

REPORT OF THE AUDITOR-GENERAL TO EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL OF MBASHE LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Mbashe Local Municipality, which comprise a statement of financial position as at 30 June 2011, and a statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory information as set out on pages ... to

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2007 (Act No. 1 of 2007) (DoRA), and for such internal control as management determines necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996) and section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with International Standards on Auditing and *General notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance that the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence for the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Irregular expenditure

7. Section 125(2) of the MFMA requires the financial statements of the municipality to disclose material irregular expenditure that occurred during the financial year. Audited payments amounting to R8,8 million were irregular as they were made in contravention of the supply chain management (SCM) requirements. These amounts were not included in the irregular expenditure disclosure note 25.1 to the financial statements. Consequently, irregular expenditure as disclosed is understated by at least this amount, it was however not practicable to determine the full extent of the understatement as there was no system of control in place to identify all irregular expenditure incurred.

Trade and other payables

8. The entity did not accrue for invoices in respect of goods and services received in current year amounting to R3,9 million resulting in the accrued liability as reported in note 8 to the financial statements being understated by this amount. Had these invoices been accrued for correctly, the effect would have been to increase both expenses by R790 569 and property, plant and equipment by R3,1 million, as reported in the statement of financial performance and note 21 to the financial statements, respectively.

Commitments

9. The municipality did not have an up to date contract management system in place for the identification and recognition of contracts and there were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all commitments were properly recorded. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of commitments of R24,1 million , as stated in note 28 to the financial statements

Leave accrual

10. I reported in my audit report for the previous year that leave taken to the value of R721 272 had not been recorded in the accounting records. No restatement of the records for the prior period has been completed yet by management and there were no satisfactory alternative procedures that I could perform to obtain reasonable assurance that the opening balances for leave not taken were properly recorded. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the valuation of the leave accrual to the value of R721 272, as disclosed in note 8 to the financial statements.

Qualified opinion

11. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Mbhashe Municipality as at 30 June 2011, and its financial performance and cash flows for the year then ended in accordance with GRAP and the requirements of the MFMA.

Emphasis of matters

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

Unauthorised expenditure

13. As reported in note 25.1 to the financial statements, the municipality incurred unauthorised expenditure amounting to R3,7 million as a result of exceeding the total amount of the budget relating to employee costs.

Irregular expenditure

14. As reported in note 25.2 to the financial statements, the municipality incurred irregular expenditure amounting to R28,9 million as the expenditure incurred was in contravention of the SCM process.

Fruitless and wasteful expenditure

15. As reported in note 25.3 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R668 702 due to overpayment of back-pay to employees, as well as legal costs incurred and interest charged on overdue accounts.

Material impairments

16. As disclosed in note 9 to the financial statements, the municipality had material impairments totalling R5,9 million related to receivables not considered recoverable.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

17. In accordance with the PAA and in terms of *General notice 1111 of 2010*, issued in *Government Gazette 33872 of 15 December 2010*, I include below my findings on the annual performance report as set out on pages ... to ... and material non-compliance with laws and regulations applicable to the municipality.

Predetermined objectives

Presentation of information

18. The following criterion is relevant to the finding below:

- Performance against predetermined objectives is reported using the National Treasury guidelines.

19. Audit finding

- Sufficient appropriate evidence in relation to the selected objectives for presentation could not be obtained from the municipality as they did not submit the annual performance report. I could not perform satisfactory audit procedures to obtain the required assurance as to the validity, accuracy and completeness of the reported performance against predetermined objectives.

Usefulness of information

20. The following criterion is relevant to the findings below:

- Measurability: Indicators are verifiable, and targets are time bound.

21. Audit findings

- Valid performance management processes and systems that produce actual performance against the planned indicators do not exist for 75% of the indicators.
- Sixty-eight per cent of planned and reported targets were not time bound in specifying the time period or deadline for delivery.

Reliability of information

22. The following criteria are relevant to the finding below:

- **Validity:** Actual reported performance has occurred and pertains to the entity.
- **Accuracy:** Amounts, numbers, and other data relating to reported actual performance have been recorded and reported appropriately.
- **Completeness:** All actual results and events that should have been recorded have been included in the annual performance report.

