

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 the Mhlontlo Local Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2012, the statement of financial performance, statement of changes in net assets and the cash flow statement for the year then ended, and 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 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, 2011 (Act No. 6 of 2011) (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 the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and 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 qualified audit opinion.

Basis for qualified of opinion

Property, plant and equipment

6. In terms of section 63 of the MFMA the municipality is required to maintain a system of internal control and a register of assets and liabilities. The asset register exceeded the amount stated in the financial statements by R19,3 million. I was unable to obtain sufficient appropriate audit evidence to confirm the valuation of movable and immovable assets stated within property, plant and equipment to the value of R38,8 million. In addition, I was unable to obtain sufficient appropriate audit evidence to confirm the existence of movable assets within

property, plant and equipment, resulting in it being overstated by R5,9 million. The physical assets were not tagged to correlate to the fixed asset register. A number of assets verified were not included in the asset register. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments to property, plant and equipment was necessary.

7. Sufficient appropriate audit evidence for the calculation of the depreciation presented in the statement of financial performance and accumulated depreciation disclosed in note 2.1 to the financial statements could not be provided and the application of alternative procedures was not possible. I was therefore unable to verify the accuracy of the depreciation amount of R12,5 million (2011: R8,5 million) and accumulated depreciation of R58,9 million (2011: R50,4 million) presented in the financial statements.
8. Sufficient appropriate audit evidence could not be obtained for the GRAP 17, *Property, plant and equipment* adjustment amounting to R22 million included in property, plant and equipment and reflected on the statement of changes in net assets. I was therefore unable to determine if further adjustments were necessary to the amount disclosed and could not verify the correct valuation of the amount. The application of alternative procedures was not possible.

Leave accrual

9. The leave accrual was incorrectly calculated resulting in the accrual being understated by R1,1 million. The personnel costs presented on the statement of financial performance have been understated by the same amount.

Irregular expenditure

10. The municipality made payments in contravention of the supply chain management (SCM) regulations, which were not included in the irregular expenditure note to the financial statements, resulting in irregular expenditure being understated by R1,7 million. It was impracticable to determine the full extent of the understatement of irregular expenditure disclosed. Consequently, I was unable to determine whether any further adjustments were necessary to the irregular expenditure disclosure note.
11. Sufficient, appropriate audit evidence was not submitted to support the council's approval of the housing allowance for employees. Furthermore, the individual employment contracts did not reflect this arrangement. Therefore the overpayment of salaries resulted in the understatement of irregular expenditure by a further amount of R400 125.

Receivables from exchange and non-exchange transactions

12. Note 6.1 to the financial statements presents consumer debtors of an amount of R17,4 million (2011: R14,9 million) and an impairment of debt amounting to R16,9 million (2011: R6,4 million). However, I was unable to verify the existence of debtors amounting to R16,7 million even with the application of alternative procedures. I was unable to determine whether any further adjustments to receivables from exchange and non exchange transactions, revenue from exchange and non exchange transactions and accumulated surplus were necessary.
13. The municipality did not charge interest of R900 000 on overdue debtors' accounts in the prior year. As a result the municipality did not reflect interest revenue in the corresponding figures in the statements of financial performance. The prior year error has not been adjusted.

Value-added taxation (VAT) receivable

14. Sufficient appropriate audit evidence could not be presented to support the VAT receivable balance of R10,1 million as disclosed in note 5.1 to the financial statements. I was unable to confirm the balance by alternative means.
15. Furthermore, the VAT portion of the debt impairment relating to the old balances on consumer debtors amounting to R5,2 million, as disclosed in note 6.1 to the financial statements, was not split between revenue from exchange and non-exchange transactions and therefore I was unable to calculate the overstatement of the VAT control account. I was unable to confirm the amounts by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the VAT receivable.

