

**REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL OF KOUGA MUNICIPALITY ON THE GROUP FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF KOUGA MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2009**

**REPORT ON THE FINANCIAL STATEMENTS**

**Introduction**

1. I have audited the accompanying group financial statements and financial statements of the Kouga Municipality which comprise the consolidated and separate statement of financial position as at 30 June 2009, and the consolidated and separate statement of financial performance, the consolidated and separate statement of changes in net assets and the consolidated and separate cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes as set out on pages 12 to 89 of the financial statements.

**The 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 the South African Statements of Generally Recognised Accounting Practice (GRAP) and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) 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.

**The Auditor-General's responsibility**

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), 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 read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit

also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

6. Paragraph 11 of *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 not effective for this financial year, 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.
7. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

#### **Opinion**

8. In my opinion these financial statements present fairly, in all material respects, the consolidated financial position of the Kouga Municipality as at 30 June 2009 and its consolidated financial performance and its consolidated cash flows for the year then ended, in accordance with the applicable reporting framework and in the manner required by the Municipal Finance Management Act.

#### **Emphasis of matter**

Without qualifying my opinion, I draw attention to the following matters.

#### **Unauthorised, irregular or fruitless and wasteful expenditure**

9. As disclosed in note 43.1 to the financial statements, unauthorised expenditure to the amount of R2 million was incurred due to the following:
  - Overpayment to a deceased employee's dependants/estate
  - Credit facilities for petrol cards
10. As disclosed in note 43.2 to the financial statements, fruitless and wasteful expenditure to the amount of R24,8 million was incurred due to the following:
  - Late payment to creditors
  - Late submission of the Employer Reconciliation Declaration (EMP501) to SARS
  - Payments for the termination of a director's employment contract and for the suspension of directors for prolonged periods
  - Tender awarded to a contractor for the remedial work due to poor workmanship by the original contractor
  - Illegal dumping activities

11. As disclosed in note 43.3 to the financial statements, irregular expenditure to the amount of R37 million was incurred during 2008/9 due to the following:

- Non-compliance with the MFMA
- Supply Chain Management Regulations deviations including Irregularities over the competitive bid process where the signature of municipal officials was forged on requisitions

#### **Possible claims against the Council**

12. With reference to note 46.2 to the financial statements, the municipality is the defendant in a number of lawsuits involving land and civil claims. Furthermore three of the municipality's landfill sites have not been issued with a permit by the Department of Economic and Environmental Affairs and the municipality may incur a fine for this contravention per landfill site. The ultimate outcome of these matters cannot be determined at this stage and no provision for any liability that may result has been made in the financial statements.

#### **Restatement of corresponding figures**

13. As disclosed in note 39 to the financial statements, the corresponding figures for 30 June 2008 have been restated as a result of errors and change in accounting policies discovered during 2008/2009 in the financial statements of Kouga Municipality at, and for the year ended, 30 June 2008.

#### **Other matters**

14. I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

#### **Unaudited supplementary schedules**

15. The supplementary information set out on pages 90 to 99 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.

**Non-compliance with applicable legislation****16. Municipal Finance Management Act**

- Contrary to section 31 of the Municipal Finance Management Act, funds for a capital programme which were initially appropriated in terms of section 16(3) exceeded 20% of that year's appropriation for the programme.
- Contrary to section 17(1) (b) of the Municipal Finance Management Act, the municipality did not budget correctly for appropriate expenditure under the different votes. There was an error of R23,7 million in the budget for appropriate capital expenditure.
- Contrary to section 74(1) of the Municipal Finance Management Act the municipality did not submit electronic and signed returns on their conditional grant spending for the period ended 30 June 2009 to the relevant provincial treasury.
- Contrary to section 32(4) of the Municipal Finance Management Act reports on unauthorised, irregular, fruitless and wasteful expenditure have not been submitted by the accounting officer to the mayor, MEC for Local Government and the Auditor-General.
- Contrary to section 32(6) (a) & (b) of the Municipal Finance Management Act the accounting officer has not reported to the South African Police Service all cases of alleged irregular expenditure that constituted a criminal offence and theft and fraud that occurred in the municipality. A number of special and forensic investigations were conducted at the municipality in response to alleged irregular expenditure, theft and fraud without being reported to the SAPS.
- Contrary to sections 45(2)(a) & (b) of the Municipal Finance Management Act, the municipality incurred short term debt via a bank overdraft facility without the necessary resolution of the municipal council and signed approvals by the mayor and the accounting officer.
- Contrary to section 9 of the Municipal Finance Management Act, the municipality did not submit bank account details to the provincial treasury and the Auditor-General before the start of the financial year and within 90 days after a new account has been opened.
- Contrary to section 11 of the Municipal Finance Management Act senior financial officials withdraw money and authorise the withdrawal of money from the municipality's bank accounts without proper written authority of the accounting officer.
- Contrary to section 65(2) (e) of the Municipal Finance Management Act the accounting officer has not ensured that all monies owed on an invoice or statement are paid within 30 days.

- Contrary to section 86(b) of the Municipal Finance Management Act the accounting officer of the Kouga Development Agency did not submit to the entity's parent municipality in writing, annually before the start of the financial year, the name of each bank where the entity holds bank accounts, the type and number of each account.
- Contrary to section 106 of the Municipal Finance Management Act delegations of responsibility were not in place for the Kouga Development Agency.

#### 17. Basic Conditions of Employment Act

- Contrary to section 10(1) (b) of the Basic Conditions of Employment Act, 1997 (Act No. 75 of 1997), the municipality (employer) permitted municipal officials (employee) to work more than ten hours' overtime a week.
- In terms of section 34(1)(a) of the Basic Conditions of Employment Act an employer may not make any deduction from an employee's remuneration unless the employee agrees in writing to the deduction in respect of a debt specified in the agreement, or the deduction is required by law. Deductions from the payroll are made in terms of this and other accounts without proper authorisation letters signed by the staff members.
- Contrary to Government Gazette no. 30872 dated 14 March 2008 read with section 10 of the Basic Conditions of Employment Act no. 75 of 1997 municipal officials who earn in excess of R149 736 per annum received overtime compensation. There was no overtime policy in place that allows the payment of overtime to these officials.

#### 18. Income Tax Act

- Contrary to Section 1(i) of the Income Tax Act, 1962 (Act No. 85 of 1962), the municipality has not included in the gross income of municipal officials and councillors the fringe benefit for the free use and acquisition of a cell phone as determined by paragraph 5(a) and 6(a) the seventh schedule.

#### 19. Value Added Tax Act

- Contrary to section 10(13) of the Value Added Tax Act, the municipality has not charged output VAT on a deemed supply for the fringe benefit related to the free use and acquisition of a cell phone as determined by paragraph 5(a) and 6(a) the seventh schedule of the Income Tax Act.
- Contrary to Supply Chain Management Regulation 43, before making an award of above R15000 to a person, the Kouga Development Agency did not first check with the South African Revenue Service (SARS) whether that person's tax matters were in order.

20. Public Audit Act

- Contrary to section 15(1) of the Public Audit Act, 2004 (No. 25 of 2005), the internal auditors did not allow the audit team unrestricted access to internal audit working papers.

21. Municipal Systems Act

- The municipality did not use the correct tariffs to calculate service charges as determined by the council as required by section 74 of the Municipal Systems Act. Furthermore, the municipality did not issue fines for certain instances where non-compliance with municipal by-laws occurred.

22. Supply Chain Management Policy (adopted by Council on 29 September 2005)

- Contrary to section 23(d)(i) of Council's Supply Chain Management Policy, certain bids were not accurately recorded in the tender register.
- Contrary to section 26(1) of Council's Supply Chain Management Policy, the municipality did not establish a bid specification committee to carry out the responsibilities as envisaged in section 27 of the policy.

**Matters of governance**

23. The Municipal Finance Management Act tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of key governance responsibilities, which I have assessed as follows:

No.	Matter	Y	N
<b>Clear trail of supporting documentation that is easily available and provided in a timely manner</b>			
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.		✓
<b>Quality of consolidated financial statements and related management information</b>			
2.	The consolidated financial statements were not subject to any material amendments resulting from the audit.		✓
3.	The annual report was submitted for consideration prior to the tabling of the auditor's report.	✓	
<b>Timeliness of consolidated financial statements and management information</b>			
4.	The annual consolidated financial statements were submitted for auditing as per the legislated deadlines as required by section 126 of the MFMA.	✓	
<b>Availability of key officials during audit</b>			

