

**REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL
LEGISLATURE AND THE COUNCIL ON MHLONTLO MUNICIPALITY**

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Mhlontlo Municipality, which comprise the statement of financial position as at 30 June 2011, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and 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 (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, 2010 (Act No.1 of 2010 as amended) (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 separate 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 about whether the financial statements are free from material misstatement.
5. 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.
6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis of qualified opinion

Financial instruments

7. The municipality did not charge interest of R 0.9 million on overdue debtors' accounts and as a result did not reflect interest revenue in the statement of financial performance, and did not initially recognise receivables at their fair values as required by IAS 39 (International Accounting Standard 39). I was unable to confirm or verify these amount by alternative means and as a result, could not confirm the existence, valuation, completeness or rights and obligations of the this figures.

Irregular expenditure

8. I was unable to verify the completeness of the irregular expenditure, stated at R 7 million in note 34 to the financial statements. Section 112(1) of the Municipal Finance Management Act, 2003, (No. 56 of 2003) (MFMA) and sections 12(1)(c) and 19(a) of the Municipal Supply Chain Management (SCM) requires the municipality to implement and maintain an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost-effective. Payments amounting to R 11.5 million were made in contravention of the supply chain management requirements. The amount was not included in irregular expenditure, disclosed in note 34 to the financial statements, resulting in irregular expenditure being understated by R 11.5 million. No alternative audit procedures could be performed to quantify the irregular expenditure that should be disclosed.

Corresponding figures

9. The auditor's report for the year ended 30 June 2010 contained a disclaimer of opinion on the financial statements as a whole due to a limitation on the scope of the audit. The matters which gave rise to the limitation, as described below, remain unresolved in the current year.
10. The municipality did not disclose capital commitments outstanding at year end as required by GRAP 17: Property, Plant and Equipment (PPE).
11. GRAP 17: PPE, read with Directive 4: Transitional Provisions for Medium and Low Capacity Municipalities require the municipality to have recognised all PPE assets. Even though the opening balance of PPE as disclosed in note 2 to the financial statements is reflected at zero (provisional values), the municipality is still required to maintain a complete listing of all PPE assets.
12. The municipality could not provide sufficient appropriate audit evidence regarding vat of R10.8 million disclosed in note 5 to the financial statements;
13. The municipality could not provide sufficient appropriate audit evidence regarding consumer debtors of R14.8 million disclosed in note 6 to the financial statements;
14. The municipality could not provide sufficient appropriate audit evidence regarding creditors amounting to R11.9 million disclosed in note 10 to the financial statements due to non-disclosure of councilors' UIF liability.
15. I was unable to confirm or verify these amounts by alternative means and as a result, could not confirm the existence, valuation, completeness or rights and obligations of the above mentioned amounts included in the corresponding figures.

Opinion

16. In my opinion, except for the effects of the matter(s) described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Mhlontlo Municipality as at June 2011 and its financial performance and cash flows for the year then ended, in accordance with GRAP and the requirements of the MFMA and DORA.

Emphasis of matters

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

Unauthorised, irregular and fruitless and wasteful expenditure

18. The municipality has incurred unauthorised expenditure of R 4,753,034 as disclosed in note 32 of the financial statements due to funds spent for purposes which were not in accordance with the vote.
19. The municipality incurred irregular expenditure of R 7,036,421 as disclosed in note 34 of the financial statements as the expenditure incurred was in contraventions with laws and regulations relating to supply chain management.
20. The municipality incurred fruitless and wasteful expenditure of R 83,154 as disclosed in note 33 of the financial statements due to interest arising from late payment of supplier invoices.

Additional matters

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

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

22. 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.