Qualified opinion

16. In my opinion, except for the possible effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of Mhlontlo Local Municipality as at 30 June 2012 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 matter

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

Material Impairments

18. The municipality had receivables for consumer debtors older than 120 days totalling R16,3 million at 30 June 2012. The recoverability of these amounts is doubtful and they were included in the impairment of doubtful debts amount by the municipality.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

19. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

20. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages xx to xx of the annual report.
21. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury annual reporting principles and whether the reported performance is consistent with the planned development priorities. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury *Framework for managing programme performance information*.

The reliability of the information in respect of the selected development priority is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

The material findings are as follows:

Usefulness of information

Presentation

Measures taken to improve performance not disclosed

22. Improvement measures in the annual performance report for all of the planned targets not achieved were not disclosed as required by section 46 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA). This was due to inadequate internal policies and procedures over the processes pertaining to the reporting of performance information. This misstatement occurred due to the lack of review of the annual performance report before it was submitted for audit purposes.

Consistency

Reported objectives, indicators and targets not consistent with planned indicators and targets

23. The MSA, section 41(c) requires that the integrated development plan (IDP) should form the basis for the annual report, therefore requiring the consistency of objectives, indicators and targets between planning and reporting documents. A total of 26% of objectives, 33% of indicators and 39% of targets of the reported objectives, indicators and targets are not consistent with the indicators and targets as per the approved IDP. This is due to the lack of a performance management system to monitor actual results against planned indicators and targets.

Measurability

Performance targets not specific

24. The FMPPi requires that performance targets be specific in clearly identifying the nature and required level of performance. All of the targets relevant to *Infrastructure development and planning* were not specific in clearly identifying the nature and the required level of performance. This was due to the fact that management was aware of the requirements of the FMPPi but did not receive the necessary training to enable application of the principles.

Performance Indicators not well defined

25. The FMPPi requires that indicators should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. All of the indicators relevant to all the key priorities of the municipality were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently.

Indicators not verifiable

26. The FMPPi requires that it must be possible to validate the processes and systems that produce the indicator. All the indicators relevant to all the key priorities of the municipality were not verifiable in that valid processes and systems that produce the information on actual performance did not exist.
27. Management failed to meet the measurability criteria as a result of the absence of a performance management system and a lack of understanding of the requirements of the FMPPi.

Reliability of Information

Validity, accuracy and completeness

28. The FMPPI requires that processes and systems which produce the indicator should be verifiable and accurate for its intended use and should respond to changes in the level of performance and that documentation addressing the systems and processes for identifying, collecting, collating, verifying and storing information be properly maintained. I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the validity, accuracy and completeness of the actual reported performance relevant to all key priorities of the municipality. This was due to limitations placed on the scope of my work due to the absence of a performance management system and management's lack of understanding of the requirements of the FMPPI.

Additional matter

29. In addition to the above material findings, I draw attention to the following matter:

Achievement of planned targets

30. Of the total number of planned targets, only 100 targets were achieved during the year under review. This represents 37% of total planned targets that were either not achieved or not reported on during the year under review. This was mainly due to the fact that indicators and targets were not suitably developed during the strategic planning process.

Compliance with laws and regulations

31. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the general notice issued in terms of the PAA are as follows:

Budgets

32. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

Financial statements, performance and annual reports

33. The accounting officer did not submit the financial statements for auditing within two months after the end of the financial year, as required by section 126(1)(a) of the MFMA.
34. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA.
35. Material misstatements of non-current assets, current assets, liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements resulted in the financial statements receiving a qualified audit opinion.
36. The annual performance report for the year under review does not include a comparison with the previous financial year and measures taken to improve performance, as required by section 46(1) of the MSA.

Strategic planning and performance management

37. The municipality did not give effect to its IDP and conduct its affairs in a manner which was consistent with its IDP as required by section 36 of the MSA and Municipal Planning and Performance Management Regulation 6 (MPPMR).

38. The municipal council did not review its IDP annually in accordance with an assessment of its performance measurements in terms of section 41 and to the extent that changing circumstances demanded, as required by section 34 of the MSA and MPPMR 3.
39. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
40. The municipality did not set measurable performance targets with regard to each development priority and objective; monitor performance, with regard to each of those development priorities and objectives and against the key performance indicators and targets set; take steps to improve performance with regard to those development priorities and objectives where performance targets are not met as required by section 41 of the MSA.

Audit committee

41. A performance audit committee was not in place. The charter of the audit committee established in terms of MFMA section 166(1) was amended during the year but not approved by the council to take on a reviewing function, as required by MPPMR 14(2)(a).
42. The performance audit committee did not meet at least twice during the financial year, as required by MPPMR 14(3)(a).
43. The performance audit committee did not review the municipality's performance management system and/or make recommendations to the council, as required by MPPMR 14(4)(a)(ii).
44. The performance audit committee did not review all the quarterly internal audit reports on performance measurement, as required by MPPMR 14(4)(a)(i).
45. The performance audit committee did not submit at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by MPPMR 14(4)(a)(iii).

Expenditure management

46. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
47. The accounting officer did not take effective steps to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
48. Unauthorised, irregular and fruitless and wasteful expenditure was not recovered from the liable person, as required by section 32(2) of the MFMA.

Revenue management

49. A tariff policy on the levying of fees for municipal services provided by the municipality was not adopted, as required by section 74(1) of the MSA and section 62(1)(f)(i) of MFMA.
50. A credit control and debt collection policy was not adopted and implemented, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of MFMA.
51. A policy on the levying of rates on rateable property within the municipality was not adopted, as required by section 3(1) of the Property Rates Act and section 62(1)(f)(ii) of MFMA.

Asset management

- 52. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
- 53. An effective system of internal control for assets, including an asset register, was not in place, as required by section 63(2)(c) of the MFMA.
- 54. The council did not approve the investment policy of the municipality, as required by Municipal Investment Regulation 3(1)(a).

Liability management

- 55. A management, accounting and information system which adequately accounts for liabilities was not in place, as required by section 63(2)(a) of the MFMA.
- 56. An effective system of internal control for liabilities, including a liability register, was not in place, as required by section 63(2)(c) of the MFMA.

Procurement and contract management

- 57. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) and (c).
- 58. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
- 59. Sufficient appropriate audit evidence could not be obtained that the preference point system was applied in the procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act, 2000 (Act No.5 of 2000) (PPPFA) and SCM regulation 28(1)(a).
- 60. Sufficient appropriate audit evidence could not be obtained that contracts were awarded to suppliers based on preference points that were allocated and calculated in accordance with the requirements of the PPPFA and its regulations.
- 61. Contracts and quotations were awarded to 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).
- 62. Bid documentation/ request for quotations did not specify the evaluation and adjudication criteria which include the preference point system (80/20 or 90/10) to be used as prescribed in terms of the PPPFA 3(c).

Internal control

- 63. Considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control 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

64. The leadership did not exercise oversight over the municipality's compliance with laws and regulations. It did not hold management accountable for reporting on its monitoring of compliance. Furthermore, the leadership did not take a systematic and detailed approach to hold management accountable for financial and performance management, and the development of a proactive approach and an in-depth understanding of the meaning and requirements of the oversight processes it requires.

Financial and performance management

65. Management has not yet completed the implementation of plans to address previous audit findings and previous deficiencies in key controls, which has resulted in uncorrected misstatements having continuous effects on the fair presentation of the current year's financial statements. Management did not review the annual report of performance against predetermined objectives for completeness and accuracy before it was submitted for audit purposes. The correction of material misstatements and the reliance on consultants for the preparation of the financial statements and supporting documentation submitted for auditing is not sustainable and there is no transfer of skills to the municipality.

Governance

66. The audit committee and internal audit were not given sufficient time to discharge their function of reviewing the accuracy, reliability and adequacy of the financial statements and performance report. As a result, the review did not have the desired impact on the fair presentation evidenced by the deficiencies noted in this report.

Auditor General

East London

30 November 2012



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence