tender process was followed to procure the fire truck. All potential bidders were aware of the shortened period and therefore the process was fair and transparent. Any potential bidder whom it is claimed could have been affected had an opportunity from date of advert to object on the shortened period. There was adherence to the 21 days appeal period.

It must also be noted in terms of the type of this bid, who and how many service providers normally submit bids. Further, it must be noted that even with the shorten period the Municipality was unable to fully spend the funds by 30 June and had to apply for rollovers to Provincial Government who has since approved such roll over. The Memo also state the other process which the Municipality tried to follow but could not due to the tender of cape Winelands having lapsed and delivery already taken place, which was a correct response from Cape Winelands.

In considering the above, a judgement call must be made as to whether KM rejects the additional service delivery funding due to periods to delivery by 30 June 2019. Alternatively, KM to follow what it has done. This can therefore not be seen as irregular expenditure as no non-compliance occurred and justifiable reasoning for shortening the period were received and approved by the MM.

Management comment on the root cause identified within the audit finding:

Management disagree with the root cause identified. In considering the above, a judgement call must be made as to whether KM rejects the additional service delivery funding due to periods to delivery by 30 June 2019. Alternatively, KM to follow what it has done. The delivery of the fire vehicles within the financial year has definitely impact on service delivery. KM does not have proper equipment for firefighting and could not have asked and received assistance from nine other Municipalities in the province during the 2017 fire had it had its own proper fire engines. It be noted that in 2018 there was again fires that broke out on the mountains up until eastern cape.

Management comment on the recommendation:

It is impossible for management to do procurement planning if Provincial or National departments decide five months of a municipal financial year to allocate additional funds to a municipality. Therefore, the expenditure cannot be seen as irregular as it was not spend in contravention of any SCM regulations and or Policy.

Remedial action:

<u>What actions will be taken:</u>	<u>By whom:</u>	<u>By when:</u>
None		
If the above findings affects an amount (s) disclosed in the financial statements:		NO
Please give an indication of whether the correcting journal entry shall be processed:		N/A
If yes, please indicate the accounting entry:		
N/A		
If no, please provide the reason why such a conclusion:		
N/A		

Auditor's conclusion

Managements responses are noted. Auditors obtained and inspected the additional supporting documentation provided, and we are in agreement with the urgency surrounding this procurement. However, the finding will be reported in the management report as an internal control deficiency remains that must be addressed regarding the documentation and supporting evidence surrounding such instances.

Statement of Comparison of Budget and Actual Amounts Misstated – COMAF 31

Audit Finding

The Municipal Finance Management Act no. 56 of 2003 (MFMA), section 122 (1) (a) states that:

“Every municipality and every municipal entity must for each financial year prepare annual financial statements which fairly presents the state of affairs of the municipality or entity, its performance against its budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results, and its financial position as at the end of the financial year.”

Paragraph 12 of the Standard of Generally Recognised Accounting Practice – Presentation of Budget Information in Financial Statements (GRAP 24), states that:

“Subject to the requirements of paragraph .19, an entity shall present a comparison of the budget amounts for which it is held publicly accountable and actual amounts either as a separate additional financial statement or as additional budget columns in the financial statements currently presented in accordance with Standards of GRAP. The comparison of budget and actual amounts shall present separately for each level of legislative oversight:

- (a) the approved and final budget amounts;*
- (b) the actual amounts on a comparable basis; and*
- (c) by way of note disclosure,*

an explanation of material differences between the budget for which the entity is held publicly accountable and actual amounts, unless such explanation is included in other public documents issued in conjunction with the financial statements, and a cross reference to those documents is made in the notes.”

Paragraph 9 of the Standard of Generally Recognised Accounting Practice – Presentation of Budget Information in Financial Statements (GRAP 24), states that:

“Entities, through the budget process are appropriated funds by Parliament, the legislatures, municipal councils or other relevant authority, which funds are to be spent in accordance with certain priorities. The budget for a financial year is usually approved before the start of that financial year or, in exceptional circumstances, on a date as soon as possible after the start of that financial year. Subsequent to this initial budget being approved, it might become necessary to revise the initial estimates of revenue and expenditure due to increased collection of revenue, unforeseen and unavoidable expenditure being incurred, the reallocation of funds between activities or types of expenses, the, use of savings generated, or the roll-over of unspent funds from prior years. These revised budgets (often called adjustment budgets or adjustment estimates) are usually required by legislation to be approved again by Parliament, the legislatures, municipal councils or other relevant authority responsible for the approval of the budget. The most recent budget approved by Parliament, the legislatures, municipal councils or other relevant authority is the approved budget for purposes of this Standard.”

During the audit of the Statement of Comparison of Budget and Actual Amounts, we compared the Third Adjustments Budget to the final budget amount disclosed in the Statement of Comparison of Budget and Actual Amounts. The following differences were identified:

Statement of Financial Performance	Amount as per the Statement of Comparison of Budget and Actual Amounts (Final Budget) (R)	Amount as per the Third Adjustments Budget (R)	Difference (R)
Expenditure by type			
Employee costs	- 250 816 627	- 251 109 000	292 373
Materials & bulk purchases	- 218 195 429	- 211 658 000	- 6 537 429
Contracted Services	- 216 341 222	- 220 140 000	3 798 778
Other expenditure	- 90 147 146	- 92 593 000	2 445 854
	Total:		- 424

The identified finding has led to a factual misstatement. The misstatement identified has resulted in the understatement of the final budget total expenditure as per the Statement of Comparison of Budget and Actual Amounts by R424. Although the aggregated misstatement identified above is clearly trivial, the misstatements per the individual line items affected finding is being communicated, as the individual misstatements are not.

Issue 2

During the audit of the Statement of Comparison of Budget and Actual Amounts, the actual amounts as per the Statement of Comparison of Budget and Actual Amounts was compared to the amounts as per the Cash Flow Statement. The following differences were identified:

Line item	Actual amounts on comparable basis as per the Statement of Comparison of Budget and Actual Amounts (R)	Amount as per the Cash Flow Statement (R)	Difference (R)
Cash Flow Statement			
Cash Flow from operating activities			
Receipts			
Ratepayers and other	586 879 819	582 657 354	4 222 465
Government grants and conditional receipts	193 164 315	193 627 325	- 463 010
	Total:		3 759 455
Payments			
Suppliers and employees	- 670 833 942	- 671 225 659	391 717
Transfers and Grants	- 4 151 165	0	- 4 151 165
	Total:		- 3 759 448

The identified finding has led to a factual misstatement. The misstatement identified has resulted in the overstatement of Receipts from operating activities by R3 759 455 and the understatement of payments from operating activities by R3 759 448 in the Statement of Comparison of Budget and Actual Amounts.

Issue 3

Line item	Approved budget (R)	Adjustments (R)	Final Budget (R)	Actual Amounts on comparable basis (R)	Difference between final budget and actual (R)	Reason Reference
Statement of Financial Position						
Assets						
Current Assets						
Cash	72 169 000	- 31 073 000	41 096 000	71 709 029	30 613 029	54.9

During the audit of the Statement of Comparison of Budget and Actual Amounts, it was identified that the actual amount of cash as at 30 June 2019, was greater than the Final Budget amount. The difference of R30 613 029 was greater than R1 000 000 and 10% and consequently resulted in a reason reference 54.9 being provided in the Notes to the Annual Financial Statements in line with Accounting Policy 1.29 of the AFS.

Extract per AFS note 54.9:

*“Cash was **reduced** to accommodate additional capital projects requirements funded through internal funds.”*

Based on the results of the above, it is clear that cash was **increased** by R30 613 029 as compared to the budget amount of R41 096 000 and not **reduced** per managements comment above. The narrative reason was therefore found to be incorrectly reported in the AFS.

Internal control deficiency**Financial and Performance Management**

Management did not prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information.

Furthermore, management did not perform adequate reviews to ensure that the disclosure narrative is accurately reported.

Recommendation

Management should amend the Statement of Comparison of Budget and Actual Amounts to accurately report the increase in the cash and cash equivalents balance in the AFS.

Management should furthermore also strengthen its review processes of the financial statements to ensure that the figures and narratives are accurately supported per review thereof.

Management response**Management comment on the audit finding:**

Issue 1:

Management agrees with the finding. The financial statements will be adjusted accordingly.

Issue 2:

Management agrees with the finding. This however does not affect the total cash outflow from operating activities disclosed in the cash-flow statements and will be adjusted in the financial statements.

Issue 3:

The reason for the difference between budget and actual is correctly indicated in paragraph 54.9 as the budgeted cash was reduced as there was anticipated by the budget department that additional funding would be required for capital projects from internal funds. However, this capital projects were deferred and will only take place in the 2020 year. The sentence refers to the budgeted cash that was reduced and not the actual cash.

Management comment on the root cause identified within the audit finding:

The disclosure narrative was adequately reported as it was clearly the budgeted amount that reduced from the approved budget to the final budget.

Management comment on the recommendation**Issue 2:**

Management will adjust the relevant line items as part of the net cash flows from operating activities in the cash flow statement.

Issue 3:

Management will adjust paragraph 54.9 narrative to specify budgeted cash:

“Budgeted cash was reduced to accommodate additional capital projects requirements funded through internal funds.”

Remedial action:

What actions will be taken:	By whom:	By when:
Management will adjust the financial statements as indicated in the response on the recommendation.	CFO	23 November 2019
If the above findings affects an amount (s) disclosed in the financial statements:	YES	
Please give an indication of whether the correcting journal entry shall be processed:		N/A
If yes, please indicate the accounting entry:		
n/a		
If no, please provide the reason why such a conclusion:		
n/a		

Auditor's conclusion**Issue 1:**

Management's response is noted. The auditors inspected the adjusted AFS and confirmed that the necessary adjustments were made. The finding will however remain in the management report as an "other important matter" to highlight the internal control deficiency identified.

Issue 2:

Management's response is noted. The auditors inspected the adjusted AFS and confirmed that the necessary adjustments were made, with the exception of the below mentioned:

Management adjusted the suppliers and employees line item in the Statement of Comparison of Budget and Actual Amounts, however, the adjustment was incorrect. The following difference remains.

Line item	Actual amounts on comparable basis as per the Statement of Comparison of Budget and Actual Amounts (Updated) (R)	Amount as per the Cash Flow Statement (R)	Difference (R)
Suppliers and employees	- 666 241 406	- 670 392 585	4 151 179

The finding will therefore remain in the management report as an "other important matter."

Issue 3:

Management's response is noted. The auditors inspected the adjusted AFS and confirmed that the necessary adjustments were made. Therefore this issue is resolved.

Contingent assets Disclosure Misstated – COMAF 33

Audit Finding

The Municipal Finance Management Act no. 56 of 2003 (MFMA), section 122 (1) (a) states that:

“Every municipality and every municipal entity must for each financial year prepare annual financial statements which fairly presents the state of affairs of the municipality or entity, its performance against its budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results, and its financial position as at the end of the financial year.”

Paragraph 17 of the Standard of Generally Recognised Accounting Practice – Presentation of Financial Statements (GRAP 1), states that:

“Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, revenue and expenses. The application of Standards of GRAP with additional disclosures, when necessary, is presumed to result in financial statements that achieve a fair presentation.”

Paragraph 44 of the Standard of Generally Recognised Accounting Practice – Presentation of Financial Statements (GRAP 1), states that:

“Except when a Standard of GRAP permits or requires otherwise, comparative information shall be presented in respect of the preceding period for all amounts reported in the financial statements. Comparative information shall be included for narrative and descriptive information when it is relevant to an understanding of the current period’s financial statements.”

Paragraph 45 of the Standard of Generally Recognised Accounting Practice – Presentation of Financial Statements (GRAP 1), states that:

“An entity shall present, as a minimum, two statements of financial position, two statements of financial performance, two cash flow statements and two statements of changes in net assets, and related notes.”

Paragraph 46 of the Standard of Generally Recognised Accounting Practice – Presentation of Financial Statements (GRAP 1), states that:

“In some cases, narrative information provided in the financial statements for the preceding period(s) continues to be relevant in the current period. For example, details of a legal dispute, the outcome of which was uncertain at the end of the preceding period and is yet to be resolved, are disclosed in the current period. Users may benefit from the disclosure of information that the uncertainty existed at the end of the preceding period, and about the steps that have been taken during the period to resolve the uncertainty.”