No.	Matter	Y	N
5.	Key officials were available throughout the audit process.		✓
<b>Development of and compliance with risk management, effective internal control and governance practices</b>			
6.	Audit committee		
	• The municipality had an audit committee in operation throughout the financial year.		✓
	• The audit committee operates in accordance with approved, written terms of reference.	✓	
	• The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.	✓	
7.	Internal audit		
	• The municipality had an internal audit function in operation throughout the financial year.		✓
	• The internal audit function operates in terms of an approved internal audit plan.	✓	
	• The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.	✓	
8.	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.		✓
9.	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.		✓
10.	The information systems were appropriate to facilitate the preparation of the financial statements.		✓
11.	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 62 (1)(c)(i) of the MFMA.		✓
12.	Delegations of responsibility are in place, as set out in section 79 of the MFMA.		✓
<b>Follow-up of audit findings</b>			
13.	The prior year audit findings have been substantially addressed.		✓
14.	Oversight resolutions have been substantially implemented.	✓	
<b>Issues relating to the reporting of performance information</b>			
15.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.		✓
16.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.		✓
17.	A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the metro against its mandate, predetermined objectives, outputs, indicators and section 68 of the MFMA.	✓	
18.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.		✓

### Investigations

24. An investigation was conducted by an independent consulting firm on request of the entity. The investigation was initiated based on the allegation of possible:

- Irregular procurement of goods and services in which officials had an interest in the contract
- payment made for construction of building which was not completed.

The investigation has been finalised and disciplinary hearings of the municipal officials were still to be held.

25. An investigation was conducted by an independent consulting firm on request of the entity regarding converting the Kouga Cultural Centre into a Public Private Partnership (PPP). The investigation has been finalised and has indicated that a Public Private Partnership is not feasible due to a lack public interest.

26. An investigation was conducted by an independent consulting firm on request of the entity related to overtime. The investigation was finalised and had the following findings:

- The information provided regarding the department and section placing of employees cannot be relied upon.
- There is no policy on overtime.
- The overtime budget needs to be carefully considered so as to be truly cognisant of the factors affecting overtime.
- The Kouga Municipality has clearly contravened legislation (Basic Conditions of Employment Act) and the proposed policy on overtime in allowing overtime hours above the specified ceiling.
- Substantial increased overtime during peak periods.
- "Personnel shortages" and "the lack of suitable equipment" continue to be the largest categories of overtime spending and need to be addressed.
- There is no definite correlation between sick leave and remunerated overtime for all employees employed at the municipality, but there were cases where there was a strong correlation between sick leave and remunerated overtime.



## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

### **Report on performance information**

27. I have reviewed the performance information as set out on pages xx to xx.

### **The accounting officer's responsibility for the performance information**

28. In terms of section 121(3)(c) of the Municipal Finance Management Act, 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).

### **The Auditor-General's responsibility**

29. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the Municipal Systems Act.

30. 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.

31. 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**

32. The Kouga Municipality does not have a separate performance audit committee during the 2008-09 financial year. The existing audit committee was also not utilised in this capacity as allowed for in terms of regulation 14(2) (a).

33. Contrary to section 53(2) of the Municipal Finance Management Act, the mayor did not report to the council and the provincial MEC for Finance the delay in the signing of the annual performance agreements.

34. The municipality did not evaluate and monitor the organisation in terms of chapter 3 of the Municipal Planning and Performance Management Regulations 2001 as the municipality has not implemented a performance management system. The municipality has adopted an institutional performance scorecard, but it has not been implemented by 30 June 2009.

35. Contrary to section 76(b) of the Municipal Systems Act service level agreements between the parent municipality and the municipal entities (Kouga Development Agency and Kouga Cultural Centre) to regulate the performance of the municipal entities could not be provided.

#### **Internal auditing of performance information**

36. 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 Municipal Systems Act. In addition, the internal auditors 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 audit committee as provided for in terms of regulation 14(1)(c).

#### **Inconsistently reported performance information**

37. The Kouga Municipality has not reported in all instances on all its key performance indicators and targets as per the Integrated Development Plan.

#### **Reported performance information not reliable**

38. The Performance Management System (Intelireg) installed in a prior year was not operational during the year ended 30 June 2009 (only as from November 2009). Chapter 6 of the Municipal Systems Act refers.

### **OTHER REPORTS**

#### **Special audits**

39. As requested by the Member of the Executive Council (MEC) of the Department Local Government and Traditional Affairs in the Eastern Cape an investigation was conducted over the sale of municipal properties. The report, submitted during October 2008 to the MEC, indicated that certain municipal officials contravened the Supply Chain Management Regulations, the Municipal Finance Management Act and other legislation governing the awarding of tenders and the sale of municipal property. As a result the municipal officials have been suspended. The legal processes, including disciplinary proceedings have not been finalized.

**APPRECIATION**

40. The assistance rendered by the staff of the Kouga group during the audit is sincerely appreciated.

*Auditor-General*

East London

21 May 2010



**AUDITOR-GENERAL  
SOUTH AFRICA**

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