

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

Report on the audit of the financial statements

Opinion

1. I have audited the financial statements of the Mhlontlo Local Municipality set out on pages XX to XX, which comprise the statement of financial position as at 30 June 2018, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. In my opinion, the financial statements present fairly, in all material respects, the financial position of Mhlontlo Local Municipality as at 30 June 2018, and its financial performance and cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2013 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2017 (Act No. 3 of 2017) (Dora).

Basis 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 financial statements section of this auditor's 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) and the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.
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.

Restatement of corresponding figures

7. As disclosed in note 36 to the financial statements, the corresponding figures for 30 June 2017 have been restated as a result of errors identified in the financial statements of the municipality at, and for the year ended, 30 June 2018.

Debt impairment – receivables from exchange and non-exchange transactions

8. As disclosed in notes 3 and 4 to the financial statements, cumulative debt impairment provisions amounted to R24,8 million (2016-17: R25,5 million) due to the slow recovery of old consumer debts.

Irregular expenditure

9. As disclosed in note 39 to the financial statements, irregular expenditure of R30,6 million (2016-17: R35,9 million) was incurred due to supply chain management (SCM) transgressions in the current year.

Unauthorised expenditure

10. As disclosed in note 37 to the financial statements, unauthorised expenditure of R4,6 million (2016-17: R15,5 million) was incurred due to the municipality exceeding the voted funds as per the approved budget in the current year.

Other matter

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

Unaudited disclosure note

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, I do not express an opinion thereon.

Responsibilities of accounting officer for the financial statements

13. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the SA Standards of GRAP and the requirements of the MFMA and Dora, and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
14. In preparing the financial statements, the accounting officer is responsible for assessing the Mhlontlo 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 appropriate governance structure either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

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

15. 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 the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

16. A further description of my responsibilities for the audit of the financial statements is included in the annexure to this auditor's report.

Report on the audit of the annual performance report

Introduction and scope

17. 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.
18. 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.
19. 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 2018:

| Development priorities | Pages in the annual performance report |
|----------------------------------|--|
| KPA – basic service delivery | x – x |
| KPA – local economic development | x – x |

20. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
21. The material findings in respect of the usefulness and reliability of the selected development priorities are as follows:

KPA – basic service delivery

Various indicators

22. I was unable to obtain sufficient appropriate audit evidence to support the measures taken to improve performance against the following key performance indicators (KPA) as reported in the

annual performance report. This was due to limitations placed on the scope of my work. I was unable to confirm the reported measures taken by the municipality by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported measures taken to improve performance.

- Assembled and installed the steel bridge and 15km access road completed by 30 June 2018 - Yes/no.
- Number of kms of street surfacing completed (Qumbu Street surfacing phase 2) by 30 June 2018.
- No. of households connected and energised by 30 June 2018.
- Number of poles planted to 298h/h network and cable stringing by 30 June 2018.
- Number of km of road maintenance to access and urban roads completed per maintenance plan by 30 June 2018

Comparison between performance of the year under review and previous year

23. A comparison per indicator between the performance of the year under review and previous year was not included for any of the indicators in the annual performance report as required by section 46 (a) and (b) of the Municipal Systems Act (Act No. 32 of 2000) (MSA).

Number of kms of street surfacing completed (Qumbu Street surfacing phase 2) by 30 June 2018

24. The achievement for the key performance indicator number of kms of street surfacing completed (Qumbu Street surfacing phase 2) by 30 June 2018 reported in the annual performance report was included as N/A. However, the supporting evidence provided did not agree with the reported achievement and indicated an achievement of 2,78kms.

Various indicators

25. I was unable to obtain sufficient appropriate audit evidence for the reported achievements of the indicators listed below as reported achievements were not supported by sufficient appropriate audit evidence. This was due to limitations placed 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 achievement of the following indicators:

- Assembled and installed the steel bridge and 15km access road completed by 30 June 2018 - Yes/no.
- Number of kms of street surfacing completed (Tsolo Street surfacing phase 2) by 30 June 2018.
- Number of km of road maintenance to access and urban roads completed per maintenance plan by 30 June 2018.
- No. of households connected and energised by 30 June 2018.
- Number of poles planted to 298h/h network and cable stringing by 30 June 2018.

KPA Local economic development, planning and rural development

Comparison between performance in the year under review and previous year

26. A comparison per indicator between the performance of the year under review and previous year was not included for any of the indicators in the annual performance report as required by section 46 (a) and (b) of the Municipal Systems Act (Act No. 32 of 2000).

No. of vaccines supplied to Mhlontlo wool growers

27. The planned indicator and target for *No. of vaccines supplied to Mhlontlo wool growers* is not consistent with the reported achievement. The target reads as supply and delivery of 500ml by 320 vaccines to the Mhlontlo wool growers association. The actual achievement has no value and is reflected as vaccines have been purchased and supplied.

Other matter

28. I draw attention to the matter below.

Achievement of planned targets

29. Refer to the annual performance report on pages x to x for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs 22 to 27 of this report.

Report on the 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:

Financial statements

32. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion.

Human resource management

33. Appropriate systems and procedures to monitor, measure and evaluate staff performance were not developed and adopted, as required by section 67(1)(d) of the MSA.

Expenditure management

34. Reasonable steps were not taken to prevent irregular expenditure of R30,6 million disclosed in note 39 to the annual financial statements, as required by section 62(1)(d) of the MFMA. The majority of the irregular expenditure was caused by contravention of SCM regulations. Irregular expenditure amounting to R12,7million was incurred on construction of the Ngqakaqheni bridge.
35. Reasonable steps were not taken to prevent unauthorised expenditure of R4,6 million disclosed in note 37 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by the municipality exceeding the voted funds as per the approved budget in the current year.

Asset management

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

Consequence management

37. Unauthorised expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a) of the MFMA.
38. 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 MFMA.
39. Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.

Procurement and contract management

40. Some of the contracts were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding, in contravention of supply chain management regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations.
41. Some construction contracts were awarded to contractors that did not qualify for the contract in accordance with section 18(1) of the Construction Industry Development Board Act, Act no. 38 of 2000 (CIDB) and CIDB regulations 17 and 25(7A). This non-compliance was identified in the procurement processes for the construction of the Ngqakaqheni bridge.
42. Some bid documentation for procurement of commodities designated for local content and production did not stipulate the minimum threshold for local production and content as required by the 2017 preferential procurement regulation 8(2).
43. Sufficient appropriate audit evidence could not be obtained that commodities designated for local content and production were procured from suppliers who met the prescribed minimum threshold for local production and content, as required by the 2017 preferential procurement regulation 8(5).
44. The performance of some of the contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA. Similar non-compliance was also

reported in the prior year. This non-compliance was identified in the procurement processes for the construction of Ngqakaqheni bridge.

45. The contract performance and monitoring measures and methods were not sufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA. Similar non-compliance was also reported in the prior year.

Strategic planning and performance management

46. The performance management system and related controls were inadequate as the described processes of planning, measurement and reporting were not conducted and managed as intended, as required by the municipal planning and performance management regulation 7(1).

Other information

47. The Mhlontlo Local Municipality's 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 and those selected development priorities presented in the annual performance report that have been specifically reported in this auditor's report.
48. 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.
49. 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.
50. I did not receive the other information prior to the date of this auditor's report. When I do receive and read this information, if I conclude that there is a material misstatement therein, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to retract this auditor's report and re-issue an amended report as appropriate. However, if it is corrected this will not be necessary.

Internal control deficiencies

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

- Leadership did not adequately implement the action plan to address the previous year's audit findings on compliance with laws and regulations and the annual performance report. As a result, the internal control deficiencies were not adequately addressed and findings

recurred. In addition, leadership had not initiated and implemented consequence management against employees who contravened the supply chain management processes.

- Adequate internal controls have not been implemented over the monthly financial and performance reporting processes, including year-end reporting, as a number of disclosures in the financial statements were dependent on manual reconciliations and schedules at year end. This resulted in material misstatements in the disclosure items, which were subsequently corrected.
- The municipality did not have adequate systems in place to monitor compliance with all applicable legislation, as recurring findings on procurement and contract management were raised in the financial year under review. Non-compliance with legislation could have been prevented had compliance been properly reviewed and monitored. In addition, fully effective steps were not taken to prevent and detect irregular and unauthorised expenditure.

Auditor-General

East London

30 November 2018



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

Annexure – Auditor-general’s responsibility for the audit

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the 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 financial statements as described in this 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 Mhlontlo Local Municipality’s 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 this auditor’s report. However, future events or conditions may cause a municipality to cease continuing as a going concern
 - evaluate the overall presentation, structure and content of the 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, where applicable, related safeguards.