During the audit of disclosure note 43 of the Notes to the Annual Financial Statements for the year ended 30 June 2019 for contingencies, the following was identified:

No information pertaining to the contingent assets disclosed in the Annual Financial Statements for the year ended 30 June 2018 was disclosed in the Annual Financial Statements for the year ended 30 June 2019. As per paragraph 46 of GRAP 1, the narrative information would be relevant in the current period, as the details of the dispute was uncertain at the end of the preceding period and was yet to be resolved. The users would benefit from the steps that have been taken to resolve the

uncertainty or the reason why the contingent assets disclosed in the prior year was removed in the current year.

The details of the contingent assets for which comparative information was not disclosed is as follows:

Property	Possible Classification	Valuation (R)
Portion 1, 2 and 3 of the farm 215 Walkers Point	Investment Property	20 200 000
Erf 20 – Belvidere	Investment Property	460 000
Erf 21 – Belvidere	Investment Property	460 000
Erf 22 – Belvidere	Investment Property	460 000
Erf 2790 Knysna	Property, plant and equipment	2 900 000
Portion 22 of farm 191 Westford	Investment Property	600 000
Portion 0, 1 and 2 of farm 185 George road - Swartvlei Caravan Park	Property, plant and equipment	39 000 000
TOTAL:		64 080 000

Due to the omission of the comparative information as required by GRAP 1, fair presentation of note 43 of the financial statements was not achieved.

Internal control deficiency

Financial and Performance Management

Management did not prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information.

Management did not adequately review the Annual Financial Statement to ensure that the comparative disclosure, as required by GRAP 1, is included in the Notes to the Annual Financial Statements for the year ended 30 June 2019.

Recommendation

Management should strengthen its review processes of the financial statements to ensure that the figures and narratives reported are complete.

Management should amend note 43 of the Notes to the Annual Financial Statements for the year ended 30 June 2019, to include the comparative information of the contingent assets disclosed in the prior year.

Management response

Management comment on the audit finding:

Management disagree that fair presentation was not achieved and that the disclosure is not in accordance with GRAP 1. Please see below the paragraphs quoted in the finding with explanations as to how this was treated by Knysna municipality:

Paragraph 44 of the Standard of Generally Recognised Accounting Practice – Presentation of Financial Statements (GRAP 1), states that:

“Except when a Standard of GRAP permits or requires otherwise, comparative information shall be presented in respect of the preceding period for all amounts reported in the financial statements.

Comparative information shall be included for narrative and descriptive information when it is relevant to an understanding of the current period's financial statements."

It is consequently clear from GRAP 1 that all comparative disclosure from the prior year financial statements are not required to be disclosed.

Paragraph 45 of the Standard of Generally Recognised Accounting Practice – Presentation of Financial Statements (GRAP 1), states that:

"An entity shall present, as a minimum, two statements of financial position, two statements of financial performance, two cash flow statements and two statements of changes in net assets, and related notes."

Par 45 was adhered to as this minimum level of disclosure was done.

Paragraph 46 of the Standard of Generally Recognised Accounting Practice – Presentation of Financial Statements (GRAP 1), states that:

"In some cases, narrative information provided in the financial statements for the preceding period(s) continues to be relevant in the current period. For example, details of a legal dispute, the outcome of which was uncertain at the end of the preceding period and is yet to be resolved, are disclosed in the current period. Users may benefit from the disclosure of information that the uncertainty existed at the end of the preceding period, and about the steps that have been taken during the period to resolve the uncertainty."

Once again par 46 states that in some cases it continues to be relevant. This also makes it clear that all comparative information from the previous year financial statements does not have to be disclosed. It is clear that only where the matter in the previous year is yet to be resolved disclosure is required. Par 46 is consequently not applicable as the contingent matter was resolved prior to year-end. Consequently, steps taken to resolve the uncertainty still existing at year, as to which par 46 refers, is not applicable.

In summary, as this matter was resolved during the year, per the requirements of GRAP 1 as quoted, the comparative disclosure for the contingent assets is not required by GRAP 1.

In addition, the disclosure requirements of GRAP 19 - Provisions, Contingent Liabilities and Contingent Assets, state the following:

- .106 Where an inflow of economic benefits or service potential is probable, an entity shall disclose a brief description of the nature of the contingent assets at the reporting date, and, where practicable, an estimate of their financial effect, measured using the principles set out for provisions in paragraphs .43 to .59.*
- .109 It is important that disclosures for contingent assets avoid giving misleading indications of the likelihood of revenue arising.*

There are no specific disclosure requirements in GRAP 1 (as evaluated and stated above) or GRAP 19 - Provisions, Contingent Liabilities and Contingent Assets, requiring the comparative disclosure. In fact, as there is no contingent asset at the reporting date there is no disclosure to be made per GRAP 19 par 106.

Par 109 of GRAP 19 also makes it clear that misleading disclosures should be avoided. As per our evaluation to disclose comparative information about a possible contingent asset that did not exist

at reporting date anymore would result in misleading disclosures which would in fact then not be a fair presentation.

From all the above, the disclosure is not required by GRAP 1 nor GRAP 19.

Management comment on the root cause identified within the audit finding:

We disagree as the disclosure is as per the requirements of GRAP 1.

Management comment on the recommendation:

We disagree as the disclosure is as per the requirements of GRAP 1.

Remedial action:

What actions will be taken:	By whom:	By when:
None		
If the above findings affects an amount (s) disclosed in the financial statements:		NO
Please give an indication of whether the correcting journal entry shall be processed:		N/A
If yes, please indicate the accounting entry:		
N/a		
If no, please provide the reason why such a conclusion:		
N/a		

Auditor's conclusion

Management's response is noted.

The auditors are however in disagreement with management.

As per paragraph 46 of the Standard of Generally Recognised Accounting Practice – Presentation of Financial Statements (GRAP 1):

“In some cases, narrative information provided in the financial statements for the preceding period(s) continues to be relevant in the current period. For example, details of a legal dispute, the outcome of which was uncertain at the end of the preceding period and is yet to be resolved, are disclosed in the current period. Users may benefit from the disclosure of information that the uncertainty existed at the end of the preceding period, and about the steps that have been taken during the period to resolve the uncertainty.”

The assets were disclosed as contingent assets in the prior year, as uncertainty existed at the end of the preceding period and was yet to be resolved. The uncertainty was resolved during the financial period under review. Consequently, the users will benefit from the disclosure of information about the uncertainty that existed at the end of the preceding period and the steps that have been taken during the period under review to resolve the uncertainty. This disclosure is relevant to the users understanding of the current period's financial statements, as this will allow the users to understand why the assets were disclosed as contingent assets in the prior year, but not in the current year.

Furthermore, management is correct in stating that disclosure should not mislead users of the likelihood of revenue arising. However, the disclosure of comparative information will not mislead the users, as the users will see that there is no likelihood of revenue arising, as the assets are not disclosed as contingent assets in the current year. The disclosure should explain to the users how the uncertainty surrounding the assets were resolved and consequently the disclosure will be clear that no revenue will arise from the assets as they are no longer contingent assets.

Subsequent to discussions with management, management agreed that the annual financial statements (AFS) are to be updated as the information will be useful to the users.

The auditors inspected the updated AFS and confirmed that the necessary amendments were made.

The finding will however remain in the management report as an “other important matter” for the internal control deficiency to be addressed.

Presentation and disclosure – COMAF 35

Audit finding

The Municipal Finance Management Act no. 56 of 2003 (MFMA), section 122 (1) (a) states that:

“Every municipality and every municipal entity must for each financial year prepare annual financial statements which fairly presents the state of affairs of the municipality or entity, its performance against its budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results, and its financial position as at the end of the financial year.”

The Municipal Finance Management Act no. 56 of 2003 (MFMA), section 125 (2), states that:

“The notes to the annual financial statements of a municipality or municipal entity must disclose the following information:

- (a) In respect of each bank account held by the municipality or entity during the relevant financial year –*
 - (i) the name of the bank where the account is or was held, and the type of account; and*
 - (ii) year opening and year end balances in each of these bank accounts.”*

Paragraph 17 of the Standard of Generally Recognised Accounting Practice – Presentation of Financial Statements (GRAP 1), states that:

“Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, revenue and expenses as set out in the Framework for the Preparation and Presentation of Financial Statements. The application of Standards of GRAP with additional disclosures when necessary is presumed to result in financial statements that achieve a fair presentation.”

Paragraph 19 of the Standard of Generally Recognised Accounting Practice – Presentation of Financial Statements (GRAP 1), states that:

“In virtually all circumstances, a fair presentation is achieved by compliance with applicable Standards of GRAP. A fair presentation also requires an entity:

- b) to present information, including accounting policies, in a manner which provides relevant, reliable, comparable and understandable information.”*

Issue 1 – Incorrect disclosure of call account

During the audit of Long-term Investments and Receivables (Note 4) we identified that the Investec 021941-500 account is being referred to as account 021941-420.

In addition, the ABSA - 9328139285 account disclosed was closed on 26/06/2018, and should thus not have any balances disclosed. The name of the account is incorrect and should be the Old Mutual bank account 500050890 instead of ABSA - 9328139285.

Issue 2 – Incorrect disclosure of ceded accounts

During the audit of long term liabilities, the following issue was identified:

In note 15 of the Notes to the Annual Financial Statements for the year ended 30 June 2019, the amount of the Nedbank account (Call Investment Deposit - 03/7881531940/54) that is ceded to the

Development Bank of Southern Africa (DBSA) does not agree to the amount as per the confirmation received from the DBSA. The difference is detailed below:

Amount as per note 15 of the AFS	Amount as per the confirmation from the DBSA	Difference
11 856 922.00	9 737 188.68	2 119 733.32

The identified finding has led to a factual misstatement of R2 119 733.32 and the overstatement of the amount disclosed in note 15 as being pledged as a guarantee.

Issue 3 – Incorrect disclosure of property rates tariffs

During the audit of the disclosure of revenue from non-exchange transactions: Property rates, it was identified that the incorrect tariff was disclosed in note 24 to the annual financial statements for the year ended 30 June 2019, for property rates levied on domestic properties and businesses. The tariffs disclosed was R0.0072969 and R0.0145948 respectively. The tariffs for domestic and business properties that should have been disclosed is R0,00711900 and R0,01423880 respectively, as per the approved tariffs, charges and fees for 2018/2019.

Internal control deficiency

Financial and performance management

Management did not prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information.

Management did not adequately review the Annual Financial Statements to ensure that the disclosures are accurate.

Recommendation

Management should amend notes 9,15 and 24 of the Notes to the Annual Financial Statements for the year ended 30 June 2019, to correct the incorrect disclosure identified above.

Management should strengthen its review processes of the financial statements to ensure that the disclosures are accurate and complete.

Management response

Management comment on the audit finding:

Management agrees with issue 1 and 3, the financial statements will be adjusted accordingly.

Management disagrees with issue 2 as the total investments are ceded to DBSA. DBSA erroneously used the balance as per the 2016 financial year end for the confirmation and did not use the correct balances at year end (30 June 2019) for these investments in their initial confirmation. Refer to the updated confirmation as received from the DBSA attached to the finding.

Management comment on the root cause identified within the audit finding:

Management take note of the root cause. The financial statements were however reviewed by various parties, including internal audit and the audit committee on a higher level. These agreed disclosure errors are immaterial and would not have been picked up by the high level review process.

<u>Management comment on the recommendation:</u>			
The financial statements will be adjusted accordingly, with reference to issues 1 and 3.			
The ceded amounts disclosed in note 15 is accurately disclosed as confirmed with the correct confirmation received from DBSA.			
<u>Remedial action:</u>			
<u>What actions will be taken:</u>	<u>By whom:</u>	<u>By when:</u>	
Note 4,9 and 24 will be adjusted accordingly.			
If the above findings affects an amount (s) disclosed in the financial statements:	YES		
Please give an indication of whether the correcting journal entry shall be processed:			N/A
If yes, please indicate the accounting entry:			
n/a			
If no, please provide the reason why such a conclusion:			
n/a			

Auditor's conclusion

Issue 1

Management's response is noted. The auditors inspected the updated annual financial financial statements (AFS) and confirmed that the necessary amendments were made. The finding will however remain in the management report as an "other important matter" to highlight the internal control deficiency identified.