Annual financial statements, performance and annual report

23. The financial statements submitted for audit did not comply with section 126(1)(a) of the MFMA. Material misstatements were identified during the audit uncorrected misstatements are included in the basis for adverse of opinion paragraphs.
24. The municipality, did not within 14 days of the adoption of its IDP give notice to the public of the adoption of the plan and that copies of or extracts from the plan are available for public inspection as by Section 25(4)(a) of the Municipal Systems Act 32 of 2000
25. The Municipal Manager of a municipality did not submit a copy of the Integrated Development Plan as adopted by the council of municipality and any subsequent amendment to the plan, to the MEC for Local Government in the province within 10 days of the adoption or amendment of the plan as by Section 32 of the Municipal Systems Act No.32 of 2000
26. The council did not adopt PMS before or at the same time as the commencement by the municipality of the process of setting KPIs and targets in accordance with its IDP as required by Reg. 8 of Municipal Planning and Performance Management Regulations.
27. The performance agreement did not include performance objectives and targets that must be met, and the time frames within which those performance objectives and targets must be met as required by Section 57(4)(a) of the Municipal Systems Act No.32 of 2000
28. The mayor of a municipality did not take all reasonable steps to ensure that the municipality's service delivery and budget implementation plan is approved by the mayor within 28 days after the approval of the budget. as required by Section 53(1)(c) of the Municipal Finance Management Act, No.56 of 2003

29. The accounting officer of the municipality did not, not later than 10 working days after the end of each month submit to the Mayor and relevant provincial Treasury a statement in a prescribed format on the statement of the municipal budget reflecting the following particulars for that month and for the financial year up to the of that month as required by Section 71 of MFMA states.
30. The annual budget of the municipality is not based on the development priorities as well as the performance targets set by the municipality in its IDP as required by regulation 6 of the Municipal Planning and Performance Management Regulations, 2001.

Procurement and contract management

31. Goods and services with a transaction value of between R10 000 and R500 000 were procured without inviting at least three written price quotations from prospective suppliers, as per the requirement of section 12(1)(c) of Supply Chain Management Regulations.
32. Goods and services with a transaction value above R200 000 were not procured by means of a competitive bidding process as per the requirements section 19(a) of Supply Chain Management Regulations.
33. Construction contracts were awarded to contractors who are not registered with the Construction Industry Development Board (CIDB), as per the requirement of section 18(1) of the CIDB Act.

Expenditure management

34. The accounting officer did not take effective and appropriate steps to prevent unauthorised, irregular and fruitless and wasteful expenditure, as per the requirements of section 62(1)(d) of the MFMA.
35. All payments due to creditors were not settled within 30 days from receipt of an invoice, as per the requirements of section 65(2)(e) of the MFMA.

Transfer of funds

36. The accounting officer did evaluate the performance of the infrastructure funded by the municipal infrastructure grants allocated to Mhlontlo Municipality and submit the evaluation to the National Treasury within two months after the end of the financial year, as per the requirements of DoRA section 11(6).

Revenue management

37. The accounting officer did not take effective and appropriate steps to collect all money due to the municipality, as required in terms of section 64(2)(a) of the MFMA.

Asset management

38. The accounting officer did not ensure that a proper control system exists for assets to eliminate theft, losses, wastage and misuse, as required in terms of section (63) of MFMA.

INTERNAL CONTROL

Achievement of internal control objectives

39. 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 disclaimer opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

- 40. Actions are not taken to address risks relating to the achievement of complete and accurate financial and performance reporting.
- 41. Control weaknesses are not analysed, and appropriate follow-up actions are not taken that address root causes
- 42. The accounting officer does not exercise oversight responsibility over reporting and compliance with laws and regulations and internal control.

Financial and performance management

- 43. General information technology controls are not designed to maintain the integrity of the information systems and the security of the data.
- 44. Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.
- 45. The financial statements and other information to be included in the annual report are not reviewed for completeness and accuracy prior to submission for audit.
- 46. The municipality does not have competent individuals who understand the financial reporting framework and performance management requirements

Governance

- 47. Implementation of internal and external audit recommendations are not monitored
- 48. Regular risk assessments, including consideration of IT risks and fraud prevention are not conducted.

Auditor General

East London

30 November 2011



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence