

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

## Report on the audit of the financial statements

### Opinion

1. I have audited the consolidated and separate financial statements of the Raymond Mhlaba Local Municipality set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2017, and the consolidated and separate 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 to the financial statements, including a summary of significant accounting policies.
2. In my opinion, the consolidated and separate financial statements present fairly, in all material respects, the consolidated and separate financial position of the Raymond Mhlaba Local Municipality as at 30 June 2017, and its consolidated and separate financial performance and cash flows for the year then ended in accordance with the South African Standards of General Accepted Accounting Practice (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, 2016 (Act No. 3 of 2016) (DoRA).

### Context for opinion

3. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the consolidated and separate financial statements section of my report.
4. I am 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 my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

### Emphasis of matters

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

#### **Fruitless and wasteful expenditure**

7. As disclosed in note 52.2 to the consolidated and separate financial statements, fruitless and wasteful expenditure amounting to R11.7 million has been incurred in the current year due to late payments of suppliers.

#### **Material losses – electricity**

8. As disclosed in note 52.4 to the consolidated and separate financial statements, material electricity losses to the amount of R13.6 million was incurred which represents 29.36% of total electricity purchased.

#### **Irregular expenditure**

9. As disclosed in note 52.3 to the consolidated and separate financial statements, irregular expenditure amounting to R30.1 million has been incurred in the current year due to the supply chain management (SCM) processes not being followed.

#### **Assets acquired and liabilities assumed on merger date**

10. As disclosed in note 47 to the consolidated and separate financial statements, the Raymond Mhlaba Local Municipality was subsequently established by the amalgamation of Nkonkobe Local Municipality and Nxuba Local Municipality.

#### **Transitional provisions**

11. As disclosed in note 9.1 to the consolidated and separate financial statements, the municipality opted to take advantage of the transitional provision contained in GRAP 107 relating to the measurement of Property, Plant and Equipment (Self constructed assets). The municipality is granted a 2 year measurement period since merger date to ensure compliance with the relevant GRAP standards.

#### **Financial sustainability**

12. As disclosed in note 63, the consolidated and separate financial results however may indicate that the going concern assumption of this municipality may be in serious doubt. The amounts promulgated in the DORA have a serious impact on the level of services that this municipality can render and it may well raise doubt about the future financial sustainability of this municipality and may cause serious health and other risks regarding service delivery to the communities within the jurisdiction of this municipality.

#### **Additional matter**

##### **Unaudited disclosure notes**

13. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the consolidated and separate financial statements and accordingly I do not express an opinion thereon.

#### **Responsibilities of the accounting officer**

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

GRAP and the requirements of the MFMA and DoRA and for such internal control as the accounting officer determines is necessary to enable the preparation of consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.

15. In preparing the consolidated and separate financial statements, the accounting officer is responsible for assessing the Raymond Mhlaba Local Municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the accounting officer either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

### **Auditor-general's responsibilities for the audit of the financial statements**

16. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated and separate financial statements.
17. A further description of my responsibilities for the audit of the consolidated and separate financial statements is included in the annexure to the auditor's report.

## **Report on the audit of the annual performance report**

### **Introduction and scope**

18. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
19. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.

20. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2017:

<b>Development priorities</b>	<b>Pages in the annual performance report</b>
KPA 1 – Basic services and infrastructure	x – x
KPA 3 – Local economic development	x – x

21. I performed procedures to determine whether the reported performance information was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

22. The material findings in respect of the usefulness and reliability of the selected development priorities are as follows:

### **KPA 1 – Basic services and infrastructure**

23. The following indicators were reported as planned indicators while the indicators were not approved as planned in the integrated development plan. This is not in line with the requirements section 41(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (for municipalities / section 121(4)(d) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA).

<b>Planned indicators</b>	<b>Reported indicators</b>
10 High Mast lights installed in Gugulethu Township, Golf Course, Hogsback, Debe Nek and Fort Beaufort Township (Debe)	5 High Mast lights installed in Gugulethu Township, Golf Course, Hogsback, Debe Nek and Fort Beaufort Township (Debe)
No indicator in SDBIP	Engineering services: Paving and Greening in Ntoleni to Hillside
No indicator in SDBIP	Engineering services: Constructed Mazotshweni Community Hall - Phase 1
No indicator in SDBIP No indicator in SDBIP	Engineering services: Constructed Thafeni Community Hall
No indicator in SDBIP	Engineering services: Construction of Recreational Facility - Horse

