

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

## Report on the audit of the financial statements

### Qualified opinion

1. I have audited the financial statements of the Mhlontlo Local Municipality set out on pages ... to ... which comprise the statement of financial position as at 30 June 2020, statement of financial performance income, statement of changes in net assets, statement of cash flows and 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, except for the possible effects of the matters described in the basis for qualified opinion section of this auditor's report, the financial statements present fairly, in all material respects, the financial position of the Mhlontlo Local Municipality as at 30 June 2020, and 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 56 of 2003 (MFMA) and the Division of Revenue Act 16 of 2019 (Dora).

### Basis for qualified opinion

#### Receivables from non-exchange transaction

3. I was unable to obtain sufficient audit evidence of contractual agreement that acknowledges the receivables recorded by the municipality, consequently, receivables from non-exchange transactions disclosed in the statement of financial position were overstated by R7,8 million (2019: R5,9 million).

#### Commitments

4. The municipality did not correctly recognise its contractual commitments for the acquisition of property, plant and equipment as required by GRAP 17, *Property, plant and equipment*. This was due to a lack of systems and processes in place at the municipality to ensure that commitments were correctly disclosed. Consequently, commitments disclosed in note 39 to the financial statements were overstated by R5,1 million (2019: R7,9 million).

### Context for the opinion

5. 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.

6. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *International code of ethics for professional accountants (including International Independence Standards)* (IESBA code) as well as other 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.
7. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

### **Emphasis of matters**

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

### **Restatement of corresponding figures**

9. As disclosed in note 32 to the financial statements, the corresponding figures for 30 June 2019 have been restated as a result of an error identified in the financial statements of the municipality at, and for the year ended, 30 June 2020.

### **Debt impairment – receivables from exchange transactions**

10. As disclosed in note 2 to the financial statements, cumulative debt impairment provision of R10,2 million (2018-19: R8,3 million) was due to the slow recovery of old consumer debts.

### **Debt impairment – receivables from non-exchange transactions**

11. As disclosed in notes 3 to the financial statements, cumulative debt impairment provision of R41,6 million (2018-19: R24,1 million) were due to the slow recovery of old consumer debts.

### **Unauthorised expenditure**

12. As disclosed in note 33 to the financial statements, unauthorised expenditure of R24 million (2018-19: R12,8 million) was incurred in the current year. The cumulative balance as at 30 June 2020 was R136,1 million.

### **Irregular expenditure**

13. As disclosed in note 35 to the financial statements, irregular expenditure of R4,5 million (2018-19: R13,7 million) was incurred due to non-compliance with SCM legislations. The cumulative balance as at 30 June 2020 was R281,8 million.

### **Other matter**

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

### **Unaudited disclosure note**

15. 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 on it.

## **Responsibilities of the accounting officer for the financial statements**

16. 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 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.
17. In preparing the financial statements, the accounting officer is responsible for assessing the 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**

18. 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.
19. 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**

20. In accordance with the Public Audit Act 25 of 2004 (PAA) and the general notice issued in terms thereof, I have a responsibility to report on the usefulness and reliability of the reported performance information against predetermined objectives for the selected development priority presented in the annual performance report. I performed procedures to identify material findings but not to gather evidence to express assurance.
21. My procedures address the usefulness and reliability of the reported performance information, which must be based on the municipality's approved performance planning documents. I have not evaluated the completeness and appropriateness of the performance indicators/measures included in the planning documents. My procedures do not examine whether the actions taken by the municipality enabled service delivery. My procedures also do 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.
22. 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 priority presented in the municipality's annual performance report for the year ended 30 June 2020:

Development priority	Pages in the annual performance report
KPA – basic service delivery	x – x

23. 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.
24. The material findings in respect of the usefulness and reliability of the selected development priority are as follows:

#### Comparison between performance of the year under review and previous year

25. 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.

#### Various indicators

26. The planned target was not consistent with the planned indicator:

Indicator	Target
Number of completed construction of gravel access roads	Planning and design of Mnqandanto to Cheka Gravel Access Road
8km gravel access road rehabilitated	Construction of Mkhumenge 2km Access Road
Number of completed construction of gravel access roads	Planning and design of T101 to lower Lwandlana access road
Km of storm water facilities installed	Preliminary design and final design of Tsolo storm water

#### Number of completed construction of gravel access roads

27. The performance measure for the below indicator is not well defined because the target is not specific, as the required level of performance is not clearly specified/defined.

Planned and reported indicator	Planned and reported target
Number of completed construction of gravel access roads	Gravel access road of Debeza

## **Other matter**

28. I draw attention to the matter below.

### **Achievement of planned targets**

29. Refer to the annual performance report on pages ... to ... 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 25 to 27 of this report.

### **Adjustment of material misstatements**

30. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of basic service delivery. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are reported above.

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

### **Introduction and scope**

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

32. The material findings on compliance with specific matters in key legislation are as follows:

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

33. 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 identified by the auditors in the submitted financial statements were not corrected and/or the supporting records were not provided subsequently, which resulted in the financial statements receiving a qualified audit opinion.

### **Procurement and contract management**

34. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding were advertised for a required minimum period of days, as required by supply chain management (SCM) regulation 22(1) and 22(2). This non-compliance was identified in the procurement processes for the PC-FBS-MHLM2020-21/CL/4-supply and delivery of paraffin cluster 4.

35. 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). This non-compliance was

identified in the procurement processes for the supply and delivery of school uniform, and supply and delivery of protective clothing.

36. Sufficient appropriate audit evidence could not be obtained that some commodities designated for local content and production were procured from suppliers that submitted a declaration on local production and content, as required by the 2017 preferential procurement regulation 8(5). This limitation was identified in the procurement processes for the supply and delivery of school uniform.

#### **Asset management**

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

#### **Consequence management**

38. Sufficient appropriate audit evidence could not be obtained that unauthorised expenditure incurred by the municipality was investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(a) of the MFMA.
39. Sufficient appropriate audit evidence could not be obtained that irregular expenditure incurred by the municipality was investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(b) of the MFMA.
40. Sufficient appropriate audit evidence could not be obtained that fruitless and wasteful expenditure incurred by the municipality was investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(b) of the MFMA.

#### **Expenditure management**

41. Reasonable steps were not taken to prevent irregular expenditure of R4,5 million disclosed in note 35 to the financial statements, as required by section 62(1)(d) of the MFMA. The majority of the irregular expenditure was caused by non-compliance with SCM legislation.
42. Reasonable steps were not taken to prevent fruitless and wasteful expenditure of R0,63 million, as disclosed in note 34 to the financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed fruitless and wasteful expenditure was caused by late payments to suppliers.
43. Reasonable steps were not taken to prevent unauthorised expenditure of R24 million, as disclosed in note 33 to the 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.

#### **Strategic planning and performance management**

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

## Other information

45. 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 and the selected objective presented in the annual performance report that has been specifically reported in this auditor's report.
46. 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 on it.
47. 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 objectives presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
48. 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

49. 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.
50. Leadership did not adequately implement the action plan to address the previous year's audit findings on the financial statements, compliance with laws and regulations and the annual performance report. This is evidenced by the repeat findings in the current financial statements and the annual performance report.
51. Adequate internal controls have not been implemented over the monthly financial and performance reporting processes. This resulted to material misstatements in the financial statements and annual performance report.
52. The municipality did not have adequate systems in place to monitor compliance with all applicable legislation, as recurring findings were raised in the financial year under review. Non-compliance with legislation could have been prevented had compliance been properly reviewed and monitored.

*Auditor - General*

East London

31 March 2021



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 priority 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 relating to events or conditions that may cast significant doubt on the ability of the Mhlontlo Local Municipality 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 my 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 operating as a going concern
  - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and determine 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, the actions taken to eliminate threats or the safeguards applied.