23. Audit finding

- Sufficient appropriate evidence in relation to the selected objectives for presentation could not be obtained from the municipality as they did not submit the annual performance report. I could not perform satisfactory audit procedures to obtain the required assurance as to the validity, accuracy and completeness of the reported performance against predetermined objectives.

Compliance with laws and regulations

Strategic planning and performance management

24. The municipal council did not, within the prescribed period after the start of its elected term, adopt a single, inclusive and strategic plan for the development of the municipality as required by section 25 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).
25. The accounting officer of the municipality did not, by 25 January, assess the performance of the municipality during the first half of the financial year, taking into account the municipality's service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan as required by section 72(1) (a) (ii) of the MFMA.
26. The accounting officer of the municipality did not submit the results of the assessment on the performance of the municipality during the first half of the financial year to the mayor of the municipality, the National Treasury, and the provincial treasury as required by section 72(1) (b) of the MFMA.

Budget

27. The municipality incurred expenditure in excess of the limits of the amounts provided for in the votes in the approved budget, in contravention of section 15 of the MFMA.

Annual financial statements, performance and annual reports

28. The financial statements submitted for auditing were not prepared, in all material respects, in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets/current assets/expenditure identified by the auditors were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.
29. The accounting officer did not make public the council's oversight report on the 2009-10 annual report within seven days of its adoption, as required by section 129(3) of the MFMA.
30. The performance report for the financial year under review was not prepared as required by section 46 of the MSA and section 121(3) (c) of the MFMA.
31. The annual performance report did not contain a comparison of the performance of the

municipality and of each external service provider with development priorities, objectives and performance indicators set out in its integrated development plan as required by section 46 of the MSA.

Performance audit committee

32. The performance audit committee did not perform the following as required by regulation 14 of the Municipal Planning and Performance Management Regulations, 2001 (MPPM):

- Review the quarterly reports of the internal auditors on their audits of the performance measurements of the municipality
- Review the municipality's performance management system and make recommendations in this regard to the council of the municipality
- Submit an auditor's report to the council regarding the performance management system at least twice during the financial year.

Internal audit

33. The internal audit processes and procedures did not include assessments of the functionality of the municipality's performance management system and whether the system complied with the requirements of the MSA as required by MPPM regulation 14. The internal audit processes and procedures did not include assessments of the extent to which the municipality's performance measurements were reliable in measuring the performance of the municipality on key as well as general performance indicators as required by MPPM regulation 14.

34. The internal auditors of the municipality did not audit the performance measurements on a continuous basis and did not submit quarterly reports on their audits to the municipal manager and the performance audit committee as required by MPPM regulation 14.

Procurement and contract management

35. Goods and services with a transaction value of between R10 000 and R200 000 were procured without obtaining written price quotations from at least three different prospective providers as per the requirements of SCM regulation 17(a) and (c).

36. Quotations were accepted from prospective providers who are not on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy in contravention of SCM regulations 16(b) and 17(b).

37. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids as per the requirements of SCM regulations 19(a) and 36(1).

38. Bid specifications were not always drafted by bid specification committees, which consist of one or more officials of the municipality as required by SCM regulation 27(3).

39. Awards were made to providers whose tax matters had not been declared by the South African Revenue Services to be in order as required by SCM regulation 43.

40. Awards were made to suppliers who did not submit a declaration on their employment by the state or their relationship to a person employed by the state as per the requirements of SCM regulation 13(c).

41. The preference point system was not applied in all procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000) (PPPF) and SCM regulation 28(1) (a).
42. Awards were made to suppliers based on preference points that were not allocated or calculated in accordance with the requirements of the PPPF and its regulations.
43. Awards were made to suppliers that did not score the highest points in the evaluation process as per the requirements of section 2(1) (f) of the PPPF.
44. Construction contracts were awarded to contractors that were not registered with the Construction Industry Development Board (CIDB) and/or did not qualify for the contract in accordance with the prescripts of the CIDB.
45. Sufficient appropriate audit evidence could not be obtained that contracts were procured in accordance with legislative requirements and the SCM policy.
46. Awards were made to providers whose directors are persons in the service of other state institutions in contravention of the requirements of Supply Chain Management (SCM) regulation 44.

Human resource management

47. Senior managers directly accountable to the municipal manager did not sign annual performance agreements within one month after the beginning of the financial year under review, as required by sections 57(1)(b) and 57(2)(a) of the MSA.
48. The municipal manager did not provide job descriptions for each post in the staff establishment as required by section 66(1) (b) of the MSA.

Expenditure management

49. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
50. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained an effective system of expenditure control, including procedures for the approval, authorisation, withdrawal and payment of funds, as required by section 65(2)(a) of the MFMA.
51. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system, which recognised expenditure when it was incurred and accounted for payments made by the municipality, as required by section 65(2)(b) of the MFMA.
52. The accounting officer did not take reasonable steps to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1) (d) of the MFMA.

Revenue

53. Interest was not charged on all arrears accounts as required by section 64(2) (g) of the MFMA.

Asset management

54. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which accounts for the assets of the municipality, as required by section 63(2)(a) of the MFMA.
55. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained an effective system of internal control for assets (including an asset register), as required by section 63(2) (c) of the MFMA.

INTERNAL CONTROL

56. In accordance with the PAA and in terms of *General notice 1111 of 2010*, issued in *Government Gazette 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the basis for qualified of opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

57. The municipality was not able to achieve stability of leadership during the year due to the suspension of certain key management, a number of vacant positions remaining unfilled and personnel acting in senior management positions. The compounding result was a lack of accountability and commitment to effective oversight and monitoring controls to ensure the proper implementation of approved internal policies and procedures at an operational level. This created an environment where internal policies and procedures were not being enforced and the required processes not being followed. The situation was further compounded by the absence of any evidence of corrective actions taken to ensure future compliance.
58. The municipality did not prevent, and detect irregular expenditure incurred through non-adherence to the SCM prescripts. In addition, for the reporting on predetermined objectives, the documented policy and procedure manuals were not implemented. As a result, the reporting on predetermined objectives was not submitted for audit purposes.
59. However, following successful implementation of the audit action plan. The leadership was able to address adequately a number of qualifications previously reported for balances, disclosures and classes of transactions reported in the financial statements. A similar approach for the current year, focused especially on the financial items still under the transitional provisions of directive 4, which expires this year, will ensure sustainability of the improved outcome.

Financial and performance management

60. The municipality does not have adequate systems in place for the complete and accurate financial reporting of commitments, irregular expenditure, accounts payable and the leave accrual balance. This is as a result of inadequate in-year monitoring of expense transactions to ensure that SCM requirements have been fully adhered to. Regarding the leave, the leave system has not yet been updated for the prior year. Accounts payable and commitments are not kept up to date during the year and the amounts reported are the result of an inadequate year-end accumulation process for financial reporting.
61. In addition, for expenditure there was inadequate review and consideration of

documentation supporting the transactions prior to processing. As a result, transactions are processed in the incorrect financial period and/or incorrectly classified.

62. In addition to the system weakness relating to irregular expenditure (SCM) and the reporting on predetermined objectives above, not all documentation requested was provided for audit purposes, indicating poor record keeping.
63. The municipality does not have adequate assignment of responsibility and processes in place to monitor compliance with the approved budget and ensure compliance with all applicable laws and regulations. The municipality has thus incurred unauthorised expenditure and not fully complied with all requirements of the MFMA, MSA and MPPM regulations, PPPF and SCM regulations.

Governance

64. The risk assessment process is not in place, resulting in the municipality not responding adequately to the monitoring of risks identified. As a result, there were numerous instances of non-compliance with the MFMA, MSA, PPPF and the SCM and MPPM regulations.
65. The performance audit committee and the internal audit function did not have the necessary capacity to review or report on the performance management system or performance reports during the year under audit. The municipality thus lost the benefit that may have been obtained had these been completed.

AUDITOR - GENERAL

East London

30 November 2011



**AUDITOR - GENERAL
SOUTH AFRICA**

Auditing to build public confidence