Planned indicators	Reported indicators
	Racing
No indicator in SDBIP	Engineering services: Constructed Hawker Stalls
No indicator in SDBIP	Engineering services: Constructed Alice Park
No indicator in SDBIP	Engineering services:  Paving and Greening in Jakaranda
No indicator in SDBIP	Engineering services:  Paving and Greening in Chris Hani
No indicator in SDBIP	Engineering services:  Newtown Internal Streets MIG
No indicator in SDBIP	Engineering services: Constructed VIC Debe Nek
No indicator in SDBIP	Engineering services: Constructed Day-care centre - Qhomfo
No indicator in SDBIP	Engineering services: Constructed of Municipal pound
No indicator in SDBIP	Engineering services: Constructed of Qomfo Community Hall

### Reliability

24. I was unable to obtain sufficient appropriate audit evidence for 46 indicators relating to this programme. This was due to limitations place on the scope of my work. I was unable to confirm the reported achievements by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievements of the following indicators:

Description of indicator	Reported Achievement
Engineering services: Paving and Greening in Jakaranda	0m
Engineering services: Constructed VIC Debe Nek	0
Engineering services: Constructed Day Care Centre in Kwa Meva	0
Engineering services: Constructed Day Care Centre	0

(Ward 1) Zigodlo	
Engineering services: Constructed Day Care Centre (Ward 16) Lugudwini	0
Engineering services: Constructed Day Care Centre - Sports Complex Fort Beaufort Phase 1	1
Engineering services: Construction of Goodwin Park Multi-Purpose centre	0
Engineering services: Upgrading of Nonzwakazi Sports Field	0
Engineering services: Rehabilitation of Wanderers Sports Field	0
Engineering services: Constructed Ngqolowa Sports Field	0
Engineering Services: Construction of Dyamala Community Hall	0
Engineering Services: Constructed Zibi Community Hall	0
Engineering Services: 1 Community Halls to be maintained and renovated	0
Engineering services: Constructed Thafeni Community Hall	0
Engineering services: Constructed Alice Park	0
Engineering services: Constructed Day-care centre – Qhomfo	0
Engineering services: Construction of Municipal Pound	0
Engineering services: Constructed Qomfo Community Hall	0
Engineering services: Constructed Mazotshweni Community Hall - Phase 1	0
Engineering services: Construction of Recreational Facility - Horse Racing	0
Engineering services: Constructed Hawker Stalls	0
Engineering services: Constructed DLTC- FORT BEAUFORT	0
Engineering services: Paving and Greening in Ntoleni to Hillside	0
By ensuring the Consumer accounts are 100% accurate and delivered timeously.	100%
Implement the Valuation Roll	1
Develop and implement 1 Revenue Collection Source showcasing 80% of revenue collected	100%
Established SCOA committee, approved implementation plan and Standard Chart of Accounts	1
Developing a compliance checklist for preventing, detecting and reporting irregular and unauthorized expenditure	1
Updated Indigent Register	1
By monthly reconciliation & payment of creditors within 30 days of the receipt of the invoice.	1
<b>Total</b>	

25. In addition to the above, the municipality did not implement adequate systems and processes to collect, collate and accurately record information relating to planned and actual performance. As a result, the reported achievements of the indicators detailed in the table below are misstated

Description	Reported Achievement
Engineering Services: Paving in Gqumashe (Phase	933m

2)	
Engineering services: Paving in Ntselamanzi (Phase 2)	0m
Engineering services: Re-Surfacing of Adelaide Streets	810m
Engineering services: Number of beneficiaries that are without electricity	0
Engineering services: 120 Houses Electrified	64
Engineering services: 5 High Mast lights installed in Gugulethu Township, Golf Course, Hogsback, Debe Nek and Fort Beaufort Township (Debe)	10
Engineering services: Constructed Day Care Centre (Mdeni)	0
Engineering services: Constructed Day Care Centre (Ward 19) Xhukwana	0
Engineering services: Constructed Binfield Community Hall- Phase 3	0
Engineering services: Constructed Khulile Community Hall- Phase 3	0
Engineering services: Constructed Hala Community Hall	0
Engineering Services: Constructed Ntonga Community Hall	0
Engineering Services: Construction of KwaMathole Community Hall	0
Engineering Services: Constructed Sityi Community Hall	0
Engineering Services: Constructed Balfour/Massdorp Community Hall- Phase 3	1
<b>Total</b>	

### KPA 3 – Local economic development

26. I was unable to obtain sufficient appropriate audit evidence for two indicators relating to this programme. This was due to limitations place on the scope of my work. I was unable to confirm the reported achievements by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievements of the following indicators:

Description	Reported Achievement
1 application letter for Funding to Industrial Development Cooperation for SBRE Strategy	0
Submission of 3 Updated Business Plans to Department of Environmental Affairs	3

27. In addition to the above, the municipality did not implement adequate systems and processes to collect, collate and accurately record information relating to planned and actual performance. As a result, the reported achievements of the indicators detailed in the table below are misstated

Description	Reported Achievement
Facilitate referrals of 12 Cooperatives/SMMEs and aspiring business to Municipal Entity (NEDA) for registration	12
1 Updated SCM Database	1

## **Other matter**

28. I draw attention to the matter below.

## **Achievement of planned targets**

29. Refer to the annual performance report on pages xx to xx for information on the achievement of planned targets for the year and explanations provided for the under/overachievement of a significant number of targets. This information should be considered in the context of the findings on the usefulness and reliability of the reported performance information in paragraphs 18 - 27 of this report.

## **Report on audit of compliance with legislation**

### **Introduction and scope**

30. In accordance with the PAA and the general notice issued in terms thereof I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.

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

### **Annual report and annual financial statements**

32. The consolidated and separate 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 disclosure items identified by the auditors in the submitted consolidated and separate financial statement were subsequently corrected, resulting in the consolidated and separate financial statements receiving an unqualified audit opinion.

### **Expenditure management**

33. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

34. Effective steps were not taken to prevent irregular expenditure amounting to R 30.1 million as disclosed in note 52.3 to the consolidated and separate annual financial statements, as required by section 62(1)(d) of the MFMA. The majority of the irregular expenditure was caused by non-compliance.

35. Effective steps were not taken to prevent fruitless and wasteful expenditure amounting to R11.5 million, as disclosed in note 52.2 to the consolidated and separate annual financial statements, in contravention of section 62(1)(d) of the MFMA.



## Procurement and contract management

36. Some of the quotations were accepted from bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
37. Sufficient appropriate audit evidence could not be obtained that all extensions or modifications to contracts were approved by a properly delegated official, as required by SCM regulation 5.
38. Some of the quotations were accepted from prospective providers who were not on the list of accredited prospective providers and did not meet the listing requirements prescribed by the SCM policy, in contravention of SCM regulations 16(b) and 17(b).

## Budgets

39. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R26.7 million, as disclosed in note 52.1 to the consolidated and separate annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by late payment of suppliers.

## Consequence Management

40. Allegations of financial misconduct laid against officials of the municipality were not investigated as required by section 171(4)(a) of the Municipal Finance Management Act.
41. Some of the 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.
42. Some of the irregular expenditure incurred by the municipality were 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 and reporting regulations 75(1).
43. Some of the 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 and Reporting regulations 75(1).

## Other information

44. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements, the auditor's report thereon and those selected development priorities presented in the annual performance report that have been specifically reported on in the auditor's report.
45. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.

46. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected development priorities presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.

47. If, based on the work I have performed on the other information obtained prior to the date of this auditor's report, I conclude that there is a material misstatement of this other information, I am required to report that fact

### Internal control deficiencies

48. I considered internal control relevant to my audit of the consolidated and separate financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance thereon. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for unqualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

- Oversight responsibilities regarding the monitoring of internal controls over financial and performance reporting and compliance with applicable laws and regulations were not adequately performed.
- The leadership did not implement adequate controls to ensure that the financial statements submitted for auditing did not contain errors and non-compliance with applicable legislation.
- The municipality did not have a proper system of record management that provided for the maintenance of information to be reported in the annual performance report. This includes information that relates to the collection, collation, verification, storing and reporting of actual performance information.
- The municipality's compliance monitoring process was not effective in the implementation and monitoring of controls to ensure that non-compliance with its laws and regulations was prevented or detected.

- The recommendations of the internal audit unit were not adequately addressed by management and therefore did not have a positive impact on addressing control deficiencies that existed in the municipality's control environment. Furthermore the audit committee was not effective in strengthening the control environment within the municipality, as a number of their recommendations had not been implemented.

*Auditor-General*

East London

13 December 2017



AUDITOR-GENERAL  
SOUTH AFRICA

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## **Annexure – Auditor-general’s responsibility for the audit**

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for selected development priorities and on the municipality’s compliance with respect to the selected subject matters.

### **Financial statements**

2. In addition to my responsibility for the audit of the separate and consolidated financial statements as described in the auditor’s report, I also:
  - identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
  - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality’s internal control.
  - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer.
  - conclude on the appropriateness of the accounting officer’s use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Raymond Mhlaba Local Municipality ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor’s report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of the auditor’s report. However, future events or conditions may cause a municipality to cease to continue as a going concern.
  - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

### **Communication with those charged with governance**

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and here applicable, related safeguards.