

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

**REPORT ON THE FINANCIAL STATEMENTS**

**Introduction**

1. I was engaged to audit the accompanying financial statements of the Kou-Kamma Municipality which comprise of the statement of financial position as at 30 June 2009, the statement of financial performance, the statement of changes in net assets and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, and the accounting officer's report, as set out on pages 6 to 96.

**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 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 the financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters described 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 for disclaimer of opinion**

### **Property, plant and equipment**

4. The fair value of property plant and equipment (PPE) not previously recorded amounting to R23,9 million and additions to property plant and equipment (PPE) of R14,6 million were not supported by appropriate supporting documentation such as valuation certificates, contract agreements, invoices and expenditure vouchers. In addition the asset register used to support the PPE balance disclosed in the financial statements included duplications to the value of R7,7 million and assets to the value of R8 million that could not be physically verified. As a result, sufficient appropriate evidence relating to the completeness, existence and valuation of property plant and equipment to the value of R54,2 million included in the property plant and equipment balance disclosed in the statement of financial position and in notes 10 and 35.16 at an amount of R73,2 million could not be obtained.
5. The municipality did not correct prior year audit differences and also did not apply the recognition and measurement requirements contained in Directive 4 issued by the ASB correctly. As a result property plant and equipment disclosed in the statement of financial position and note 10 at an amount of R73,2 million is understated by R25,3 million, the backlog depreciation disclosed in note 35.16 is overstated by R23,4 million, impairment losses disclosed in note 10 are overstated by R0,3 million and the accumulated surplus at the beginning of the year as disclosed in the statement of changes in net assets is understated R1,6 million.

### **Operating expenditure**

6. Contract services, bulk purchases of electricity and water, general expenses and rental expenses were not supported by appropriate documentation such as contracts and invoices. As a result, sufficient appropriate audit evidence relating to the occurrence and accuracy of expenditure to the value of R11,8 million included in total operating expenditure disclosed in the statement of financial performance at an amount of R62,4 million could not be obtained.
7. The municipality did not correct prior period audit differences relating to expenses of R2,9 million that were incorrectly recorded in the current year instead of in the prior year. The corresponding figures were also not amended. As a result, operating expenditure disclosed in the statement of financial performance at an amount of R62,4 million and the opening accumulated surplus disclosed in the statement of changes in net assets of R58, 6 million are overstated by R2,9 million. The corresponding figures relating to trade and other payables and operating expenditure are understated by the same amount.

### **Employee costs**

8. The municipality was unable to provide payslips and overtime forms from July 2008 to October 2008 in support of salaries paid to officials and councillors amounting to R6,6 million due to the theft of a computer server that contained this information. The

municipality did not keep backups of the information and did not have a disaster recovery plan in place. In addition employees who received salaries and benefits totalling R893 989 did not present themselves for physical inspection. I was unable to confirm by alternative means that these employees were in fact employed by the municipality and were entitled to the salaries and benefits paid to them. As a result, sufficient appropriate audit evidence relating to the occurrence and accuracy of salaries and overtime costs to the value of R7,6 million included in the total employee costs of R21,7 million disclosed in the statement of financial performance and note 25.

9. The municipality incorrectly recognised an amount of R353 000, which was transferred into an attorney firm's trust account for the possible payment of a severance settlement to a former official, as employee costs instead of debtors. As a result employee related costs disclosed in the statement of financial performance and note 25 of R21,7 million is overstated by R353 000 and other debtors disclosed in the statement of financial position and note 15 of R1,6 million is understated by the same amount.

#### **Value added tax (VAT)**

10. Management was unable to provide supporting documentation for expenditure vouchers and journals that have been passed in the VAT control account to the estimated amount of R5,4 million. Furthermore, VAT was incorrectly journalised in some instances and there was no authorisation of journal entries and no journal narrations. The municipality did not have adequate accounting records to permit the application of alternative audit procedures. As a result I was unable to determine that the input VAT that was claimed in terms of these transactions occurred and was accurate. The VAT payable is reflected on the statement of financial position and note 7 at an amount of R3,1 million.

#### **Creditors**

11. The general ledger exceeded the creditors age analysis by an amount of R3,7 million which management could not explain nor provide supporting information for. In addition, documentation related to a salary suspense account amounting to R883 642 could not be provided. As a result, sufficient appropriate audit evidence relating to the completeness and accuracy of creditors to the value of R4,6 million included in the creditors balance disclosed in the statement of financial position at an amount of R16,8 million could not be obtained.
12. Management has not raised operating and capital expenses of R14,8 million that were incurred during the financial year as creditors. As a result, the creditors balance disclosed in the statement of financial position and note 5 at an amount of R16,7 million is understated by R14,8 million, total expenditure disclosed in the statement of financial performance at an amount of R62,4 million is understated by R14,5 million and property, plant and equipment disclosed in the statement of financial position and note 10 at an amount of R73,2 million is understated by an amount of R323 226.

