

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Koukamma Municipality which comprise the balance sheet as at 30 June 2007, income statement 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 6 to 13.

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 entity specific basis of accounting as determined by the National Treasury as set out in accounting policy note 1, to the financial statements 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) (PAA) and section 126 (3) of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit in accordance with the International Standards on Auditing. Because of the matters discussed in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis of accounting

4. The Municipality's policy is to prepare financial statements on the entity specific basis of accounting determined by the National Treasury as set out in accounting policy note 1 to the annual financial statements.

Basis for disclaimer of opinion

5. As a result of insufficient recordkeeping of financial records and documentation as well as inadequate reconciliation processes performed as described in my basis for disclaimer of opinion paragraphs underneath, I was unable to verify the completeness, accuracy, valuation and validity of balances and transactions audited. As a result of the circumstances, I was unable to carry out all auditing procedures I considered necessary for my audit. This is a clear indication of inadequate control activities, monitoring of controls and a poor control environment that exists at the municipality.

Accumulated surplus

6. The 2006 balance of the accumulated surplus of R14,7 million in the balance sheet (see also note 16 to the financial statements) included journal entries processed in the prior financial years to the amount of R2,2 million that could not be substantiated nor verified to supporting documentation. This was reported to council in the prior year audit report. The supporting documentation was not provided during the current year audit and as a result, the correctness of the opening balances remained uncertain.

Trust funds

7. The 2006 balance of Trust funds amounted to (R26'1 067) in the balance sheet. During the prior year audit, transactions to the value of R12,2 million could not be verified and entries totaling R4,3 million was found not to be recorded. The prior year uncertainty and incompleteness remained uncorrected during 2006/7 with the result that the correctness of the year end balance for Trust funds (R5.7 million) and the Accumulated surplus (R10.6 million) remain uncertain.

Fixed assets

8. Fixed assets as disclosed in note 4 to the annual financial statements reflects total fixed assets as at 30 June 2007 amounting to R45,1 million, while the fixed asset register reflects a balance of R40,6 million, resulting in a R4,5 million unexplained difference and possible misstatement. Management was unable to explain the difference due to the fixed asset register not being properly maintained.
9. I was unable to satisfy myself as to the existence, valuation and completeness of fixed assets at year – end due to a lack of supporting documentation.

Debtors

10. Debtors to the value of R 24 million as reflected in note 8 to the annual financial statements could not be verified due to a lack of supporting documentation. In addition, journal entries with a net effect of R3,4 million were processed against debtors, but due to a lack of supporting documentation the journal entries could not be verified.
11. Included in note 8 to the annual financial statements is a Provision for bad debts amounting to R9,3 million (2006: R9,3 million). Due to a lack of supporting documentation and lack of information as to how the provision was

arrived at, I was unable to satisfy myself as to the reasonability for the provision for bad debts.

12. Debt repayment in the amount of R370 678 was incorrectly allocated to Rental income instead of being allocated to the KEDC Debtor. This has the effect that revenue, accumulated surplus and debtors are overstated by R370 678.

Creditors

13. Creditors to the value of R7,7 million as reflected in note 11 to the annual financial statements could not be verified due to a lack of supporting documentation. In addition, journal entries with a net effect of R933 510 were processed against creditors. However, due to a lack of supporting documentation, the journal entries could not be verified.
14. Included in note 11 to the annual financial statements is a Value Added Taxation (VAT) liability in the amount of R2,5 million (2006: R1,9 million). However upon inspection of the VAT 201's for the period under review it was noted that the Municipality had refunds due to them for each applicable period, which had been subsequently remitted to the Municipality. I was unable to verify the VAT liability at year-end.
15. Journal entries with a net effect of R 719 292 were processed to the VAT account. Due to a lack of supporting documentation I was unable to verify these transactions.

Cash and Bank

16. Due to a lack of supporting documentation Cash and bank balance amounting to R661 087 as well as the Bank overdraft amounting to R763 527 as disclosed in the balance sheet and journals relating to cash and bank, with a net effect of R353 564 could not be verified.

Income

17. Included in the Total for Rate and General Services of R26,8 million in the Income statement is an amount of R17,5 million relating to service income. Due to a lack of supporting documentation I was unable to verify service income. In addition journal entries with a net effect of R4,5 million processed against income could not be verified due to a lack of supporting documentation.