Issue 2

Management's response is noted. Audit inspected the updated confirmation from the Development Bank of Southern Africa (DBSA) and confirmed that the amount disclosed in note 15 as being pledged as a guarantee agreed to the amount as per the confirmation. The finding is therefore resolved.

Issue 3

Management's response is noted. The auditors inspected the updated AFS and confirmed that the necessary amendments were made.. The finding will however remain in the management report as an "other important matter" to highlight the internal control deficiency identified.

Use of Consultants – COMAF 37

Background

Knysna Municipality appointed Mubesko Africa (Pty) Ltd / Moore Stephens Mo Inc Consortium in terms of Regulation 32 of the Municipal Supply Chain Regulations by using tender number SBM 56 of 2017/2018 of Saldanha Municipality. The contract period is for three years commencing on the 1 July 2018 to the 30 June 2021. Based on the reference letter to Mubesko Africa (Pty) Ltd, Knysna Municipality confirmed that the consortium was appointed to perform the following services:

- Assistance on GRAP compliant annual financial statements
- Assistance on GRAP compliant consolidated annual financial statements
- Assistance on the audit file and working papers supporting the financial statements
- Assistance with the audit process
- Assistance with the physical verification of assets, both movable and immovable assets
- Assistance with compilation of a GRAP compliant fixed asset register
- Assistance with mSCOA implementation
- Compilation of annual budget
- Review and develop account policies
- Ongoing skills transfer

Audit Finding

During the audit of the use of consultants, we determined that this consultant is appointed for a three-year period as the municipality is reliant on the consultant to provide accounting services and ongoing skills transfer services as there is a scarcity of accounting skills in-house.

However, we could not establish if a formal skills transfer plan was in place between the municipality and Moore Stephens, which could result in the municipality being continually dependent on consultants to prepare the annual financial statements as staff are not appropriately upskilled.

Internal control deficiency

Leadership

Implement effective HR management to ensure that adequate and sufficiently skilled resources are in place and that performance is monitored.

Management did not ensure that a formal transfer skills plan was in place.

Recommendation

Management should ensure that a formal transfer skills plan is prepared and agreed with the consultant relating to the upskilling of staff in respect of accounting and auditing concepts and processes.

Management response**Management comment on the audit finding:**

Management agrees in so far as not having a formal skills transfers plan between Knysna Municipality and Moore Stephens.

Management comment on the root cause identified within the audit finding:

Management agrees in so far as not having a formal skills transfers plan between Knysna Municipality and Moore Stephens.

However management want to bring to the attention of the AG the following:
CFO has evaluated the staff qualification and developed a program to assist staff with relevant accounting qualification. Most of the staff were enroll in this program. The following articles was publisized and other neighbouring Muniicplaities were invited to participate.

*Articles: Knysna Municipality brings SAIPA Project Achiever Extended Programme to the Garden Route
Dear readers*

We are proud to announce that Knysna municipality is hosting the South African Institute of Professional Accountants (SAIPA) Project Achiever Extended Programme, which will run from 12 July 2019 till 02 November 2019.

The initiative is designed to prepare candidates for the SAIPA Professional Evaluation exam, allowing them to become a Professional Accountant (SA). Ordinarily the course is being conducted in the capital city of each province. In the Western Cape, it is conducted in Cape Town.

This initiative comes after the CFO made an evaluation of the staff qualification within finance department. This evaluation come because of an audit finding last year of which the CFO had to develop an action plan on how the audit finding will be addressed. The audit finding relate to most of the finance staff not having an accounting qualification. The Auditor General raised a finding on this matter and indicated that this has a risk for the Municipality to be reliant on consultants. The CFO of Knysna Municipality negotiated with SAIPA to conduct the classes in Knysna to afford our qualifying employees the opportunity to attend while saving cost for accommodation and travel and substance to Cape Town.

More information on the Program are available on the website of SAIPA www.saipa.co.za

The idea is to firstly ensure that staff possess the relevant and necessary accounting theory. the in-house, undocumented training is being done by Moore Stephens.

Management comment on the recommendation:

Management take note of the recommendations.

Remedial action:

What actions will be taken:	By whom:	By when:
Proper job descriptions have been prepared, staff have been placed in positions and all finance staff will sign personal development plan and undergo a focus training.	CFO	Ongoing. Started 1 July 2019 and will be completed in 30 June 2021.
If the above findings affects an amount (s) disclosed in the financial statements:		NO
Please give an indication of whether the correcting journal entry shall be processed:		N/A

<p>If yes, please indicate the accounting entry:</p> <p>N/A</p>
<p>If no, please provide the reason why such a conclusion:</p> <p>N/A</p>

Auditor's Conclusion

Managements responses are noted. The finding will however remain in the management report as an "other important matter" to highlight the internal control deficiency identified.

Traffic fines overstated - COMAF 3

Audit finding

The Municipal Finance Management Act no. 56 of 2003 (MFMA), section 122 (1), states that:

“Every municipality and every municipal entity must for each financial year prepare annual financial statements which -

- (b) fairly presents the state of affairs of the municipality or entity, its performance against its budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results, and its financial position as at the end of the financial year.”*

Paragraph 90 of the Standard of Generally Recognised Accounting Practice: Revenue from Non-Exchange Transactions (Taxes and Transfers) (GRAP 23) states that:

“Fines normally require an entity to transfer a fixed amount of cash to government and do not impose on the government any obligation that may be recognized as a liability. As such, fines are recognized as revenue when the receivable meets the definition of an asset and satisfies the criteria for recognition as an asset set out in paragraph 30. As noted in paragraph 11, where an entity collects fines in the capacity of an agent, the fine will not be revenue of the collecting entity. Assets arising from fines are measured at the best estimate of the inflow of resources to the entity.”

Paragraph 30 of GRAP 23 states that:

“Other than services in-kind not recognized in terms of paragraph 99, an inflow of resources from a non-exchange transaction that meets the definition of an asset shall be recognized as an asset when, and only when:

- c) it is probable that the future economic benefits or service potential associated with the asset will flow to the entity; and*
- d) the fair value of the asset can be measured reliably.”*

Based on the application of paragraph 30, traffic fines should be recognised in the accounting period that the offence occurs, as it is probable that future economic benefits will flow to the entity and the fair value of the asset can be measured reliably at the date of the offence.

During the audit of traffic fines, the following fines were identified which occurred in the 2017-18 financial year, but was erroneously recorded in the 2019 financial year.

Number	Notice number	Date of offence	Issued amount (R)
1	90/63925/657/128597	29-06-2018	200.00
2	90/63929/657/128605	29-06-2018	200.00
Total:			400.00

This identified finding has led to a factual misstatement of R400.00, which is projected to a misstatement of R4 227 132.69.

The misstatement identified has resulted in the overstatement of revenue from non-exchange transactions: Fines, penalties and forfeits for the 2019 financial year. The misstatement has also led to the understatement of revenue from non-exchange transactions: Fines, penalties and forfeits for the 2018 financial year.

Internal control deficiency

Financial and performance management

Management did not prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information.

Management did not account for traffic fines issued in terms of GRAP 23 and did not perform thorough reviews of the schedules supporting the fines to ensure that all fines are accounted for correctly in the correct period.

Recommendation

Management should strengthen its review processes of the financial statements to ensure that the figures reported are accurate.

Management should examine the population to which the misstatement relates to understand the cause of the misstatement and to make the appropriate adjustments.

Management should process a retrospective restatement in terms of GRAP 3 to correct the omission of traffic fines issued in the previous financial year in the comparative figures.

Management should put in place controls to identify traffic fines issued in prior accounting periods, to ensure traffic fines are recorded in the correct accounting period.

Management should account for all fines issued in terms of GRAP 23.

Management response

Management comment on the audit finding:

We disagree with the comaf on the following two matters:

- i) Although the fines identified relates to the previous financial year it is not to be corrected retrospectively per the requirements of GRAP. This is due to the following:

As per the GRAP 3 par 4, a prior period error is defined as such:

“Prior period errors are omissions from, and misstatements in, the entity’s financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

- (a) was available when financial statements for those periods were authorised for issue; and***
- (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.***

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.”

These two fines are part of a total amount of R 861 100 of fines with dates relating to the prior year period which was not included in the report used during the compilation of the prior year financial statements. This was clearly identified and communicated to the auditors as part of the fines reconciliation and working papers. GRAP 3 par 4 (a) and (b) is therefore not applicable as no mistake or misinterpretation were made with the information available in the previous financial

year. There was no failure to use, or misuse of reliable information relating to fines received in the previous financial year.

Consequently, as per GRAP 3 this is not a prior year error and consequently retrospective correction as per GRAP is not required nor applicable.

As clearly indicated in our reconciliation provided for the auditor this R 861 100 is fines on the report received in the current year, which was not part of the report received in 2018 (prior year).

This was our argument and consequently the amount was recognised in the current year in line with the requirements of GRAP as retrospective correction only applies in instances of a prior period error and change in accounting policy, of which none apply in this current situation.

ii) The calculated extrapolation is fundamentally and mathematically incorrect. The total population of these identified fines, as indicated in our reconciliation is R 861 100. Also refer to the attached working paper comparing the prior year report used with the current year report clearly showing that the total population of prior year dated fines recognised in the current year only amounts to R 861 100.

In summary we disagree that there is any misstatement at all as the recognition of the R 861 100 in the current year is correct per the requirements of GRAP.

Management comment on the root cause identified within the audit finding:

We disagree with the root cause as the recognition is complete and accurate and per the requirements of GRAP as evaluated during the recognition of the fines and explained above.

Management comment on the recommendation:

It should be noted that this amount of R 861 100 relating to previous year fines was clearly indicated and communicated to the audit team as part of the submitted fines working papers and reconciliation. This was consequently not first identified by the audit but already identified and communicated to the auditors. This was identified as part of the financial statement compilation and review process and evaluated for GRAP compliance in treatment during the review process. It is consequently erroneous to recommend that the review process should be strengthened.

We also disagree that retrospective GRAP 3 correction should be made as explained above.

Remedial action:

<u>What actions will be taken:</u>	<u>By whom:</u>	<u>By when:</u>
None		
If the above findings affects an amount (s) disclosed in the financial statements:		NO
Please give an indication of whether the correcting journal entry shall be processed:		NO
If yes, please indicate the accounting entry:		
N/a		
If no, please provide the reason why such a conclusion:		
N/a		

Auditor's conclusion

Management's response is noted.

The auditors are in agreement with management's response that the fines identified in the communication of audit finding were correctly recognised in the current year in line with the requirements of GRAP.

Consequently, the auditors had to reassess the revenue from fines, penalties and forfeits. During the reassessment, it was identified that fines with offence dates in the 2018/2019 financial year, but with issue dates in the 2019/2020 financial year, were erroneously recorded in the 2018/2019 financial year.

The identified misstatement has resulted in the factual overstatement of revenue from non-exchange transactions: Fines, penalties and forfeits by R4 868 200 for the 2018/2019 financial year. As management did not correct the AFS this will be taken to the statement of uncorrected misstatements for further assessment.

Assets - Non-compliance with GRAP – COMAF 38

Issue 1

Investment Property- Disclosure for investment properties that do not produce rental income

Para 91 of the Standard of Generally Recognised Accounting Practice (GRAP) 16 states:

“An entity shall disclose:

(e) the amounts recognised in surplus or deficit for:

(i) rental revenue from investment property;

(ii) direct operating expenses, separately disclosing repairs and maintenance arising from investment property that generated rental revenue during the period; and

(iii) direct operating expenses, separately disclosing repairs and maintenance arising from investment property that did not generate rental revenue during the period;”

During the audit of investment property, it was noted that the municipality did not disclose the repairs and maintenance arising from investment property that did not generate rental revenue during the period resulting in non-compliance with GRAP 16.91(e)(iii).

