



The Accounting Officer
Mkhondo Local Municipality
P. O Box 23
Piet Retief
1380
30 November 2015

Reference: 02394REG14/15

Dear Sir

Report of the Auditor-General on the financial statements and other legal and regulatory requirements of Mkhondo Local Municipality for the year ended 30 June 2015

1. The above-mentioned report of the Auditor-General is submitted herewith in terms of section 21(1) of the Public Audit Act of South Africa read in conjunction with section 188 of the Constitution of the Republic of South Africa and section 121(3) of the Municipal Finance Management Act of South Africa (MFMA)
2. We have not yet received the other information that will be included in the annual report with the audited financial statements and have thus not been able to establish whether there are any inconsistencies between this information and the audited financial statements and the reported performance against pre-determined objectives. You are requested to supply this information as soon as possible. Once this information is received it will be read and should any inconsistencies be identified these will be communicated to you and you will be requested to make the necessary corrections. Should the corrections not be made we will amend and reissue the audit report.
3. In terms of section 121(3) of the MFMA you are required to include the audit report in the municipality's annual report to be tabled.
4. Until the annual report is tabled as required by section 127(2) of the MFMA, the audit report is not a public document and should therefore be treated as confidential.
5. Prior to printing or copying the annual report which will include the audit report you are required to do the following:
 - Submit the final printer's proof of the annual report to the relevant senior manager of the Auditor-General of South Africa for verification of the audit-related references in the audit report and for confirmation that the financial statements and other information are those documents that have been read and audited. Special care should be taken with the page references in your report, since an incorrect reference could have audit implications.
 - The signature *Auditor-General* in the handwriting of the auditor authorised to sign the audit report at the end of the hard copy of the audit report should be scanned in when preparing to print the report. This signature, as well as the place and date of signing and the Auditor-General of South Africa's logo, should appear at the end of the report, as in


the hard copy that is provided to you. The official logo will be made available to you in electronic format.

6. Please notify the undersigned Senior Manager well in advance of the date on which the annual report containing this audit report will be tabled.
7. Your cooperation to ensure that all these requirements are met would be much appreciated.

Kindly acknowledge receipt of this letter.

Yours sincerely

Signed

A handwritten signature in black ink, appearing to be 'Vusi Gcaba', written over a horizontal dotted line. The signature is stylized and somewhat cursive.

Senior Manager: Mpumalanga Business Unit

Enquiries: Vusi Gcaba

Telephone: (012) 345 6789

Fax: (012) 345 6789

Auditor's report

Mkhondo Local Municipality

30 June 2015

Report of the auditor-general to the Mpumalanga Provincial Legislature and the council on the Mkhondo Local Municipality

Report on the financial statements

Introduction

1. I have audited the financial statements of the Mkhondo Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2015, 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, 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 (SA 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, 2014 (Act No. 10 of 2014) (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 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 municipality'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 municipality'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 opinion

Property, plant and equipment

6. In terms of GRAP 17 *Property, plant and equipment*, an entity shall recognise items of property, plant and equipment that qualify for recognition as assets in the financial statements. Contrary to this requirement, the municipality did not recognise all assets in its financial statements, as assets selected from the floor or identified through deed searches could not be traced to the fixed asset register. I was unable to determine the full extent of this misstatement, as it was impracticable to do so.
7. The municipality did not have adequate systems to properly record assets and maintain accurate records in order to account for property, plant and equipment in accordance with GRAP 17. Assets were duplicated in the fixed asset register and instances of incorrect bar codes and a lack of descriptions were also identified. Assets amounting to R8 574 562 could not be physically verified. In addition, the carrying amounts were not adequately reflected in the fixed asset register, as additions were not consistently depreciated. Misstatements amounting to R3 676 064 were identified in the carrying amounts selected.
8. Consequently, I was unable to determine whether the property, plant and equipment of R1 232 071 183 (2013-14: R1 204 542 365) disclosed in note 5 to the financial statements and the depreciation expense of R70 046 052 (2013-14: R71 900 041) disclosed in note 31 to the financial statements were fairly stated.

Investment property

9. The municipality did not recognise all property held to earn rental or for capital appreciation as investment property, in accordance with GRAP 16 *Investment property*. These properties were identified through deed searches and no information could be provided to prove that these properties had indeed been handed over to the community. I was unable to determine the full extent of the misstatement of investment property, as it was impractical to do so. Furthermore, some properties that were not registered in the name of the municipality were included in the fixed asset register to the value of R748 000. Sufficient appropriate evidence was not provided to prove ownership of these properties. Consequently, I was unable to determine whether the investment property amounting to R18 309 600 (2013-14: R18 949 100) disclosed in note 4 to the financial statements and the depreciation expense of R639 500 (2013-14: R639 500) disclosed in note 31 to the financial statements were fairly stated.

Revenue

10. During 2013-14, I was unable to obtain sufficient appropriate audit evidence for property rates in relation to new connections processed and to confirm the revenue by alternative means. Consequently, I was unable to determine whether any adjustment to property rates stated at R20 107 868 had been necessary. My audit opinion on the financial statements for the period ended 30 June 2014 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Expenditure

11. During 2013-14, I was unable to obtain sufficient appropriate audit evidence for operating expenditure and to confirm the expenditure by alternative means. Consequently, I was unable to determine whether any adjustment to operating expenditure stated at R183 268 753 had been necessary. My audit opinion on the financial statements for the period ended 30 June 2014 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Payables from exchange transactions

12. During 2013-14, I was unable to obtain sufficient appropriate audit evidence for trade payables and sundry creditors and to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustment to operating expenditure stated at R91 163 014 had been necessary. My audit opinion on the financial statements for the period ended 30 June 2014 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Material losses

13. During 2013-14, I was unable to obtain sufficient appropriate audit evidence for material losses and to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any adjustment to material losses stated at R27 969 251 had been necessary. My audit opinion on the financial statements for the period ended 30 June 2014 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Aggregation of immaterial uncorrected misstatements

14. The financial statements were materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following item making up the statement of financial position:
 - Consumer debtors as reflected as R23 647 617 are understated by R1 666 274
15. In addition, I was unable to obtain sufficient appropriate audit evidence and to confirm the following items by alternative means:
 - Consumer deposit of R3 150 537 as included in the disclosed balance of R3 150 537
 - Payables from exchange transactions (debtors with negative balances) of R3 066 517 as included in the disclosed balance of R149 928 499

As a result, I was unable to determine whether any further adjustments to these items were necessary.

Qualified opinion

16. In my opinion, except for the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Mkhondo Local Municipality as at 30 June 2015 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of 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.

Restatement of corresponding figures

18. As disclosed in note 49 to the financial statements, the corresponding figures for 30 June 2014 have been restated as a result of an error discovered during 2014-15 in the financial statements of the municipality at, and for the year ended, 30 June 2014.

Material losses

19. As disclosed in note 46 to the financial statements, material losses of R29 213 404 (2013-14: R27 252 134) were incurred as a result of electricity distribution losses, which represented 36% (2013-14: 31%) of the total electricity purchased. Material losses of R1 696 593 (2013-14: R717 117) were incurred as a result of water distribution losses, which represented 83% (2013-14: 84%) of the total water purchased.

Material impairments

20. As disclosed in note 12 to the financial statements, the receivables balance was significantly impaired. The impairment of consumer debtors amounted to R139 138 993 (2013-14: R114 064 056), which represented 85% (2013-14: 86%) of the total consumer debtors. The contribution to the provision for debt impairment was R25 074 935 (2013-14: R19 646 494).

Additional matters

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

Unaudited supplementary schedules

22. The supplementary information set out on pages ... to ... does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

Unaudited disclosure notes

23. 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 financial statements and, accordingly, I do not express an opinion thereon.

Report on other legal and regulatory requirements

24. 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 findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

25. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2015:

- Development priority 1: basic service delivery, on pages ... to ...
- Development priority 4: financial viability and management, on pages ... to ...

26. I evaluated the reported performance information against the overall criteria of usefulness and reliability.

27. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development priorities. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPi).

28. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

29. The material findings in respect of the selected development priorities are as follows:

Basic service delivery

Usefulness of reported performance information

30. Section 41(c) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) requires the integrated development plan or service delivery agreement to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 23% of the reported indicators and objectives as well as 33% of the reported targets were not consistent with those in the approved integrated development plan or service delivery agreement. This was due to a lack of review by management as well as a lack of skills in the performance section.

31. Section 25(2) of the MSA determines that an integrated development plan adopted by a municipal council may be amended in accordance with the process as prescribed per section 34 of the MSA, and that such a plan remains in force until an integrated development plan is adopted by the next elected council. Material changes were made to the development priorities, indicators and targets in the annual performance report, without following the process as prescribed in section 34 of the MSA and without adoption by the municipal council. This was due to management oversight.
32. Performance targets should be specific in clearly identifying the nature and required level of performance, as required by the FMPPI. A total of 51% of the targets were not specific.
33. Performance targets should be measurable, as required by the FMPPI. I could not measure the required performance for 35% of the targets.
34. Performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use, as required by the FMPPI. A total of 36% of the indicators were not well defined.
35. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 20% of the indicators were not verifiable.

This was because management was not trained in the requirements of the FMPPI due to a lack of attendance of training sessions by staff members.