Expenditure

18. Journals with a net effect of R933 510 were processed against expenditure, amounting to R38,4 million in the Income statement for the year ended 30 June 2007. Due to a lack of supporting documentation I was unable to verify these journal entries.
19. General Expenditure in the amount of R 198 674 does not agree to supporting documentation.
20. Motor vehicle registration payments in the amount of R2,96 million was incorrectly allocated to repairs and maintenance expenditure. This was not adjusted with the result that maintenance expenditure was overstated and payments for motor vehicle registration fees are understated for the period under review.

Employee cost

21. Salaries, wages and allowances amounts to R14,4 million for the 2006-07 financial year as disclosed in Appendix D to the annual financial statements. In terms of section 7(5) of the South African Local Government Bargaining Council agreement, leave pay should not be paid in excess of 48 days. It was noted that leave pay was paid to employees for leave accumulated in excess of 48 days, resulting in an overpayment of leave in the amount of R104 542. This overpayment is regarded as irregular expenditure in terms of section 1 of the MFMA.

Unauthorised expenditure

22. The total operating expenditure for the year amounts to R38,4 million according to the Income statement for the year ended 30 June 2007. This is R1,5 million more than the operating expenditure budget of R36,9 million for the 2006-07 financial year. The over expenditure is regarded as unauthorised expenditure in terms of section 1, read with section 15, of the MFMA and should have been disclosed as required by section 125(2)(d)(i) of the MFMA.

Going concern

23. The Municipality has serious cash flow problems and Creditors are not paid within 30 days. Payroll creditors and other payroll deductions as well as the audit fees are not paid timeously. Certain suppliers have placed the municipality on terms and only cash purchases are allowed. The average debtor's days outstanding rate also increased substantially since the prior year.

Based on the balance sheet amounts and the previous year audit results, there appears to be an immediate financial and serious cash flow problem. Factors supporting this includes:

- (a) The average collection period of debtors days has increased from 388 days in 2005/2006 financial year to 412 days in 2006/2007;
- (b) A number of the municipality's assets are at the end of their useful lives;
- (c) The Municipality is largely dependant on Government grants to fund their operational activities especially with regards to any replacement of infrastructure (capital items) or improvement of service capacity;
- (d) The municipality's average rate of payment of creditors was 125 days in 2006/2007 which is above the norm of 30 days; and
- (e) Section 75(1) of Ordinance 20 of 1974 prescribes that 7,5% of the prior year's rates must be contributed to the revolving fund. These contributions were made but were not supported by concomitant funds.

The above circumstances actually meets some of the criteria set for determining serious financial problems at municipalities in terms of section 138 of the MFMA.

Contingent liabilities

24. I did not obtain written confirmation from the Municipality's legal representatives at date of this report regarding any possible legal disputes,

outstanding contracts and the existence and the value of any possible contingent liabilities that might have existed at year end. Therefore the completeness of the disclosure in note 19 to the financial statements could not be verified.

Disclaimer of opinion

25. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have been unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of the Koukamma Municipality. Accordingly, I do not express an opinion on the financial statements.

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

26. The following non compliance with legislation was evidence during the audit:
- 26.1 Municipal Finance Management Act, 2003 (Act No. 56 of 2003) and relevant regulations and notices
- (a) Section 125(2)(a): Non- disclosure in respect of each bank account held.
 - (b) Section 125(2)(b): Non- disclosure of summary of all investments.
 - (c) Section 125(1)(c): Non-disclosure of statutory contributions.
 - (d) Section 125(1)(a): Non- disclosure of KEDC- Qhubekaka Charcoal as a related party (municipal entity).
 - (e) MFMA exemption in terms of Government Notice No. 522 dd. 29 June 2007 refers. The Kareedouw Economic Development Company (KEDC) is a municipal entity registered as a section 21 company of which Koukamma is the parent municipality. No financial statements have been prepared for the entity and could thus not be attached as an annexure as required in paragraph 3(2)(d) of the notice.
- 26.2 Division of Revenue Act, 2007 (Act No. 1 of 2007)
Section 25: Non-submission of reports to National treasury.
- 26.3 Remuneration of Public Office Bearers Act, 1998 (Act No. 20 of 1998)

Gazette No. 29447 dated 1 December 2006: Councillors salaries and allowances was paid above the upper limits determined by Government Gazette. The excess expenditure constitutes irregular expenditure and should be disclosed and dealt with in terms of section 125(2)(d)(i) of the MFMA.
- 26.4 Basic Conditions of Employment Act, 1997 (Act No. 75 of 1997)

- (a) As per section 34(1)(a): Deductions from payroll are made in terms of repayments of loans and other accounts without proper authorisation letters signed by the staff.
- (b) As per section 34(1)(a) of the Basic Conditions of Employment Act, 1997 (Act No. 75 of 1997) an employer may not make any deduction from an employee's remuneration unless the employee in writing agrees to the deduction in respect of a debt specified in the agreement, or the deduction is required by law. Deductions from payroll are made in terms of this and other accounts without proper authorisation letters signed by the staff.

26.5 Municipal Property Rates Act, 2004 (Act No. 6 of 2004)

The valuation role is older than 4 years contrary to section 32(1)(b).

26.6 Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000)

Section 2(1): In the absence of tender documentation I was unable to confirm the implementation of policy.

Internal control

27. 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 exist in more than one internal control component.

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
Basic financial statements					
Accumulated surplus	X			X	
Trust funds	X			X	
Fixed assets	X	X	X	X	X
Debtors	X	X	X	X	X
Creditors	X	X	X	X	X
Cash and Bank	X		X		X
Income	X		X	X	X
Expenditure	X		X	X	X
Employee cost	X	X	X	X	X
Unauthorised expenditure	X		X		X
Going concern	X	X	X		X
Contingent liabilities		X	X	X	X
Other matters					
Non-compliance with applicable laws and regulations	X	X	X	X	X

Control environment

- 27.1 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 financial processes to be accurately performed.

Assessment of risk

- 27.2 The municipality does not have sufficient mechanisms in place to assess business and related risks, as evident in the matters reported and especially relating to going concern issues.

Control activities

- 27.3 The effectiveness of control activities over business and accountancy processes was not adequate. This is evident from the matters reported relating to debt recovery, bank reconciliations and the asset register.

Information and communication

- 27.4 The municipality does not have adequate systems for the accounting and processing of transactions. As a consequence various records are maintained on Excel spreadsheets or manually, which resulted in the relating matters reported above.

Monitoring controls

- 27.5 The monitoring of controls, such as the review of reconciliations, confirmations from external parties and the internal audit process, was not effective. This contributed to the matters reported relating to the recoverability of debtors.

Fraud investigation

28. A fraud investigation proceeded in terms of payroll manipulation during the financial year. The investigation is still in process and no more detail was made available by the municipality.

Unaudited supplementary schedules

29. The supplementary information set out on pages 14 to 19 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

30. I was engaged to audit the performance information.

Responsibility of the accounting officer

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

Responsibility of the Auditor-General

32. 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.
33. 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.
34. 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)

Non compliance with regulatory requirements.

35. The annual report of the Koukamma municipality did not include an assessment by the entity's accounting officer of the entity's performance against any measurable performance objectives set in terms of the service delivery agreement or other agreement between the entity and its parent municipality, as required by section 121(4)(d) of the MFMA.
36. The annual performance report of the municipality is not prepared as required in terms of section 46 of the MSA.
37. Existence and functioning of a performance audit committee.

The Koukamma Municipality did not appoint and budget for a performance audit committee as required in terms of regulation 14(2)(a) of the Municipal Planning and Management Regulations, 2001.

38. Internal auditing of performance measurements.

The Koukamma Municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as

part of its internal auditing processes as required in terms of section 45 of the MSA.

Lack of sufficient appropriate audit evidence

39. I was unable to obtain sufficient appropriate audit evidence in relation to the performance information of the Koukamma Municipality, as I was unable to obtain access to the records pertaining to the programmes, objectives and key performance indicators that relates to the same period and records pertaining to performance measurement.

APPRECIATION

40. The assistance rendered by the staff of the Koukamma Municipality during the audit is sincerely appreciated.

Auditor-General.

Port Elizabeth

21 December 2007



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

4.2 Response to Report of The Auditor-General To The Eastern Cape Provincial Legislature On The Koukamma Municipal Financial Statements And Performance Information For The Year Ended 30 June 2007

In Response To The Auditor-General Report The Following Comments Are Made:

1. Accumulated Surplus

Journal entries totaling to R2,2 million will be investigated and necessity will be verified and documents will be made available in the 2007/2008 financial year.

2. Trust Funds

All trust funds will be looked at and be correctly adjusted to their true balances starting from previous years.

3. Fixed Assets

The municipality has started verifying all assets and their values to the asset register and financial statements. This will be finalised in the 2007/2008 financial year.

4. Debtors

Balancing of debtors control account has started and all journal entries will be investigated and be supported with source documents and included for audit for 2007/2008.

Guidelines on the calculation of provision for bad debts will be included in the received

Verification of mis-allocation of R370 678 to rental income and necessary correction will be done against surplus and credited to KEDC debtor.

5. Creditors

The correctness of commitments in a form of invoices will be verified and necessary corrections will be affected

6. Cash and Bank

VAT control accounts are to be analysed and balanced to VAT returns in order to come up with amount due to the municipalities owned. Journal entries to the amount of R719 262 will also be verified.

7. Income

Journals to the amount of R353 564 will be verified and necessary supporting

documents will be provided in the 2007/2008 audit.

A breakdown of Rates and General Services income will be provided for audit of 2007/2008 and all other income penetrated/reflected in the income statement.

8. Expenditure

Journals to the amount of R933 510 will be investigated and supporting documents be provided and corrections necessary will be affected to the accumulated surplus.

All expenditure reflected in the income statement will be supported by payment vouchers and invoices the in the 2007/2008 audit.

Misallocation of expenditure will be carefully monitored and responsible official will be cautioned about such errors and negative effects.

9. Employee Cost

This matter will be further investigated and after it is proved correct will be reported to Council and necessary corrective measures in terms of MFMA will be effected.

10. Unauthorised Expenditure

Unauthorised expenditure in 2006/2007 has been noted and expenditure controls have been put in place to guard against over-expenditure.

11. Going Concern

- (a) Lack of good governance and no sufficient personnel to implement credit control and debt collection policy has deteriorated the situation of non-payment and debt by consumers. This matter is receiving serious attention and as such more personnel will be employed to improve performance in this important function.
- (b) The municipality will approve asset disposal policy and all vehicles which are not longer economically viable will be disposed of in 2007/2008.
- (c) A financial turn-around strategy has been drafted by the municipality to try and boost the financial viability and increase the turnover rate of debt collection and improve budgeting.
- (d) An amount of R8,1 million has been approved by the Department of Local Government Housing and Traditional affairs to assist the municipality to settle its long outstanding creditors.

12. Contingent Liabilities

Contingent liabilities in note 19 will be totally disclosed and supported with necessary documents for year 2007/2008 financial year.

All matters for emphasis are acknowledged by council and will try to address all of them in the 2007/2008 financial year.

13 Employee cost, item 21:

A request was forwarded to the SALGBC to obtain an extension in time to address encashment of accrued leave in terms of the Agreement due to financial constraints. This request was granted by the SALGBC. The payment of leave referred to here is in line with this agreement.

14. Existence and functioning of a performance audit committee, item 37

Remuneration Committee performs the function of Performance Audit Committee together with the Audit Committee.

15. Internal auditing of performance measurements, item 38:

The statement cannot be agreed to. Performance Contracts for each Section 57 Manager was developed and provided. Monitoring, Calculation and determination of performance is stipulated in these documents.

4.3 AUDIT COMMITTEE ANNUAL REPORT FOR THE 2006/2007 FINANCIAL YEAR

Koukamma Municipality (Part of the Western Cluster of the Cacadu District Municipality)

The following report deals with the activities of the Audit Committee for the period 1 July 2006 to 30 June 2007.

The report is presented to the Council of Koukamma Municipality for its consideration.

The Audit Committee was appointed during July 2006 in terms of the MFMA no 56 of 2003 and the Shared Audit Committee Terms of Reference were approved on 6 July 2006.

The Audit committee consisted of the following independent external members;

Ronel Shaw (Chairperson)	Appointed for a three year term
Bongeka Jojo	Appointed for a three year term
Andre Saayman	Appointed for a one year term.

Mr Saayman is the only member residing within the demarcated area of the Kouga Municipality. I would like to recommend to council that Mr Saayman be appointed for another term should he make himself available.

