

Mhlontlo Municipality

Audit Report

For the year ended 30 June 2016

Report of the auditor-general to the Eastern Cape Provincial Legislature and the council on Mhlontlo Local Municipality

Report on the financial statements

Introduction

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

Accounting officer's responsibility for the 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 Account Practice (SA standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2014 (Act No. 10 of 2014) (DoRA) and for such internal control as the accounting officer determines is 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. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about 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.

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

Opinion

6. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Mhlontlo Local Municipality as at 30 June 2016 and its financial performance and cash flows for the year then ended, in accordance with the SA standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

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

Irregular expenditure

8. As disclosed in note 39 to the financial statements, irregular expenditure amounting to R182,6 million accumulated over a number of years. This amount includes R51,87 million that was incurred by the municipality during the year ended 30 June 2016 as a result of non-compliance with supply chain management principles. No steps have been taken at this stage to recover any monies.

Unauthorised expenditure

9. As disclosed in note 33 to the financial statements, Unauthorised expenditure amounting to R79,29 million accumulated over a number of years. This amount includes R18,24 million that was incurred by the municipality during the year ended 30 June 2016 as a result of depreciation adjustments after budget adoption and adjustments to the asset registers.

Fruitless and wasteful expenditure

10. As disclosed in note 38 to the financial statements, fruitless and wasteful expenditure amounting to R915 619 has accumulated over a number of years. This amount includes R56 878 that was incurred by the municipality during the year ended 30 June 2016 as a result of interest and penalties on overdue suppliers account. No steps have been taken at this stage to recover any monies.

Additional matter

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

Unaudited disclosure notes

12. In terms of section 125(2) (e) of the MFMA the municipality is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the financial statements and accordingly we do not express an

opinion thereon.

Report on other legal and regulatory requirements

13. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives of selected objectives presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

14. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information of the following selected development priority presented in the annual performance report of the Mhlontlo Local Municipality for the year ended 30 June 2016: KPA 4: Basic Service Delivery and Infrastructure on pages xx to xx
15. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned objectives I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPi).
16. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
17. The material findings in respect of the selected objective are as follows:

Basic service delivery and infrastructure

Usefulness of reported performance information

18. I did not identify any material findings on the usefulness of the reported performance information for the following development objective: Basic Service Delivery and Infrastructure.

Reliability of reported performance information

19. The FMPPi requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. The reported achievements against planned targets of four (4) important indicators were not reliable when compared to the evidence provided.

Additional matter

20. I draw attention to the following matters:

Achievement of planned targets

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

Compliance with legislation

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

Annual financial statements, performance and annual reports

23. 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 and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected.

24. The annual performance report for the year under review did not include the performance of the municipality and its external service providers and a comparison of the performance with set targets with the previous financial year as required by section 46 (1)[(a) and (b) of the MSA.

Expenditure management

25. Reasonable steps were not taken to prevent unauthorised, irregular expenditure as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Asset management

26. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) / 96(2)(b)] of the MFMA.

Consequence management

27. Unauthorised expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a) of the Municipal Finance Management Act.

28. Irregular expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the Municipal Finance Management Act.

29. Fruitless and wasteful expenditure incurred by the municipality was not investigated to

determine if any person is liable for the expenditure, as required by section 32(2)(b) of the Municipal Finance Management Act .

Procurement and contract management

30. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a).
31. Contracts were extended without tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.
32. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
33. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, in contravention of section 116(2)(c) of the MFMA.

Internal control

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

Leadership

35. Monitoring at an oversight level was not fully effective as some assurance was provided by leadership with respect to the functioning of internal controls in the current year. Lack of adherence to policies and procedures, as well as the late implementation of the audit action plan, resulted in a breakdown in the credibility of information and the material misstatements identified in the financial statements.

Financial and performance management

36. There is an inadequate control environment at the municipality with ineffective daily and monthly processing and reconciliation of transactions occurring in non-current assets, liabilities and disclosure items. Misstatements existed in the submitted financial statements that were not identified by the municipality's system of internal control. Furthermore, compliance with laws and regulations is not monitored adequately, resulting in findings of non-compliance in the current year.
37. The annual performance report also included material misstatements, due to the lack of oversight of the collection, collation and reporting of performance information. There is limited accountability and ownership over the performance management system.

Governance

38. A risk assessment was conducted by the municipality to identify and respond to the risks identified; however material misstatements were identified in the financial statements and annual performance report due to weaknesses in the monitoring of controls to mitigate the risks identified.
39. The internal audit unit was considered ineffective, due to the unit being understaffed and unable to fully implement the internal audit plan. Due to the ineffectiveness of internal audit, and the misstatements identified through the audit process, the audit committee only provided some assurance to council on the internal controls of the municipality

Auditor General

East London

15 December 2016



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence