



A U D I T O R - G E N E R A L

The Municipal Manager
PO 21
JEFFREYS BAY
6330

31 January 2008

Reference: 60046REG06/07

Dear Dr. Rankwana

Report of the Auditor-General on the financial statements and performance information of Kouga municipality for the year ended 30 June 2007

The above-mentioned report of the Auditor-General are submitted herewith in terms of section 21(1) of the Public Audit Act, 2004 (Act No. 25 of 2004 read in conjunction with section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996) and section 121(3) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003)(MFMA)

In terms of section 121(3) and 127(2) of the MFMA municipalities have to include the audit report in the municipality's annual report for tabling within seven months after the end of the financial year.

Until tabled as required by section 127(2) the report is **not a public document** and should therefore be treated as **confidential**.

As your municipality will be responsible for publishing the attached audit report as part of the annual report, you are required to do the following:

- Submit the final printer's proof of the annual report (which includes the audit report) to the relevant audit manager of the Auditor-General for verification of the audit-related references before it is printed or copied. Special care should be taken with the page references in your report, since an incorrect reference could have audit implications.
- The signature at the end of the hard copy of the audit report should be scanned in when preparing to print the report. The signature Auditor-General in the handwriting of the auditor authorised to sign the audit report, as well as the place and date of signing and the logo should also appear at the end of the report, as in the hard copy that is provided to you. The official logo and the authorised signature will be made available to you in electronic format.

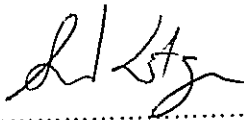
Please notify the Provincial Auditor-General (Business Executive) as well as the Senior Manager: PEL1 well in advance of the date on which the audit report, or the annual report containing this audit report, will be tabled at the municipality.

Your cooperation to ensure that all these requirements are met would be much appreciated.

Kindly acknowledge receipt of this letter.

Yours sincerely

Signed



.....
Manager: PEL1

Enquiries: Naude Kotze
Telephone: (041) 3672823
Fax: (041) 3674465
Email: naude.kotze@agsa.co.za

REPORT OF THE AUDITOR-GENERAL TO THE COUNCIL OF THE KOUGA MUNICIPALITY AND THE EASTERN CAPE PROVINCIAL LEGISLATURE ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF THE KOUGA MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2007

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Kouga Municipality which comprise the statement of financial position at 30 June 2007, 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 notes, as set out on pages 1 to 8.

Responsibility of the accounting officer for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). This responsibility includes:
 - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
 - selecting and applying appropriate accounting policies
 - making accounting estimates that are reasonable in the circumstances.

Responsibility of the Auditor-General

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996, read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004), my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with the International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance 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 controls 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 controls.
6. An audit also includes evaluating the:
 - appropriateness of accounting policies used

- reasonableness of accounting estimates made by management
 - overall presentation of the financial statements.
7. Paragraph 11 et seq. of the Statement of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is still in the process of being developed, I have determined that my audit of any disclosures made by the Kouga Municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.
8. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis of accounting

9. The municipality's policy is to prepare financial statements on the basis of accounting determined by the National Treasury, as set out in accounting policy note 1.

Basis for qualified opinion

Property, plant and equipment (PPE)

10. Property, plant and equipment amounted to R110 million in the statement of financial position at year end and as disclosed in note 10 to the financial statements. As a result of the circumstances detailed below, the extent to which property, plant and equipment might be misstated could not be determined:
- (a) ~~As reported previously, the value of PPE per the asset register and the financial statements differed by R2,1 million since the year ended 30 June 2003. The uncertainty on the correctness of opening balances will exist until such time that a complete and accurate asset register is available and verified/reconciled with a physical stocktaking of assets.~~
 - (b) Not all assets recorded had asset identification numbers.
 - (c) The municipality excluded from the PPE balance in the statement of financial position the assets leased in terms of finance leases that should be capitalised in order to conform to the South African Statement of Generally Accepted Accounting Practice, IAS 17 (AC 105) *Leases*. The recordkeeping of the municipality was inadequate to determine the value of finance lease assets held at year-end.
 - (d) The council proceeded with an asset count on movable assets after year-end. This process was not finalised at the date of this report.

Revenue: Other income

11. Municipal land sold during the 2006-07 financial year was recorded in the statement of financial performance as Other income amounting to R20 million. The necessary records were not provided during the audit in order to verify the completeness of the land sale transactions reflected in the financial statements.

Government grants and subsidies

12. Government grants and subsidies recognised as income in the statement of financial performance for the year ended 30 June 2007 amounts to R35,9 million. Conditional grants related to housing are recognised as revenue when the houses are constructed and the amounts expended. Included in the above mentioned balance is conditional grants related to housing projects to the amount of R9,7 million. (See note 19 to the financial statements). Housing records to verify the administration and allocation of low-cost houses could not be provided in time for audit purposes. I was unable to verify that projects were completed and that all expenditure incurred for housing was valid.