Meeting Dates:

The Audit Committee met on a quarterly basis, on the following dates:

3 October 2006
5 December 2006
15 March 2007
14 June 2007

Attendees

Besides the audit committee members, the meetings were also attended at various times by:

The -
Mayor
Municipal Manager
Chief Finance Officer
Principle Finance Officer
Information Technology Manager
Corporate Support Services Manager
Representatives from the internal audit – PriceWaterhouseCoopers
Representatives from the Auditor General's Office.

Special issues addressed

- The approval of the Internal Audit Charter
- The review and approval of the proposed internal audit plan for 2007/2008.

Recurring Issues Addressed

To ensure the effective and efficient execution of the Audit Committee's responsibilities, a number of recurring issues were evaluated, monitored and recommendations were made by the committee including:

- The review of risk areas and monitoring the management of these risks
- Evaluating the internal audit reports and making recommendations where appropriate as well as reviewing actions taken by management.
- Considering reports of the Auditor General and resultant actions taken by management.
- Monitoring disagreements and unresolved accounting and auditing issues between the external auditors and management
- Encouraging efforts towards full compliance with GRAP and GAMAP.
- Reviewing audited annual financial statements albeit for periods prior to the appointment of the audit committee.
- Cautioning against fruitless expenditure
- Encouraging the implementation of an effective performance management system at all levels to promote accountability.

Annual Financial Statements

The audit committee would like to express its concern about:

- the unacceptable delays in finalising annual financial statements. The finance department seems to operate under capacity constraints resulting in slow/unsatisfactory responses to external audit requests and queries. Furthermore, the high staff turnover impacts negatively on internal controls as well as the ability of members of staff to become proficient with the new financial system.
- the fact that the audit of the annual financial statements for the year ended 30 June 2006 has not yet been finalised. The audit committee can therefore not make any recommendations to council as required per our terms of reference, paragraph 8.19.

Other areas of concern

- No monthly management accounts were prepared during the period under review which makes it impossible for the municipality to manage and monitor its financial

affairs, especially its cash flow, effectively. It furthermore means that the preparation budgets could be seen as fruitless expenditure as it is not used as a tool to continuously measure performance of the various departments as intended. Significant variances would only become evident at year end when it would be too late to address and/or rectify any significant over expenditure.

- Poor revenue control and the inability to improve collections is a huge concern. A workshop to improve debt collection was held with all stakeholders and the audit committee is optimistically awaiting the results of this initiative.
- Poor management of bad debts.
- Arrear councillors; service accounts. Council should lead by example and at all times comply with relevant legislation and aspire to maintain high ethical standards.
- Slow service delivery, to a large extent the result of poor collection of revenue and thus lack of resources.
- Lack of project management capacity and the resultant mal-administration of housing projects, translating into significant financial loss to the municipality that can ill afford it.
- The slow progress in the implementation of an effective Performance Management System.
- The audit committee is aware of investigations currently underway into probable fraud in relation to unauthorised inflated salaries during the month of December 2006 as well as corruption claims in relation to certain housing projects. We are concerned that the current internal control environment would not effectively curb further fraud. All staff needs to buy into a zero tolerance approach against fraud and corruption. Towards this end, we urge Council to adopt an official fraud prevention policy.

Full details of our activities are set out in the minutes of our quarterly audit committee meetings.

Frustrations experienced in executing the committee's duties and responsibilities

The audit committee is hampered in effectively discharging its duties due to the fact that:

- Agendas and meeting 'packs' for audit committee meetings are either not received at all or issued at the last minute, which is completely counter productive.
- It appears as if audit committee meetings are reviewed as a quarterly formality and recommendations do not receive the necessary timely attention.
- Agendas and minutes of council meetings are not being made available to the audit committee members thus making it impossible for the audit committee to advise and guide council on a range of issues as stipulated in section 166(2)(a) of the MFMA.

For audit committee meetings not to become fruitless expenditure, the members are adamant that its recommendations be implemented as far as possible for meaningful improvement to be attained.

Conclusion

In conclusion, the audit committee would like to acknowledge the co-operation and support it received from the internal auditors as well as the management of Koukamma Municipality.

R. Shaw (CA(SA))
Chairperson Audit Committee

4.4 OVERSIGHT REPORT

The Annual Report was tabled at the Kou-Kamma Municipality Special Council Meeting held on
8 April 2008.

The Council unanimously approved the Annual Report for 2006/2007.