Internal control deficiency

Financial and performance management

Review and monitor compliance with applicable laws and regulations

Management did not adequately review the annual financial statements to ensure that all disclosure requirements per GRAP 16 were adhered to.

Recommendation

It is recommended that management reassess the costs incurred on investment property that did not generate rental revenue for both the current financial year and the prior comparative period and amend the financial statement to accurately account for this disclosure requirement in line with GRAP 16.91(e)(iii) requirements.

Issue 2

Impairment Indicators Assessment- Heritage Assets

The Standard of Generally Recognised Accounting Practice (GRAP) 103 states:

“.62 A heritage asset shall not be depreciated but an entity shall assess at each reporting date whether there is an indication that it may be impaired. If any such indication exists, the entity shall estimate the recoverable amount or the recoverable service amount of the heritage asset.

.63 In assessing whether there is an indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications:

External sources of information

(a) During the period, a heritage asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use.

(b) The absence of an active market for a revalued heritage asset.



Internal sources of information

(a) Evidence is available of physical damage or deterioration of a heritage asset.

(b) A decision to halt the construction of the heritage asset before it is complete or in a usable form."

During the audit of heritage assets, it was noted that the municipality did not assess heritage assets for any indications of impairment resulting in non-compliance with GRAP 103.62.

Internal control deficiency

Financial and performance management

Review and monitor compliance with applicable laws and regulations

Management only assessed asset items which highlighted indicators of impairment during the annual asset verification process and this was not extended across all heritage asset items as required by GRAP.

Recommendation

It is recommended that management incorporates the assessment of impairment indicators at each reporting date for heritage assets. These assets are not depreciated and therefore this assessment is essential to ensure the accuracy of their valuation from year to year. The financial statements should also be amended with any additional impairments which may be identified through this exercise.

Management response

Management comment on audit finding

Issue 1

The total value of direct operating expenses incurred during the year on investment property all relates to Investment Property that generated rental income. Consequently, the total amount of R 306 507 as disclosed in the Financial statements was disclosed as such.

We consequently disagree with the finding as there were no other expenditure to be disclosed.

Issue 2:

The process at Knysna is to issue internal memorandums to all relevant departments to assess all assets under their control for indicators of impairment. Please find attached the memorandum communicated for the 30 June 2019 audit.

We disagree with the finding statement that the municipality did not assess heritage assets for indicators of impairment as it is clear that all assets were assessed for indicators of impairment.

Management comment on internal control deficiencies		
Management disagrees with the finding. <ul style="list-style-type: none"> - The financial statements were reviewed by various parties. - The memorandum includes all assets within the municipality for assessment of indicators for impairment. 		
Management comment on recommendation		
Management disagrees with the finding and it is clear from the responses given that the recommendations were complied with during the year.		
Remedial action		
What actions will be taken:	By whom:	By when:
None		
If the above finding affects an amount(s) disclosed in the financial statements:		
Please give an indication of whether a correcting journal entry shall be processed		No
If yes, please indicate the accounting entry: N/A		
If no, please provide the reason why such a conclusion has been reached: N/A		

Auditor's conclusion

Management's response is noted and assessed as follows:

Issue 1

Managements response is noted but not accepted as not all investment property were subject to a rental lease agreement. Upon discussion with management it was also noted that the expenditure incurred herein were incidental costs like fuel costs used for the cutting of grass and therefore considered to be insignificant in relation to costs incurred on rental property. Consequently, any misstatements herein is not expected impact in the decision making ability of users of the financial statements.

The finding will therefore remain in the management report as an "other important matter" as therein is an internal control deficiency which needs to be addressed.

Issue 2

Management's response is noted but not accepted as the memorandum submitted per the response only confirms the existence of the memorandum but does not detail whether these assessments were conducted as required or not which gave rise to this finding being reported.

The finding will therefore remain in the management report as an "other important matter" as therein is an internal control deficiency which needs to be addressed.

Bloemfontein housing project of 150 top structures in Knysna - COMAF 1

BACKGROUND

One of the strategic objectives of the municipality is to improve and maintain current basic service delivery through specific infrastructural development projects. Housing delivery of the municipality is dependent on funding from other spheres of government and there is an increased demand for adequate housing.

In October 2016, the municipality applied for funding for the Bloemfontein Housing Project of 150 top structures (project) at the Western Cape Department of Human Settlements (DoHS) via the Upgrading Informal Settlements Programme (UISP). The project was seen as a necessity as housing received priority in the municipality's Integrated Development Plan (IDP)¹⁹. Bloemfontein is an existing informal settlement of more than 25 years that is situated in the north of Knysna where the people live in poor conditions. The area is also congested with informal structures.

The head of the DoHS confirmed the financial details for the project on 7 September 2017 to the amount of R21 612 562. This included the appointment of the municipality as the accounts administrator in terms of the Peoples Housing Empowerment Process (PHEP)²⁰. The breakdown of the approved subsidy amount is indicated in table 1 below:

Table 1: Subsidy amount approved by DoHS

Description	Units	Amount per unit	Total
Houses construction subsidy	150	R140 975	R21 146 250
Disability allowance	8	R53 189	R425 512
Grant Funding	150	R272	R40 800
Total excluding VAT			R21 612 562

After the tender evaluation report dated 24 April 2018 indicated that the construction works for each unit would cost R158 857, the municipality had to apply for additional funding on 30 April 2018 from the DoHS in order to proceed with the project. The DoHS approved the revised funding on 24 July 2018 to the amount of R22 937 396²¹. The revised funding allocated is indicated in the table below:

Table 2: Revised subsidy amount approved by DoHS on 24 July 2018

Description	Units	Amount per unit	Total
Houses construction subsidy	150	R149 654	R22 448 100
Disability allowance	8	R56 062	R448 496
Grant funding	150	R272	R40 800
Total excluding VAT			R22 937 396

A contract was awarded on 15 June 2018 to A and P Civils and Trading (contractor) for the amount of R21 662 369 (excluding VAT) to construct the 150 double storey top structures consisting of two

¹⁹ The IDP is the principal strategic instrument of a municipality that gives effect to its developmental mandate as enshrined in the Constitution of South Africa. The external focus of an IDP is to identify and prioritize the most critical developmental challenges of the community whilst organizing internal governance and institutional structures in order to address those challenges

²⁰ The process where beneficiaries are actively involved in the decision making over the housing process, product and make a contribution towards the building of their own homes

²¹ The amount excludes a 6.5% contingency fee for the DoHS project manager of R1 408 054 and a National Home Builders Registration Council (NHBRC) allowance of R137 797 that did not form part of the allocation

bedrooms, one separate bathroom with a shower, one hand basin and toilet, one combined kitchen living area as well as a pre-paid ready board electrical installation.

Chauke Quantity Surveyors and Project Managers (Chauke) were appointed as the external project manager for the project and were responsible for the contract administration on behalf of the municipality. The project was divided into two phases and it included the following:

- Phase one: 75 duplex units made up of 28 x 2 units in a row blocks, 5 x 3 units in a row blocks and 1 x 4 units in a row block
- Phase two: 75 duplex units made up of 5 courtyard blocks x 15 units in a block.

The commencement date of the project was 16 August 2018 and the estimated duration of the project was 12 months with a 30 days' relocation time between phases one and two. The original planned completion date for phase one was set at 10 February 2019 and the original planned completion date for phase two was set at 6 July 2019.

Management response

Reference is made to Communication No. 1 of 2019 dated 20 September 2019 and a response to issues raised is herein found below on the topics discussed. It should further be noted that the performance of the contractor concerned has been a source of concern between the municipality and its development and funding partner, the DoHS as well as the appointed project management team, Chauke. This is reflected in the various formal correspondence exchanges between the partners as well as Chauke as well as in various Bloemfontein project technical meetings whose records have been documented by our directorate.

Further to this, the Integrated Human Settlements (IHS) directorate has until recently not been fully capacitated to effectively deal with internal and external programme efficiencies for quite some time. To this end and in endeavouring to plug such an internal institutional weakness, a new Director: IHS (J Mkunqwana, with effect from June 2019) as well as Manager: IHS (Mr Lindile Petuna appointed with effect from 1 August 2019) and a finance officer on a contractual basis (Mr Herbert Daries with effect from 1 October 2019) will together be instrumental in providing much needed capacity relating to governance, performance, documentation of intellectual property and contract management efficiencies and coordination of the housing programme and related projects.

This process has already been initiated with the formulation and adoption of the following key milestones:

- Formulation and adoption of a new Knysna Municipality Strategic Integrated Human Settlements Plan
- The putting together of a new organisational structure which reflects such capacity, as well as review and designation of all existing housing posts to give form and structure to the proposed plan and envisaged operational efficiencies as an adequately capacitated directorate. This will also include reorientation, training and development of staff to undertake their respective duties on the basis of a collectively understood and supported policy framework that will consistently be applied on the basis of fair and good administrative behaviour across all divisions
- Putting together of a IHS policy framework and related operational procedures

- Improved cooperation and coordination of new housing projects (planned and active projects currently being implemented) in consultation with our project management teams appointed with the support of the DoHS.
- The project under focus, Bloemfontein, having been turned around to produce to date 48 units with the balance of 27 units to be handed over shortly notwithstanding the completion date for phase 1 having been delayed
- The necessary corrective measures being implemented which were necessary will include putting the contractor on terms if the balance of 27 units are not completed by end September 2019 still remain an option that will be followed in terms of the normal General Conditions of Contract process.

Auditor's response

The response is noted and the additional clarity that was provided is appreciated. It is also an indication that the municipality is pro-actively in the process of addressing the shortcomings.

AUDIT FINDINGS

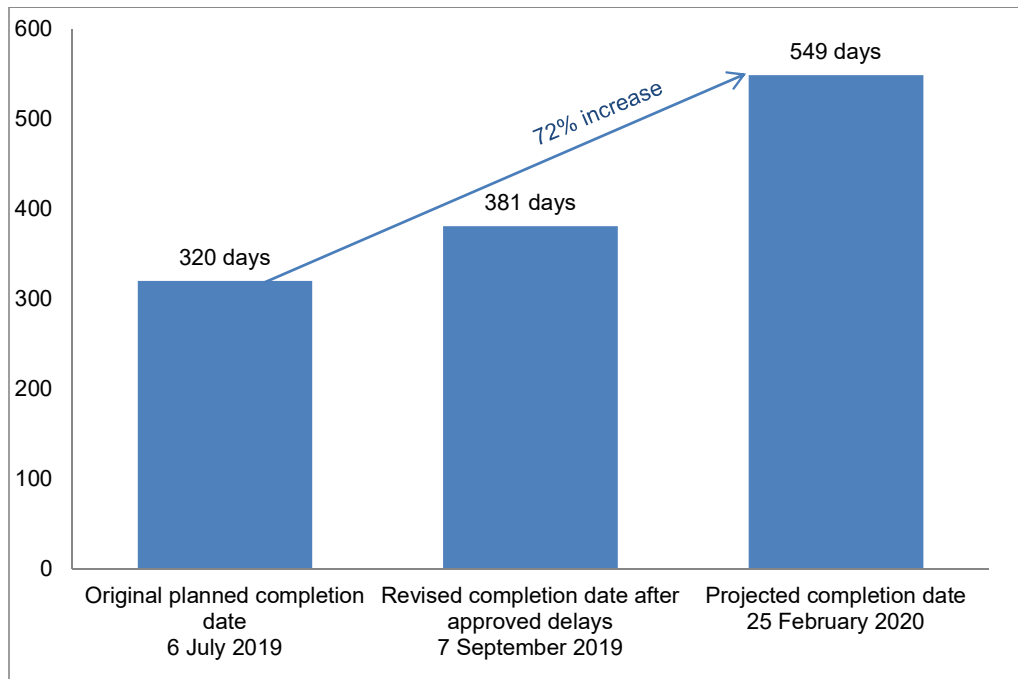
1. Delays experienced during the construction of the 150 top structures

Audit finding

- 1.1 Delays were experienced during the construction of the 150 double story houses. Even though the original planned completion date for the entire project was 6 July 2019, phase one of the project (50% of the total development) was only 15% completed as at 15 July 2019 and phase two has not even commenced as yet.
- 1.2 When the project started, the original planned completion date was 10 February 2019 for phase one and 6 July 2019 for phase two. These dates were later revised and approved to 21 March 2019 for phase one and 7 September 2019 for phase two. A new project plan was submitted by the contractor to the external project manager on 15 July 2019 and this indicated the projected completion date for the project would now be 25 February 2020, more than seven months after the original planned completion date of 6 July 2019 for the entire project. It is not clear whether the municipality approved the revised completion date of 25 February 2020 for the project.

The figure below indicates the delays in days for the project and if the project is completed on the new proposed completion date of 25 February 2020 without any further delays, the contractor would take 72% longer than originally planned. This is 229 days after the original planned completion date.

Figure 1: Delays in days for completion of the project



- 1.3 During the site visit by the audit team on 21 August 2019 pictures were taken of the construction site. The pictures below show that phase one of the project was at various stages of completion with 11 of the 75 units (15%) completed and the other 64 units (85%) in progress. Phase two of the project was not started yet.

Pictures 1 to 8: Status of work on the construction site as at 21 August 2019





- 1.4 Even though the contractor was put on terms²² on 2 October 2018 as well as on 6 February 2019 by the external project manager due to minimal progress on site, the poor performance continued. As a result, the municipality failed to provide for the community's demand for adequate housing and the community was unhappy with the progress on the project.

The external project manager indicated that the contract with the contractor could, however, not be terminated due to the following reasons:

²² When a contractor is put on terms, the contractor is in breach of the contract. The contractor should proceed with due diligence, regularity, expedition, skill and appropriate resources to bring the work to completion. If the breach is not remedied the employer reserves the right to terminate the contract

- Budgetary constraints. At the outset of the project the tender amount was above the subsidy amount provided²³ by the DoHS and to introduce a new contractor at this time would escalate the costs more. Escalation of prices of at least 18 months had to be added and according to the latest Bureau of Economic Research this would add another 7% to the costs.
- Delays. To terminate the contract due processes must be followed and a new bill of quantities (BOQ) must be prepared to go out on tender again. By the time the site is handed over to the new contractor at least another six months would have expired.
- Damages. Once the current contractor moves off site there is a risk of vandalism of the works. Security is expensive and not always considered effective.

The external project manager therefore recommended to the DoHS on 31 July 2019 that the current contractor continued with the project as well as to execute the work on phase two. The contractor's progress had to be monitored in terms of the revised programme provided as well as their resources on site and any delays would then immediately result in a contractual notice to put them on terms as per clause 29.1.2 of the Joint Buildings Contract Committee (JBCC) contract.

Root cause

1.5 The construction of the 150 double story houses was delayed due to the following:

- The conditions of the contract between the municipality and DoHS required that 90% of the labour employed on the contract should be procured from the local community. The contractor, however, had problems with the skills of the local community and indicated that there were no local skills available for the construction of first floor slabs and that they had to negotiate with external teams. The contractor then encountered a shutdown on the project when they wanted to introduce skilled people from outside the community. According to the contractor, the challenges with using local labour remained as absenteeism was a problem, especially after a pay weekend.
- The conditions of the contract between the municipality and DoHS required that 20% of the project value should be allocated to local subcontractors. The contractor expressed concern about this target as none of the local subcontractors could supply the required material. In addition, the Community Liaison Officer (CLO) was also not able to come up with subcontractors that could supply the required material.
- The contractor expressed frustration with the local workers and subcontractors who failed to follow procedures as far as the Personal Protective Equipment (PPE) is concerned. The workers were continuously issued with equipment but they failed to wear it. When the contractor addressed this issue they were threatened by action of closing the site when the rules are enforced.
- Delays were encountered by the contractor due to illegal electrical connections from the local community that had to be removed, which prevented the construction work to start. Wires were running across the site for electrification for units on the one side of the road to the other side of the road and the CLO had to intervene. These illegal

²³ The original subsidy amount from DoHS for the construction was R21 146 250 (excluding VAT) and the contractor's original tender amount was R23 828 606 (excluding VAT). However, the municipal manager negotiated the contract amount down to R21 662 369 (excluding VAT)

electrical cables were later reintroduced on part of the site, however, the contractor was able to work around the problem.

- The contractor had cash flow problems due to technical reasons and the local workers could not be paid. There were also delays due to the late payment of subcontractors. The late payment of workers resulted in a lockout every two weeks. Lockouts are initiated by the employer and are a denial of employment during a labour dispute.
- The process of casting of slabs took longer than planned and this process had to be streamlined first to make up for some lost time.
- Delays in the pegging of the boundary pegs.
- Some of the work had to be redone and rectified. For example, the raft slabs had to be increased in size and some of the expansion joints were in the incorrect position. The stairs for the first 11 units were structurally not acceptable and had to be demolished and redone in totality. The ceiling boards were installed incorrectly and had to be rectified.
- Poor planning by the contractor in terms of a lack of materials and the supply of materials.
- Lack of project management by the contractor.
- Inclement weather.
- Community unrest that affected the workers' attendance and the delivery of retaining blocks and plaster sand.
- Ineffective project management by the municipality. Even though an external project manager was appointed that was responsible for the hands-on management of the project on behalf of the municipality, the municipality was still the administrator of the account and was therefore overall responsible to monitor the deliverables in the contract and oversee the project.

Internal control deficiency

- 1.6 The principle of effective leadership based on good governance including project management was not always applied.

Recommendations

- 1.7 Projects should be managed by the external project managers throughout their lifecycle to ensure quality work is delivered by the contractors in a timely manner. The external project managers should strengthen their coordination and management of the daily project activities in order to identify deviations from the deliverables early in the process. When the individual deliverables start to fall behind schedule, the external project manager together with the contractor should develop and implement an action plan to fast track the progress.
- 1.8 Project planning and design should be comprehensive, taking into account all the possible project risks and contingencies such as the non-availability of local workers with certain skills and subcontractors to supply the required materials etc. This should be done to avoid delays in completion of the projects.

- 1.9 The municipality's monitoring and oversight function should be strengthened. This includes, among others, adherence to project management principles, monitoring the actual progress on the site against the planned completion date and the contract amount, attending meetings etc. When the project starts to fall behind schedule, the municipality, specifically the project manager should intervene, develop and implement an action plan to fast track the project.

Management responses

- 1.10 It is correct that there were delays in relation to the project and as such the project did not start as originally planned due to various reasons that existed. Of importance is that this project was the first of its kind to be implemented within the municipality and supply chain management (SCM) processes followed, resulting in the appointment of a contractor who performed far greater than any of the other tenderers. Whilst this was the case, it was necessary for the municipality to negotiate the tender value down so that it is in line with the allocation by the DoHS, and this in fact had a further impact on sourcing of the material supply for the construction of the units.

Whilst there were delays in the projects, there was continuous assessment of the project to ensure that issues that were identified as the cause of delay were dealt with during the technical meetings which took place periodically with the involvement of all stakeholders inclusive of the DoHS and external service providers (Chauke and A&P) who were appointed to augment internal capacity.

As an assessment tool for the project during technical meetings, progress reports tabled at section 80 committee meetings and other project team meetings, it was required to have a realistic tool to monitor progress going forward and this was not meant as a validation of the poor performance which was identified during the technical meetings.

Due to the contractor being behind due to various sighted issues, which were illuminated due to continuous monitoring of the project, it became necessary that a revised programme be prepared to mitigate against the amount of time it would take for a new contractor to be appointed once the existing contract is terminated due to poor performance. There was a further risk associated with the amount it would cost in the case of a new supply chain management process being followed resulting in community unrest.

As a result of the techniques being applied, there was improved performance on the project resulting in 37 more units being completed in August 2019 and the 27 being in the final stages of completion, with the completion date being 30 September 2019 for phase 1. The contractor already started work towards phase 2 of the project while completing phase 1.

- 1.11 The root cause for non-performance is well documented in the minutes of the technical meetings where this issue was first identified and measures were taken to address this issue while keeping in mind consequences for decisions taken on the project. The most severe measure being putting the contractor on terms for non-performance.

IHS by its nature is used for employment creation and economic development and, as such, certain conditions are built up in the tender documents. To this end, our SCM and procurement policy obligates successful tenderers to reserve 20% of the value of the project for local subcontractors and use 90% of local labour as part of an empowerment drive. The imposed conditions related to the labour component and sub-contracting are included in each tender document and as such the tenderer ought to have known about them. From the beginning of the projects, these conditions were discussed with the

contractor as can be identified in the minutes of technical meetings. Skills development is then flagged as an issue that needs to be addressed within the building industry in the Knysna municipal area, especially in areas where projects of this nature are to be implemented.

Causes of delays were indeed identified during technical meetings and measures were taken to address the matters, whilst this was done by Chauke, this was discussed in technical meetings and agreed to by both the municipality and the DoHS.

1.12 The main contractor was new to the area and has limited ability in terms of management. The cash flow of the main contractor was and continues to be under pressure due to a very keen tender price despite the demonstrated ability during supply chain processes. Other external issues such as skills deficiency, reliability and sense of entitlement of the community became a challenge on the project, however, control measures were put in place to ensure performance of the contractor. During the SCM process, the indication was that the company had adequate financial and technical capacity to cater for a project of this size.

1.13 The municipality appointed an external project manager who was present on site on a daily basis and engaged the contractor continuously about quality and management. Issues around skills availability/deficiency is a matter identified prior to this project and is being addressed through the Enhanced Peoples Housing Process (EPHP) program where local contractors and members of the community are continuously capacitated. This is necessary as it will always be the case that community members will always claim ownership of the project in their area and expect benefits in the form of employment and sub-contracting. This matter has been flagged in this project as it was the first of its kind in the municipal area with lessons learned.

Internally, the municipality itself has undergone some changes from a situation where human settlements was under the planning and development directorate and due to the enormity of the responsibility, could not receive the required level of attention. The situation has since changed with the formation of a standalone directorate focusing on human settlements, which is currently being capacitated in terms of human resource capacity. Furthermore, an analysis of challenges experienced by the directorate in the past have been extensively debated and documented, resulting in a strategy document being presented to council on how to improve the operations of the directorate.

Auditor's response to 1.10 to 1.13

The responses are noted and the additional clarity that was provided is appreciated. It is also an indication that the municipality is pro-actively in the process of addressing the shortcomings. The audit finding will be included in the management report.

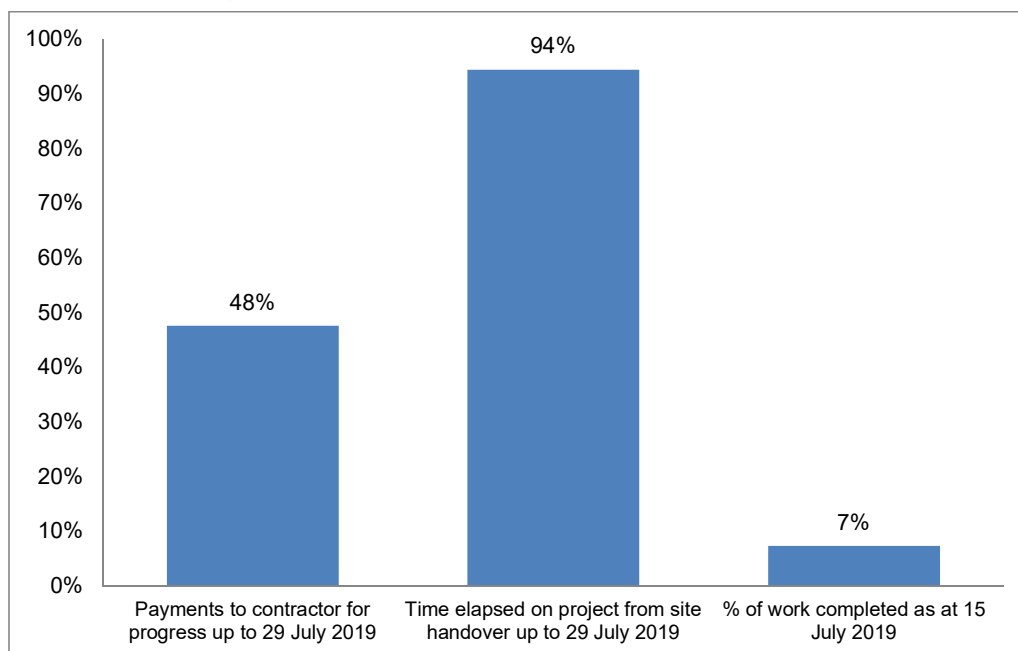
2. Misalignment between payments made and progress on the project

Audit finding

- 2.1 There was a misalignment between the % completion date, % of contract amount paid to the contractor and the actual progress on the project.

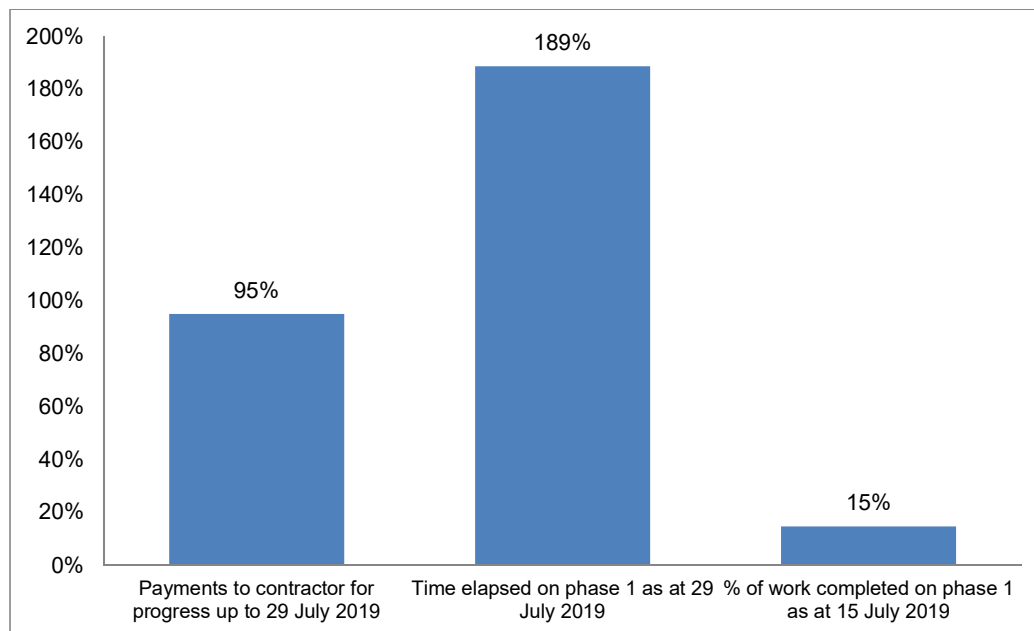
Even though more than 11 months (94%) of the 12 months' contract for the entire project has lapsed, the works on the ground were only at approximately 7% of the overall construction as at 15 July 2019. Also, 48% (R10 297 815 excluding VAT and payments for variation orders) of the total contract amount of R21 662 369 and 95% of the contract amount for phase one was already paid to the contractor as at 25 August 2019 for progress up to 29 July 2019. The figure below shows the misalignment between the dates, payments and actual completion for the entire project.

Figure 2: Misalignment between the dates, payments and actual completion of works for the entire project inclusive of phases one and two



- 2.2 As at 15 July 2019, the structural works for phase one (50% of the total development) was 15% complete as only 11 of the 75 units were handed over to the beneficiaries. The other 64 units were in various phases of completion and some were not even constructed as yet. The figure below shows the misalignment between the dates, payments and actual progress of works of phase one of the project. As at 29 July 2019, the contract period already expired and the municipality has expensed 95% of the available budget of the project for phase one, while only 15% of the units were completed and handed over to the beneficiaries.

Figure 3: Misalignment between the dates, payments and actual completion of works for phase one



Root cause

2.3 The following contributed to the misalignment between the dates, payments to the contractor and actual completion of the works on site:

- The monitoring and the reconciliation of the actual payments made towards the contractor *versus* the approved budget were not always done by the municipality. All the payment certificates indicated that the contract value was R21 662 369 plus a 10% contingency fee of R2 166 237, therefore totalling R23 828 606. The contract, however, only made provision for R21 662 369 and a 10% contingency fee on motivation. Therefore, the progress of the payments was measured against the incorrect contract amount.
- Ineffective project management and document administration by the municipality.
- DoHS agreed to delay the deduction of penalties to the contractor until the completion of the project.

Internal control deficiency

2.4 The principle of effective leadership based on good governance including project management was not always applied.

Recommendations

- 2.5 The municipality should strengthen the internal project management of infrastructure projects. This includes the reconciliation of the actual payments made to contractors *versus* the approved budget of the contract, including the actual progress on site.
- 2.6 The municipality should follow up the discrepancies in the contract amounts between the various project documents and update these to include the correct amounts. This will

ensure that the progress in terms of payments to the contractors would be measured against the correct contract amounts.

Management responses

- 2.7 It is documented through various technical committee meetings minutes that progress was well behind the programme, however, all payments to the contractor was meticulously calculated on actual progress and value created. Further on and to ensure that no over or under payments were done, a certificate of completion detailing work done is produced and attached with each tax invoice. Periodic inspections by municipal officials dedicated to the project are also carried out prior to any payment so as to validate such claims.
- 2.8 At the back of the payment certificates the progress is calculated per milestone (calculated per each individual house) and not against contingencies.
- 2.9 No retention fees are being withheld but a performance guarantees to the value of 10% of the contract was provided by the main contractor at the beginning of the project. It is therefore not understood how the root cause relates to the finding as there are measures implemented to protect the interest of government.
- 2.10 At all times, proper finance processes were adhered to with payment certificates being issued by the project manager to ensure that all payments relate to value created on site. Technical meetings held on site also discussed progress of the project which was then clarified against project milestones. Also, prior to processing and payment of an invoice additional inspections were carried out on site.
- 2.11 Municipal officials and the external project manager should continue to consistently follow a strict process in ensuring actual payments align to related progress on site by adhering to project governance as addressed above.

Auditor's response to 2.7

- 2.12 The responses are noted and the additional clarity that was provided is appreciated. The management response was not accompanied by documented evidence, such as dates, names of officials and detail of the periodic inspections that was done by the municipal officials prior to payments being made to the contractor as indicated in the management response. The audit finding will be included in the management report.

Auditor's response to 2.8

- 2.13 The responses are noted and the additional clarity that was provided is appreciated. The management response was not accompanied by documented evidence that the progress of the payments was measured against the correct contract amount. The audit finding will be included in the management report.

Auditor's response to 2.9

- 2.14 The responses are noted and the additional clarity that was provided is appreciated. The audit team did not receive a signed copy of the contract or service level agreement and could therefore not determine what type of guarantee or security the contractor provided to the municipality.

It was, however, noted that the contract document is indicated as the JBCC Principal Building Agreement Edition 6.1 (March 2014) and in this document there are three options of security that can be provided as described in Clause 11:

- Variable construction guarantees: The contractor provides a construction guarantee from an approved guarantor which is normally a bank or insurance company. The value of this guarantee is initially 10% of the contract sum. This is enforceable until the final payment certificate has been issued to the contractor.
- Fixed construction guarantee: The contractor provides a construction guarantee from an approved guarantor which is normally a bank or insurance company. The value of this guarantee is 5% of the contract sum. In addition to this a payment reduction of 5% of the value of each payment certificate up to a maximum of 5% of the contract sum is made. The security adjustment reduces when practical completion is reached.
- Withhold in interim payment certificates an amount equal to 10% of the contract value. The security adjustment reduces when practical completion is reached.

As a performance guarantee to the value of 10% of the contract was provided by the main contractor at the beginning of the project, measures were implemented to protect the interest of government and retention was therefore not needed. The audit finding has been updated and the reference to the retention fees has been removed.

Auditor's response to 2.10 and 2.11

2.15 The responses are noted and the additional clarity that was provided is appreciated.

3. Ineffective project management and document administration

Audit finding

3.1 Project management and document administration by the municipality on the project was not always effective. Even though Chauke Quantity Surveyors and Project Managers was appointed as the external project manager for the project and was responsible for the hands-on management of the project on behalf of the municipality; the municipality was still the administrator of the account and was therefore responsible for the overall document administration and project management of the contract. The following provides more detail:

- The form of offer and acceptance was signed by the contractor on 1 June 2018, however, according to the site meeting minutes dated 9 July 2019, the entire tender document has still not been signed.
- According to the site handover meeting that was held on 16 August 2018, the municipal inspector was to provide a schedule of when he will do inspections on the site relating to quality control. On 9 October 2018, the municipality contract liaison and administration contact person indicated that the municipality does not have the necessary capacity to allocate inspectors to this project. Also, according to the minutes of the site meetings that were held on 13 November 2018 and 11 December 2018, a concern was raised that there were no municipal inspectors available for inspection of the work on site in terms of quality control. As a result, the municipality did not inspect the site works in terms of quality control.
- According to a site meeting held on 11 December 2018, there was never a representative from the municipality available at the meetings to sign off on the minutes. At the site meeting held on 5 February 2019 it was decided that DoHS representatives was to sign off on the minutes in the absence of a representative from the municipality. According to the attendance registers for all the site meetings since the site hand over date of 16 August 2018 up to 9 July 2019, the municipality only attended three of the 11 (27%) meetings.
- The contractor expressed his concern about the issue of way leaves²⁴ and he had a meeting with the municipality regarding this on 10 September 2018. The way leaves were, however, still outstanding as at 11 June 2019, nine months after the initial meeting.
- Payment certificates were not signed and certified in a timely manner. For example, payment certificate number 7 dated 27 March 2019 was never signed and certified by the external project manager.
- Discrepancies existed between the signed form of offer and acceptance, appointment letter, minutes of the site meetings and payment certificates regarding the contract amount for the construction of the 150 units. The signed form of offer and acceptance indicated a contract amount of R23 621 401. The appointment letter indicated a contract amount of R21 662 369. The minutes of site meetings indicated a contract value of R24 483 247 and the payment certificates indicated a contract amount of R23 828 606.

²⁴ Way leaves allow the right to use the property of another without possessing it. It entitles the holder only the right to use such land in a specified manner, generally used in the case of roads for the right to work in the road reserve to bury cables or access utility lines

Root cause

- 3.2 Comprehensive project management and document administration throughout the project was not always done by the municipality.

Internal control deficiency

- 3.3 The principle of effective leadership based on good governance, including project management and documentation administration, was not always applied

Recommendations

- 3.4 The municipality should adhere to project management principles and strengthen the administration of documentation. For example, the tender documents should be signed in a timely manner, the contract amount should be used consistently in all project related documents, inspectors should be made available to conduct quality control work throughout the projects, requests from the contractors should be responded to in a timely manner (especially if it affects the completion of the works), site meetings should be attended regularly and payment certificates should be signed and certified in a timely manner.

Management responses

- 3.5 From the inception of the project as already stated above, IHS formed part of the planning and development directorate and at that time, the division did not possess the required capacity in terms of human resources. However, due to recent council decisions, this is being addressed through the creation of a standalone directorate which is being capacitated in terms of human resources. The appointment of external project managers was mainly due to capacity gaps and to augment available capacity. The municipality clearly understands that it remains the administrator of the account and is responsible for the overall document administration and project management and thus a dedicated official is responsible for the project.
- 3.6 Documentation related to the project are filed in the municipal electronic system and on hardcopy documentation and are easily accessible on request. The form of offer and acceptance was signed by both the accounting officer and the contractor after the successful negotiation of the tender value.
- 3.7 The municipal building inspectorate has been poorly capacitated and at this stage has not been conducting inspections in the municipalities' housing project. This has now been raised in the top management team of the municipality to ensure that sufficient capacity is sought to ensure that all projects adhere to national building regulations and that a building inspector carries out necessary statutory inspections and issue relevant approvals.
- 3.8 Currently, municipal capacity is being strengthened to ensure that all technical meetings are attended consistently. There was an instance on 27 March 2019 where the external project manager inadvertently sent an unsigned certificate, but later realised it was unsigned and thus a signed certificate was resent the same day. This certificate was not processed by the municipality as its processing could have resulted in non-compliance with municipal financial procedures. The matter was rectified by the project manager prior to processing by the municipality.
- 3.9 The signed form of offer and acceptance is a result of a negotiation between the accounting officer and the contractor. The appointment letter showed the contract value inclusive of VAT, meaning that the amount indicated in the signed form of offer and acceptance being

- R21 662 369. The signed form of offer remains as the Human Settlements Development Grant does not attract VAT. The site meetings then indicated facts as per official documentation with no discrepancies whatsoever.
- 3.10 The municipality followed proper processes in relation to project management thus various responsibilities were assigned to various parties. Documentation in relation to the issues raised above is available within municipal records and has previously been explained above, especially in relation to the issue of the tender amount *versus* the signed form of offer.
 - 3.11 Project related documentation is kept with municipal records and is available when required. The issue surrounding capacity of the directorate and capacity in relation to the building control is being addressed at top management level. The municipal organogram is also being amended to respond to various needs and this process is now undergoing consultation with social partners prior to final approval by council. On approval of this and subject to available funding, critical positions will be filled. The IHS directorate has also started a process of enhancing its capacity by the recruitment of various professionals.
 - 3.12 All tender documentation is safely kept at the SCM office while all other documentation is kept within the municipal electronic system and hardcopy files. Council is however in a process of implementing a new electronic system to manage the administration of documents.
 - 3.13 The directorate has always been cognisant of issues raised as recommendations related to this project as issues of importance to be implemented in each project. Capacity issues are being addressed through the organisational structure and discussed at technical meetings in order to address deficiencies, for example. the availability of building inspectors. All other issues are duly noted.
 - 3.14 Further to the above, the municipality has identified the matter in relation to the reliance on external capacity for project management due to internal capacity shortages. To deal with this, on the job capacitation of existing staff is taking place through weekly interactions with project teams dealing with technical matters.

Auditor's response to 3.5 to 3.8

- 3.15 The responses are noted and the additional clarity that was provided is appreciated. It is also an indication that the municipality is pro-actively in the process of addressing the shortcomings. The audit finding will be included in the management report.

Auditor's response to 3.9

- 3.16 The management response is noted. However, the management response was not accompanied by documented evidence and discrepancies still existed between the signed form of offer and acceptance, appointment letter, minutes of the site meetings and payment certificates regarding the contract amount for the construction of the 150 units:
 - The signed form of offer and acceptance dated 1 June 2018 indicated a contract amount of R23 621 401 excluding VAT.
 - The schedule of deviations signed by the municipal manager on 15 June 2018 indicated a contract amount of R21 662 369 excluding VAT.
 - The appointment letter dated 15 June 2018 indicated a contract amount of R21 662 369 excluding VAT.

- All the payment certificates indicated a contract amount of R23 828 606 excluding VAT.
- The minutes of site meetings indicated a contract value of R24 483 247 and the progress was measured against R27 164 611 including VAT.

Auditor's response to 3.10 to 3.14

- 3.17 The responses are noted and the additional clarity that was provided is appreciated. It is also an indication that the municipality is pro-actively in the process of addressing the shortcomings. The audit finding will be included in the management report.

4. Variation orders for work that should have been included during planning

Audit finding

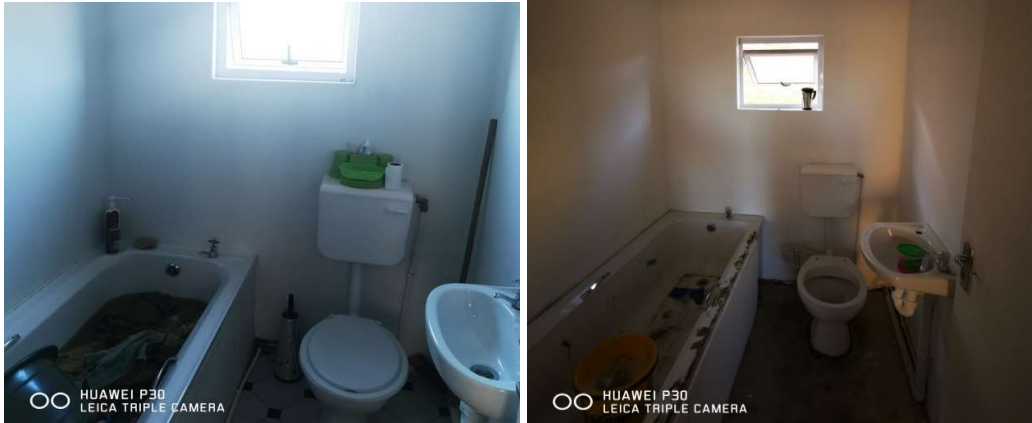
- 4.1 The planning of the project was not comprehensive, resulting in items that had to be added to the scope of works at a later stage. Variation orders two and three contained items that should have been included during the planning and design phase of the project and captured in the BOQ. The total value of the additional items was R564 778 (excluding VAT) and the additional work as per variation orders one to three included the following as indicated in the table below:

Table 3: Variation orders submitted by the contractor

No	Description	Date of variation order	Date approved	Date paid	Amount of variation order (excluding VAT)	Amount paid
1	Shifting of manholes and breaking and removal of existing strip footing	15 February 2019	18 March 2019	24 April 2019	R15 256	R15 256
2	Supply and installation of wooden hand rails	10 April 2019	Not approved by the municipality	25 August 2019	R55 362	R22 883 (41%)
3	Supply and installation of block retaining wall	30 May 2019			R494 160	R352 530 (71%)
Total					R564 778	R390 669

- 4.2 The contractor proceeded to work on variation orders two and three without prior approval of the municipality. Part of both of these variation orders were paid on 25 August 2019 together with payment certificate number 11.
- 4.3 In addition to the above variation orders, it was also noted by the audit team when conducting the site visit on 21 August 2019 that some of the units were equipped with bathtubs. Picture 9 and 10 below show the bathtubs that were installed in the houses instead of showers. The scope of work as described in the signed agreement between the DoHS and the municipality only made provision for shower installations within the bathrooms. No approved documentation regarding the change in scope from a shower installation to a bathtub was provided to the audit team and it could therefore not be determined if the variation in the scope of work had any cost and time implications on the project.

Pictures 9 and 10: Bathtubs that were installed in the houses instead of showers



Root cause

- 4.4 The planning of the project was not comprehensive, resulting in some of the variation orders containing items that should have been included during the planning and design phase of the project and captured in the BOQ.
- 4.5 The variation orders were not approved yet due to the municipality waiting for a Bid Adjudication Committee (BAC) resolution. At the municipality, it is a standard procedure that variation orders are first processed by the BAC before approval by the municipality.

Internal control deficiency

- 4.6 The principle of effective leadership based on good governance including project planning and management was not always applied.

Recommendations

- 4.7 The municipality should ensure that comprehensive planning process are done for each project. This will ensure that the scope of the work required are determined at the onset of the project, thereby eliminating the need for variation orders later in the project.
- 4.8 The municipality should determine why the additional work was completed by the contractor before approval of variation orders two and three by the municipality.

Management responses

- 4.9 This was the first time a project of this nature was implemented within the municipality due to the number of beneficiaries that resided in this area needing to be accommodated on a limited portion of land. It then meant that double storey units be implemented as a density measure. The BOQ contains handrails but in consultation on site with DoHS it was felt that the detail can be improved to accommodate the beneficiaries' needs. The size of the units meant that it could have been difficult to move the furniture of the beneficiaries to the bedrooms thus needing a different type of hand rail. The original type could not be removed easily by the beneficiary and assembled again. While planning was done, this was identified during implementation and the stairs remained as they were.
- 4.10 Block retaining walls were done under the platform and services contract. After construction of the top structures started it turned out that additional retaining is required as a

considerable amount of time elapsed between servicing and top structure construction. On a sloping and tight site like this it is not unusual to happen.

- 4.11 Variation orders were clarified with all the stakeholders as discussed in the technical meeting where both the DoHS and the municipality agreed and the costs approved. In the past, the Director: Housing would sign these orders, however, this process was enhanced through the introduction of a safety step being the tabling of variation orders to bid evaluation and bid adjudication committees.
- 4.12 There was always going to be bathtubs in the units as specified in the drawings from the beginning of the project. This was also included as part of the tender.
- 4.13 As already stated above, this was the first project of this nature in the municipality and there were some matters like hand rails that required amendments. The other variation orders related to the lapse of time between servicing and top structure construction.
- 4.14 It is correct that the municipal process was enhanced and as such variation orders could only be approved via a municipal bid adjudication committee resolution. This was a safety measure implemented by the municipality to ensure documentation of decisions taken.
- 4.15 Project technical meetings were used as one measure for the management of the project whilst there are other measures like progress reports submitted to the municipalities' section 80 committee.
- 4.16 The municipality takes into cognisance the recommendation relating to variation orders and in future, the scope of work will include items which were not in the past included from the onset thereby eliminating the need for variation orders later in the project.

Auditor's response to 4.9 to 4.11

- 4.17 The responses are noted and the additional clarity that was provided is appreciated. It is also an indication that the municipality is pro-actively in the process of addressing the shortcomings. The audit finding will be included in the management report.

Auditor's response to 4.12

- 4.18 The management response is noted. The response was not accompanied with the specified drawings where the showers were indicated or where it was included in the tender. The scope of work as described in the signed agreement between the DoHS and the municipality only made provision for shower installations within the bathrooms. No approved documentation regarding the change in scope from a shower installation to a bathtub was provided to the audit team. The audit finding will be included in the management report.

Auditor's response to 4.13 to 4.16

- 4.19 The responses are noted and the additional clarity that was provided is appreciated. It is also an indication that the municipality is pro-actively in the process of addressing the shortcomings. The audit finding will be included in the management report.

5. The quality of the work delivered by the contractor was not always satisfactory

Audit finding

5.1 The work delivered by the contractor was not always of acceptable quality. The poor workmanship included the following:

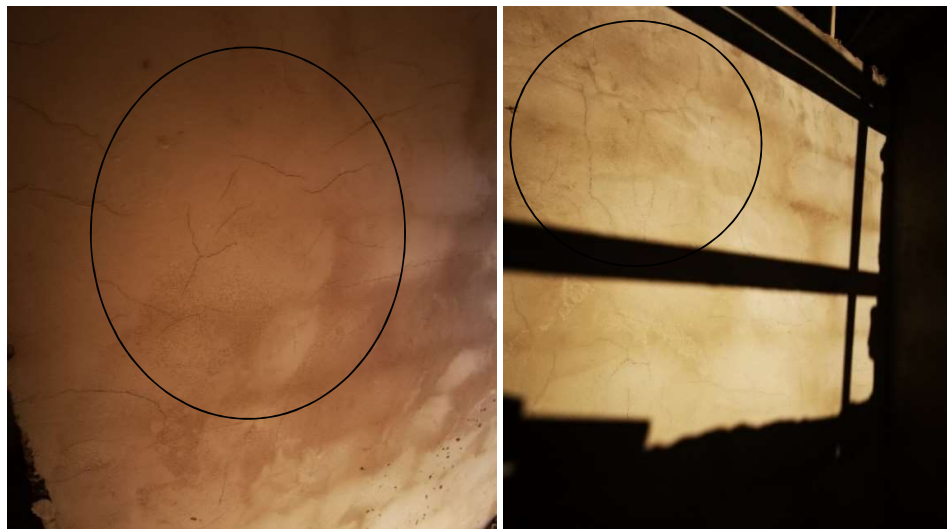
- Honeycombing occurred on the staircases. Honeycombing is encountered when inadequate concrete compaction is done. The reinforcement within the staircase is vulnerable to exposure of air and water and can result in durability concerns in the future. Refer to picture 11.
- The proper quality protocol and methods were not adhered to during construction. The end result was a poor product with multiple defects such as cracks and concrete expansion. Refer to pictures 12,13 and 14.

Picture 11 to 14: Picture 11 refer to honeycombing on the staircases and pictures 12 to 14 refer to defects such as cracks and concrete expansion



- Plastic shrinkage cracks were noted on the walls. These cracks occur soon after fresh concrete is placed due to the high evaporation rate from the mix. It occurs due to extreme heat or inadequate sand. The end result is a surface with cracks which becomes a serviceability limit state concern²⁵. See pictures 15 and 16 in this regard.

Pictures 15 and 16: Plastic shrinkage cracks on the walls



- 5.2 Also, according to the minutes of the site meetings, the following issues regarding poor quality of work and workmanship were indicated:
- The blockwork deteriorated and lintols were bending through and blocks were cut by hand instead of cut by grinder.
 - Door frames and walls were not built plumb due to inadequate scaffolding.
 - The quality of the blockwork remained a problem due to the ongoing turnover of workers.
 - Some of the door frames were not braced and bending.
 - The brickwork done was of very poor quality. Various examples were pointed out where the brickwork was visibly skew.
- 5.3 Even though the contractor was put on terms on 2 October 2018 as well as on 6 February 2019 due to minimal progress on site and the problems with quality and project management, the poor quality of work continued on site.

Root cause

- 5.4 The municipality did not have the necessary capacity to allocate inspectors to this project and therefore the municipality did not inspect the site in terms of quality control.
- 5.5 Project management was not always done effectively by the external project manager and the municipality to ensure that the work of acceptable quality was delivered by the contractor throughout the project.

²⁵ Structural failures that can restrict the normal use and occupancy or which affect durability i.e. excessive deflection cracking and vibration

Internal control deficiency

- 5.6 The principle of effective leadership based on good governance including project management was not always applied.

Recommendations

- 5.7 The municipality should perform regular site inspections to ensure that work of acceptable quality is delivered by the contractor throughout the project. Where quality defects are identified, it should be communicated to the contractor on a timely basis to ensure immediate rectification thereof.
- 5.8 The external project managers and municipality should ensure that all defects identified at the end of the project are rectified on a timely basis. A report on the progress made with addressing quality defects should be compiled by the municipality and filed centrally together with the other project documentation.

Management responses

- 5.9 The representative of the external project manager visited the site daily and pointed out poor workmanship on a continuous basis, whilst the municipal representatives visited the site weekly to assess progress. Representatives of DoHS visit the site from time to time and conduct inspections with the external project manager's representative. Defects pointed out are rectified on a continuous basis. All the defective work referred to, was picked up and being corrected. Records will show that quality of work gets continuous attention and that two staircases had to be redone due to poor quality.
- 5.10 The municipality is addressing the capacity issue in respect of building inspectors to ensure that inspections are carried out in line with national building regulations.
- 5.11 A performance guarantee instead of a retention fee is held and is a measure to protect the municipality.
- 5.12 The municipality, DoHS and the external project manager went to every effort to ensure acceptable quality of work with a contractor not performing well. The contractor's shortcomings and challenges are well documented.
- 5.13 The capacity issue in relation to the building inspectorate is being addressed.
- 5.14 All recommendations are noted for implementation. However, it must be said that the external project manager is on site on a daily basis in order to identify quality issues to be addressed immediately. This is done continuously throughout the execution of the project.
- 5.15 A performance guarantee is in place and thus there is no need for a retention fee.

Auditor's response to 5.9

- 5.16 The responses are noted and the additional clarity that was provided is appreciated. However, the management response was not accompanied by documented evidence, such as dates, names of officials and detail of the periodic inspections that was done by the municipal officials as alluded to in the management response. The audit finding will be included in the management report.

Auditor's response to 5.10

- 5.17 The responses are noted and the additional clarity that was provided is appreciated. It is also an indication that the municipality is pro-actively in the process of addressing the shortcomings. The audit finding will be included in the management report.

Auditor's response to 5.11

- 5.18 The response is noted. The audit finding has been updated and the reference to the retention fees has been removed.

Auditor's response to 5.12 to 5.14

- 5.19 The responses are noted and the additional clarity that was provided is appreciated. It is also an indication that the municipality is pro-actively in the process of addressing the shortcomings. The audit finding will be included in the management report.

Auditor's response to 5.15

- 5.20 The response is noted. The audit finding has been updated and the reference to the retention fees has been removed.

ANNEXURE C: ADMINISTRATIVE MATTERS

No findings to report in Annexure C

Annexure D: Performance management and reporting framework

The Performance Management and Reporting Framework (PMRF) consists of the following:

- Legislation applicable to performance planning, management and reporting, which includes the following:
 - MFMA
 - Municipal Systems Act, 2000 (MSA)
 - Regulations for planning and performance management, 2001, issued in terms of the MSA.
 - Municipal performance regulations for municipal managers and managers directly accountable to municipal managers, 2006, issued in terms of the MSA.
- The Framework for Managing Programme Performance Information (FMPPI), issued by the National Treasury (NT). This framework is applicable to all spheres of government, excluding parliament and provincial legislatures.
- Circulars and guidance issued by the NT regarding the planning, management, monitoring and reporting of performance against predetermined objectives.

Annexure D – Criteria developed from the performance management and reporting framework

Criteria	References to PMRF per institution
	Municipalities
1. Reported strategic or development objectives are consistent or complete when compared to planned objectives.	Section 121(3)(f) of the MFMA Section 41 (a) - (c) & 46 of the MSA
2. Changes to strategic or development objectives are approved	Section 25(2) of the MSA
3. Reported indicators are consistent or complete when compared to planned indicators	Section 121(3)(f) of the MFMA Section 41 (a) - (c) & 46 of the MSA
4. Changes to indicators are approved	Section 25(2) of the MSA
5. Reported targets are consistent or complete compared to planned targets	Section 121(3)(f) of the MFMA Section 41 (a) - (c) & 46 of the MSA
6. Changes to targets are approved	Section 25(2) of the MSA
7. Reported achievements are consistent with the planned and reported indicator and target	Section 121(3)(f) of the MFMA
<i>Measurability: Performance indicators are well defined and verifiable, and targets are specific, measurable and time bound.</i>	
1. A performance indicator is well defined when it has a clear, unambiguous definition so that data will be collected consistently and is easy to understand and use.	Chapter 3.2 of the FMPPI
2. A performance indicator is verifiable when it is possible to validate or verify the processes and systems that produce the indicator.	Chapter 3.2 of the FMPPI
3. A target is specific when the nature and required level of performance of the target is clearly identifiable.	Chapter 3.3 of the FMPPI
4. A target is measurable when the required performance can be measured.	Chapter 3.3 of the FMPPI
5. A target is time bound when the timeframes for achievement of targets are indicated.	Chapter 3.3 of the FMPPI
<i>Relevance: Performance indicators relate logically and directly to an aspect of the institution's mandate and the realisation of its strategic goals and objectives.</i>	
1. The performance indicator and target relates logically and directly to an aspect of the institution's mandate and the realisation of its strategic goals and objectives.	Chapter 3.2 of the FMPPI
<i>Presentation and disclosure: Performance information in the annual performance report are presented and disclosed in accordance with the requirements contained in the legislation, frameworks, circulars and guidance.</i>	
1. Actual performance compared to planned targets and prior year performance is disclosed in the annual performance report	Section 46 of the MSA

Criteria	References to PMRF per institution
	Municipalities
2. Measures taken to improve performance are disclosed in the annual performance report	Section 46 of the MSA
3. Measures taken to improve performance are corroborated with audit evidence	Section 46 of the MSA
<i>Reliability: Recording, measuring, collating, preparing and presenting information on actual performance achievements is valid, accurate and complete.</i>	
1. Reported performance occurred and pertains to the reporting entity.	Section 45 of the MSA Chapter 5 of the FMPPi
2. Amounts, numbers and other data relating to reported performance is recorded and reported correctly.	
3. All actual performance that should have been recorded is included in the reported performance information.	

Annexure E: Auditor-general's responsibility for the audit of the reported performance information

1. As part of our engagement conducted in accordance with ISAE 3000, we exercise professional judgement and maintain professional scepticism throughout our reasonable assurance engagement on reported performance information for selected objectives.
2. We are independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* (IESBA code) together with the ethical requirements that are relevant to our audit in South Africa. We have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA code.

QUALITY CONTROL RELATING TO ASSURANCE ENGAGEMENTS

3. In accordance with the International Standard on Quality Control 1, the Auditor-General of South Africa maintains a comprehensive system of quality control that includes documented policies and procedures on compliance with ethical requirements and professional standards.

REPORTED PERFORMANCE INFORMATION

4. In addition to our responsibility for the assurance engagement on reported performance information as described in the auditor's report, we also:
 - identify and assess risks of material misstatement of the reported performance information, 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 our opinion. In making those risk assessments, we consider internal control relevant to the management and reporting of performance information per selected objective 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 documentation maintained by the municipality that supports the generation, collation, aggregation, monitoring and reporting of performance indicators and their related targets for the selected objectives.
 - evaluate and test the usefulness of planned and reported performance information, including presentation in the annual performance report, its consistency with the approved performance planning documents of the municipality and whether the indicators and related targets were measurable and relevant.
 - evaluate and test the reliability of information on performance achievement to determine whether it is valid, accurate and complete.

COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE




5. We 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 we identify during our audit.

We also confirm to the accounting officer that we have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to bear on our independence and, where applicable, related safeguards.


Annexure F: Assessment of internal controls
















Below is our assessment of implementing the drivers of internal control based on significant deficiencies identified during our audit of the financial statements, the annual performance report and compliance with legislation. Significant deficiencies occur when internal controls do not exist, are not appropriately designed to address the risk, or are not implemented. These either had caused, or could cause, the financial statements or the annual performance report to be materially misstated, and material instances of non-compliance with legislation to occur.

The internal controls were assessed as follows:

	The required preventative or detective controls were in place.
	Progress was made on implementing preventative or detective controls, but improvement is still required, or actions taken were not or have not been sustainable.
	Internal controls were either not in place, were not properly designed, were not implemented or were not operating effectively. Intervention is required to design and/or implement appropriate controls.

The movement in the status of the drivers from the previous year-end to the current year-end is indicated collectively for each of the three audit dimensions under the three fundamentals of internal control. The movement is assessed as follows:

	Improved
	Unchanged
	Regressed

	Financial statements		Performance reporting		Compliance with legislation	
	Current year	Prior year	Current year	Prior year	Current year	Prior year
Leadership						
Overall movement from previous assessment						
• Provide effective leadership based on a culture of honesty, ethical business practices and good governance, and protecting and enhancing the best interests of the entity						
• Exercise oversight responsibility regarding financial and performance reporting and compliance as well as related internal controls						

	Financial statements		Performance reporting		Compliance with legislation	
	Current year	Prior year	Current year	Prior year	Current year	Prior year
• Implement effective human resource management to ensure that adequate and sufficiently skilled resources are in place and that performance is monitored						
• Establish and communicate policies and procedures to enable and support the understanding and execution of internal control objectives, processes and responsibilities						
• Develop and monitor the implementation of action plans to address internal control deficiencies						
• Establish and implement an information technology governance framework that supports and enables the business, delivers value and improves performance					N/A	N/A
Financial and performance management						
Overall movement from previous assessment						
• Implement proper record keeping in a timely manner to ensure that complete, relevant and accurate information is accessible and available to support financial and performance reporting						
• Implement controls over daily and monthly processing and reconciling transactions						
• Prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information						
• Review and monitor compliance with applicable legislation						
• Design and implement formal controls over information technology systems to ensure the reliability of the systems and the availability, accuracy and protection of information					N/A	N/A
Governance						
Overall movement from previous assessment						
• Implement appropriate risk management activities to ensure that regular risk assessments, including the consideration of information technology risks and fraud prevention, are conducted and that a risk						

	Financial statements		Performance reporting		Compliance with legislation	
	Current year	Prior year	Current year	Prior year	Current year	Prior year
strategy to address the risks is developed and monitored						
<ul style="list-style-type: none"> Ensure that there is an adequately resourced and functioning internal audit unit that identifies internal control deficiencies and recommends corrective action effectively 	😊	😊	😊	😊	😊	😊
<ul style="list-style-type: none"> Ensure that the audit committee promotes accountability and service delivery through evaluating and monitoring responses to risks and overseeing the effectiveness of the internal control environment, including financial and performance reporting and compliance with legislation 	😊	😊	😊	😊	😊	😊