Receivables: Other debtors

13. As reported previously, councillor allowances were, from time to time, not paid in accordance with the approved upper limits as determined in terms of section 7 of the Remuneration of Public Office Bearers Act, 1998 (Act No. 20 of 1998).

In terms of section 167(2)(b) of the MFMA, such expenditure should have been regarded as irregular and the municipality must, and has the right to, recover such remuneration overpaid and may not write off any expenditure incurred by the municipality in this regard.

Council allowances / overpayments made to councillors prior to 1 July 2004, totalling approximately R1 million, were not raised as a receivable notwithstanding a council decision that such overpayments must be raised as a debtor. These overpayments should have been included as part of the balance of Sundry: manual debtors amounting to R3,8 million as at 30 June 2007 in note 15 to the financial statements.

As a result, receivables and the accumulated surplus balances are understated by an amount of R1 million in the statement of financial position

Qualified opinion

14. In my opinion, except for the 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 the Kouga Municipality as at 30 June 2007 and its financial performance and cash flows for the year then ended, in accordance with the basis of accounting determined by the National Treasury, as set out in accounting policy note 1 and in the manner required by the MFMA.

OTHER MATTERS

I draw attention to the following matters that are ancillary to my responsibilities in the audit of the financial statements:

Non-compliance with applicable legislation

Municipal Finance Management Act

15. Section 32(6) of the MFMA requires that the accounting officer must report to the South African Police Service all cases of alleged irregular expenditure that constitute a criminal offence as well as theft and fraud that occurred in the municipality. Alleged fraud at the stores investigated in August 2006 was not reported during the financial year.

Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA)

16. The municipality did not have a human resources plan in place as required in terms of section 67 of the act.

Basic Conditions of Employment Act, 1997 (Act No. 75 of 1997) and related regulations

17. Overtime worked often exceeded 40 hours per month which was in contravention of sections 10(1)(b) and 1A of the act.

Value-Added Tax Act, 1991 (Act No. 89 of 1991)

18. No output VAT had been charged on receipts for town hall rentals as required by section 7 of the act.

Material corrections made to the financial statements submitted for audit

19. The financial statements, approved by the accounting officer and submitted for auditing on 31 August 2007, have been significantly revised (and resubmitted on 18 December 2007) in respect of the following adjustments that came to my attention during the conduct of the audit:
 - (a) The details of PPE as per Appendix B to the financial statements was inconsistent with the the balance amounting to R110 million in the statement of financial position. The Appendix was adjusted to correctly classify the individual line items and to remove negative carrying values.
 - (b) The increase for bad debt provision, amounting to R6,9 million (refer to note 14 to the financial statements) was incorrectly set off in the statement of changes in net assets for the year ended 30 June 2007, instead of being expensed in the statement of financial performance for the year ended 30 June 2007. This resulted in the line item for bad debts being adjusted in the latter statement, which affected the surplus for the year.
 - (c) Comparative amounts related to the Kouga Cultural Centre (Municipal entity) that were included in the prior year consolidated financial

statements, were restated. The most notable restatements made were to the PPE balance (adjusted from R97,9 million to R90,7 million) and Reserves (adjusted from R62 million to R56,9 million).

- (d) Contingent liabilities to the value of R3 million that had been omitted were added to note 36 to the financial statements.
- (e) A net adjustment amounting to R846 325 as a result of year-end stocktaking differences and unrecorded inventory was effected to the balance of inventory as disclosed in note 13 to the financial statements.
- (f) A provision for obsolete stock amounting to R600 000 was recorded, as disclosed in note 13 to the financial statements, which also increased the expenditure for the year.

- (h) The following adjustments were made in the cash flow statement:
 - (i) Cash flow from operating activities:
 - Cash receipts from ratepayers, government and other was adjusted from R231,7 million to R232,6 million.
 - Cash paid to suppliers and employees was adjusted from R206 million to R207 million.
 - (ii) Cash flows from investing activities:
 - (Increase)/decrease in non-current receivables was adjusted from R1,4 million to R233 337.
 - (iii) Cash flows from financing activities:
 - Other capital receipts was adjusted from R7,1 million to R5,6 million.

 - (iv) Net cash from financing activities was adjusted from R19,4 million to R17,9 million.

- (i) Unauthorised expenditure in terms of the MFMA amounting to R14,7 million previously not disclosed. Note 32 to the financial statements was adjusted to disclose the unauthorised expenditure.

Value- for-money matters

20. Capital budget not utilised:

The council budgeted for capital expenditure of R82,1 million for the 2006-07 financial year, but only R28,2 million (34,3%) was spent during the financial year. The cause of underspending appeared to be the non-availability of cash resources, both internally and externally. The budget for borrowing cost and depreciation impacts on the rates tariff set in preparation of the annual operating budgets. The non- delivery of budgeted capital projects therefore implied that the ratepayer did not receive value for money for rates paid.