Reliability of reported performance information

36. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work, as the municipality could not provide sufficient appropriate evidence in support of the reported performance information and the municipality's records not permitting the application of alternative audit procedures.

Financial viability and management

Usefulness of reported performance information

37. Section 41(c) of the MSA requires the integrated development plan or service delivery agreement to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 60% of the reported objectives, 23% of the reported indicators and 63% of the reported targets were not consistent with those in the approved integrated development plan or service delivery agreement. This was due to a lack of review by management as well as a lack of skills in the performance section.

38. Section 25(2) of the MSA determines that an integrated development plan adopted by a municipal council may be amended in accordance with the process as prescribed per section 34 of the MSA, and that such a plan remains in force until an integrated development plan is adopted by the next elected council. Material changes were made to the development priorities, indicators and targets in the annual performance report, without following the process as prescribed in section 34 of the MSA and without adoption by the municipal council. This was due to management oversight.
39. Performance targets should be specific in clearly identifying the nature and required level of performance, as required by the FMPPI. A total of 24% of the targets were not specific.
40. Performance targets should be measurable, as required by the FMPPI. I could not measure the required performance for 24% of the targets.
41. Performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use, as required by the FMPPI. A total of 58% of the indicators were not well defined.
42. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 21% of the indicators were not verifiable.

This was because management was not trained in, and did not adhere to, the requirements of the FMPPI due to a lack of attendance of training sessions by staff members.

Reliability of reported performance information

43. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. Significantly important targets were not reliable when compared to the source information or evidence provided. This was due to a lack of monitoring of the completeness of source documentation in support of actual achievements as well as frequent review of the validity of reported achievements against source documentation.

Additional matter

44. I draw attention to the following matter:

Achievement of planned targets

45. Refer to the annual performance report on pages ... to ... for information on the achievement of the 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 for the selected development priorities reported in paragraphs 30 to 43 of this report.

Compliance with legislation

46. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Strategic planning and performance management

47. The municipality did not give effect to its integrated development plan and conduct its affairs in a manner consistent with its integrated development plan, as required by section 36 of the MSA, section 21(2)(a) of the MFMA and municipal planning and performance management regulation 6.
48. The service delivery and budget implementation plan, used for implementing the municipality's delivery of municipal services and annual budget, did not indicate projections for each month of the revenue to be collected (by source) and the operational and capital expenditure (by vote), as required by section 1 of the MFMA.
49. The performance management system and related controls were inadequate, as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting and improvement as well as how it is to be conducted, organised and managed, as required by section 38 of the MSA and municipal planning and performance management regulation 7.

Annual financial statements, performance report and annual report

50. The 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 unauthorised and irregular expenditure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records provided, but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.
51. The annual performance report for the year under review did not include a comparison with the previous financial year and measures taken to improve performance, as required by section 46(1)(b) and (c) of the MSA.

Procurement and contract management

52. Bid adjudication was not always done by committees composed in accordance with supply chain management (SCM) regulation 29(2).
53. 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 SCM regulations 21(b) and 28(1)(a) and the preferential procurement regulations.
54. A list of accredited prospective providers was not in place for procuring goods and services through quotations, as required by SCM regulation 14(1)(a).
55. Contracts and quotations were awarded to bidders based on preference points that had not been allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act of South Africa, 2000 (Act No. 5 of 2000) and its regulations.

Expenditure management

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

57. Reasonable steps were not taken to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Conditional grants

58. The municipal infrastructure grant allocation was not spent in accordance with the applicable grant framework, in contravention of section 17(1) of DoRA.

Revenue management

59. A credit-control and debt-collection policy was not implemented, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of the MFMA.
60. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

Asset management

61. An adequate management, accounting and information system was not in place to account for assets, as required by section 63(2)(a) of the MFMA.
62. 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.

Internal control

63. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. 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

64. The accounting officer did not exercise oversight responsibility regarding financial and performance reporting, compliance as well as related internal controls.
65. Effective human resource management was not implemented to ensure that adequate and sufficiently skilled resources were in place and that performance was monitored.

Financial and performance management

66. Proper record keeping was not implemented in a timely manner to ensure that complete, relevant and accurate information was accessible and available to support financial and performance reporting, resulting in insufficient audit evidence for audit purposes.
67. Management did not ensure that controls were implemented over daily and monthly processing and reconciling of transactions.
68. Management did not prepare regular, accurate and complete financial and performance reports that were supported and evidenced by reliable information.

69. Management did not review and monitor compliance with applicable laws and regulations.

Governance

70. The internal audit unit and audit committee operated effectively during the current period as per their legislated mandate. Recommendations were made to management to improve internal controls and ensure reliable reporting of financial and performance information as well as compliance with legislation. However, this did not result in improved controls due to management not implementing the recommendations.

Auditor - General

Mbombela

30 November 2015



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