In addition, the council entered into an agreement in November 2006 to sell land (golf course) for R120 million in order to generate funds for future capital projects. The 2007-08 capital budget was subsequently prepared in the

anticipation that these funds would become available. The purchaser of the municipal land could not fulfil the terms of the sale agreement and the sale was cancelled. The utilisation of the capital budget for the next financial years would be affected as a result.

Internal control

21. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes of the matters indicated, as they relate to the five components of internal control. In some instances deficiencies existed in more than one internal control component.

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
Basis for qualification of opinion					
Property Plant & Equipment	X		X		X
Revenue: other income			X		X
Government grants and subsidies	X		X		X
Receivables: other debtors	X		X		X
Other matters					
Non-compliance with applicable legislation	X		X		X
Material corrections made to the financial statements submitted for auditing			X		X
Value for money matters			X		X

22. Control environment

The municipality did not establish the key elements of a control environment to achieve sound financial management. This resulted in an inadequate level of skills and knowledge to enable the accurate preparation of the financial statements in accordance with the applicable basis of accounting, which in turn gave rise to a number of audit findings concerning non-adherence to the accounting standards as well as the corrections needed to the financial statements.

23. Control activities

The effectiveness of control over business and accountancy processes was not adequate. This was evident from the matters reported relating to the asset register (for example the identification markings of fixed assets were found to be inadequate to verify the existence of movable assets), administration of housing and land sales.

24. Monitoring activities

The monitoring of controls, such as the review of reconciliations, confirmations of external parties, maintenance of land sale registers, administration of housing activities and preparation of financial statements, was not effective.

Investigations in progress

25. An investigation is currently being conducted by the Auditor-General into the processes followed by the municipality regarding the disposal of municipal land. (See also paragraph 11 and 20 of this report) The investigation aims to establish whether relevant regulations and other statutory requirements were complied with during the process of disposal. The investigation was still ongoing at the reporting date.

26. An investigation into alleged irregularities at the stores was conducted by a professional firm during August 2006. Various recommendations for action to be taken were made in the report that was tabled to council in March 2007. The subsequent internal investigation to be taken as result of the abovementioned report was still ongoing at the reporting date.

Unaudited supplementary schedules

27. The supplementary information set out on pages 9 to 17 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 on them.

OTHER REPORTING RESPONSIBILITIES

Reporting on performance information

28. I was engaged to audit the performance information.

Responsibility of the accounting officer for the performance information

29. In terms of section 121(3)(c) of the MFMA the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the MSA.

Responsibility of the Auditor-General

30. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 646 of 2007*, issued in *Government Gazette No.29919 of 25 May 2007* and section 45 of the MSA.

31. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

32. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Audit findings (performance information)

33. Non-compliance with regulatory requirements

33.1 The draft annual report of the Kouga Municipality did not include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the MSA, as required by section 121(3)(c) of the MFMA.

33.2. The performance management system (PMS) as stipulated in chapter 6 of the MSA was not yet in place at the Kouga Municipality during the 2006-07 financial year. (MSA sections 38-49 refers)

33.3. The integrated development plan (IDP) of the Kouga Municipality did not include all the key performance indicators and performance targets as required by section 26(i) of the MSA.

33.4 The Kouga Municipality did not have a properly functioning performance audit committee during the 2006-07 financial year. The existing audit committee was also not utilised as the performance audit committee, as was intended, as required in terms of regulation 14(2)(a) of the Municipal Planning and Management Regulations, 2001.

33.5 The internal audit processes and procedures did not include assessments of the extent to which the Kouga Municipality's performance measurements were reliable in measuring performance of the municipality on key as well as general key performance indicators, as required in terms of section 45(a) of the MSA.

- 33.6 The internal auditors of the Kouga Municipality did not audit the performance measurements on a continuous basis and did not submit quarterly reports on their audits to the municipal manager and the performance audit committee as required in terms of regulation 14(1)(c) of the Municipal Planning and Management Regulations, 2001.
34. No properly developed and implemented PMS and IDP (as indicated above) as well as a Service Delivery and Budget Implementation Plan (SDBIP) were in place during the 2006-07 financial year in order to allow for the alignment of the performance agreements/contracts of municipal officials. Despite this, the council approved and paid performance bonuses to certain officials totalling R181 129 in the 2006-07 financial year. Subsequent to the year-end (in October 2007) a further amount of R250 756 was paid. These payments were made before the annual reports were finalised as required by regulation 8, read with regulations 23 and 34, of GNR.805 of 1 August 2006.

Lack of sufficient audit evidence

35. I was unable to obtain sufficient appropriate audit evidence in relation to the performance information of the Kouga Municipality, as the system used for generating information on the target of all performance outcomes and measures was not adequate for purposes of the evaluation.

APPRECIATION

36. The assistance rendered by the staff of the Kouga Municipality during the audit is sincerely appreciated.

Auditor - General

Port Elizabeth

31 January 2008



A U D I T O R - G E N E R A L