### **Grants paid**

13. Application forms, proof of income and copies of identity documents used to support grant expenditure of R3,4 million received by indigent persons could not be obtained. There were no alternative procedures that could have been performed to verify this expenditure. As a result, sufficient appropriate evidence relating to the occurrence and accuracy of grants and subsidies paid of R3,4 million out of the R8,4 million disclosed in the statement of financial performance and in note 32 could not be obtained.

### **Unspent conditional grants**

14. Management was unable to provide explanations for the difference of R2,1 million between the statement of financial position and the general ledger balance. As a result, sufficient appropriate evidence relating to the occurrence, accuracy and completeness of unspent grants to the value of R2,1 million included in the unspent conditional grants balance of R19,9 million as disclosed in the statement of financial position and note 6.
15. Grant funding for flood damage to the amount of R82,8 million is held by the District Municipality on behalf of Kou-Kamma municipality. The municipality has not accounted for this grant in the financial statements. As a result unspent conditional grants and receipts disclosed in the statement of financial position and note 6 at an amount of R19,9 million is understated by R82,8 million. Other debtors disclosed in the statement of financial position and note 15 at an amount of R1,6 million is understated by R83,7 million, and interest earned disclosed in the statement of financial performance and note 21 at an amount of R1,5 million is understated by R911 607.

### **Accumulated surplus**

16. The prior year audited balance for the accumulated surplus of R10,9 million did not agree with the opening balance of R8,9 million as per the ledger provided for audit purposes. Management could not provide documentation nor explanations for the difference of R2 million. As a result, sufficient appropriate evidence relating to the accuracy and completeness of the accumulated surplus balance included in the statement of financial position and in note 2 to the financial statements at an amount of R57 million could not be obtained.
17. The correction of prior period errors are disclosed in note 36 to the financial statements at an amount of R1,1 million. Supporting documentation was not provided and contrary to GRAP 3.42(a), management did not adequately disclose the nature of the prior period error in the notes to the financial statements. Furthermore, the 2008 error correction of R50 422 has been incorrectly processed through the statement of changes in net assets instead of the statement of financial performance.

### **Provisions**

18. The leave pay provision of R1,5 million was not supported by appropriate source documents (leave forms) and leave reconciliations. The absence of these records

resulted in it not being possible to confirm the leave balance due to employees in order to verify the provision for leave. The municipality did not have adequate accounting records to permit the application of alternative audit procedures. As a result sufficient appropriate evidence relating to whether the leave provision as reflected on the statement of financial position and note 4 at an amount of R1,5 million was accurate and properly valued could not be obtained.

### **Bank, cash and cash equivalents**

19. Supporting documentation for journals that were passed in the internal bank transfer suspense account to the amount of R373 510 could not be provided. Cash deposit slips with accompanying reconciliations for daily takings to the value of R64 080 could also not be provided and could therefore not be traced to the bank statements. Furthermore, the June and July 2009 deposit slips could also not be provided. The municipality did not have adequate accounting records to permit the application of alternative audit procedures. As a result sufficient appropriate evidence relating to the completeness and accuracy of the bank, cash and cash equivalents disclosed in the statement of financial position and note 16 at an amount of R9,8 million could not be obtained.

### **Revenue**

20. There was a lack of a sufficient audit trail relating to prepaid electricity sales which prevented the tracing of daily takings to deposit slips, bank statements and the relevant ledger accounts. The municipality did not have adequate accounting records to permit the application of alternative audit procedures on this revenue. As a result sufficient appropriate evidence relating to the completeness of electricity revenue amounting to R1,1 million as disclosed in note 19 to the financial statements could not be obtained.
21. No reconciliations were performed by management between traffic income, payments to the service provider and the fines ledger account. The municipality did not have adequate accounting records to permit the application of alternative audit procedures on this revenue. As a result sufficient appropriate evidence relating to the completeness of fines revenue disclosed in the statement of financial performance at an amount of R236 270 could not be obtained.
22. The municipality erroneously duplicated the correction of an error to the amount of R506 612 on the debtors age analysis. As a result total revenue disclosed in the statement of financial performance of R61,5 million is understated by R506 612 and consumer debtors disclosed in the statement of financial position and note 14 at an amount of R1,6 million is understated by the same amount.

### **Government grants**

23. The equitable share received is reflected in note 22 to the financial statements at an amount of R13,7 million. Management was unable to provide supporting documentation for an amount of R304 767 received, which did not agree to the Government Gazette. Furthermore, no reconciliation was performed by management between actual amounts received to what should have been received. The

municipality did not have adequate accounting records to permit the application of alternative audit procedures. As a result I was unable to obtain sufficient appropriate evidence relating to the occurrence of this additional amount.

### **Consumer debtors**

24. No loan agreements were in place to support the loan instalments with consumer debtors to the nett amount of R269 863. In addition management was unable to provide a property transfer list for all properties that had transferred ownership. As a result sufficient appropriate evidence relating to whether the consumer debtors actually existed and whether all new property owners have been included as consumer debtors for municipal service and property rates could not be obtained. Consumer debtors are reflected on the statement of financial position at an amount of R16,2 million and note 14 to the financial statements.
25. The provision for doubtful debts is understated as sufficient evidence could not be obtained to confirm that consumer debtors of R14 million are recoverable. Furthermore, contrary to section 64(2)(g) of the MFMA the accounting officer did not raise interest to an estimated amount of R5,7 million on long-outstanding receivables. In addition, the municipality did not reverse inter-departmental transactions to the amount of R3,1 million. As a result consumer debtors disclosed in the statement of financial position and note 14 of R16,2 million is overstated by R11,4 million, impairment losses disclosed in the statement of financial performance and note 28 of R10,1 million is understated by R14 million, interest earned on outstanding debtors disclosed in the statement of financial performance and note 21 is understated by R5,7 million and total revenue disclosed in the statement of financial performance at an amount of R61,5 million is overstated by R3,1 million.

### **Long-term receivables**

26. The municipality was unable to provide a listing or loan agreements for long-term receivables to the amount of R122 978. The municipality did not have adequate accounting records to permit the application of alternative audit procedures. As a result sufficient appropriate evidence relating to whether the gross balance in respect of the long-term receivables amount of R122 978 existed and whether it was accurately disclosed in note 13 to the financial statements could not be obtained.

### **Consumer deposits**

27. The municipality was unable to provide a consumer listing that supported the existence of the consumer deposit balance in the statement of financial position and note 3 to the amount of R104 700. In addition, as the balance has not changed since the prior year notwithstanding the degree of non payment by existing consumers and the addition of new consumers, the consumer deposits are understated by an estimated amount of R65 800.

### **Disclosure notes**

28. Unauthorised and irregular expenditure as disclosed in note 41 to the financial statements does not include the following:

- (a) the municipality incurred capital expenditure of R11,3 million which was not budgeted for in the municipality's annual budget. This was not disclosed as unauthorized expenditure.
  - (b) The municipality incurred unauthorised expenditure in terms of the definitions per section 1 of the MFMA by exceeding the approved operating expenditure budget by an amount of R10 million and has not disclosed this amount in the notes to the financial statements as unauthorized expenditure
  - (c) A councillor applied for "volunteering leave of office" as from February 2009, but he was paid for the period (five months in the year being audited) that he was not in the office. This resulted in irregular expenditure. The councillor resumed his duties in the office only from January 2010 again. Irregular expenditure is thus understated by R81 940.
  - (d) Section 11(1) of the MFMA only authorizes the accounting officer, chief financial officer or a duly delegated senior official to make withdrawals against the primary bank account of the municipality. A petrol card was issued to the mayor of the municipality. Withdrawals made contravene section 11(1) of the MFMA and are thus regarded as irregular expenditure and were not disclosed in note 41. As a result the irregular expenditure disclosed is understated by an amount that could not be quantified due to the lack of documentation.
29. Management has not disclosed the theft of cash to the amount of R11 470 as required by section 125(2)(d)(i) of the MFMA. As a result of the omission, the disclosures in terms of the MFMA are understated by an amount of R11 470.
30. Contingent liabilities are reflected in note 47 to the financial statements. A list of contingent liabilities that agrees with the balances and disclosures in note 47 could not be obtained. In addition note 47 does not reconcile by R400 958 to the supporting notes and disclosures referred to therein. Furthermore, the corresponding figure of contingent liabilities includes an amount of R498 000 that was also not disclosed in the 2008 financial statements. There is no reconciliation explaining or detailing this change in the notes to the financial statements. As a result, the disclosure for contingencies is not complete and accurate.
31. The municipality did not disclose in the notes to the financial statements its municipal entity, the Kareedouw Economic Development Company (KEDC) – Qhubekeka Charcoal, a section 21 company, as required by section 125 (1)(a) of the MFMA. No financial statements were prepared for the entity and thus could not be attached as an annexure, as required by paragraph 3(2)(d) of *Government Notice No. 522 of 29 June 2007*. The completeness of statutory disclosures is understated in the financial statements.
32. Consumer debtors are reflected in the statement of financial position at an amount of R16,2 million. The municipality did not disclose amounts owing by the various government debtors separately in note 14 the financial statements.
33. Service charges are reflected on the statement of financial performance at an amount of R13,6 million. The breakdown of this amount is disclosed in note 19 to the financial

statements. The descriptions per the note do not relate to the correct amounts as per the trial balance. As a result the disclosure for service charges is not accurate.

34. Leave pay provision as reflected in note 4 to the financial statements has not been disclosed as an accrual in terms of IAS 19.10(a). Furthermore, as per note 4 it does not reflect the movement for leave taken during the year. As a result note 4 is incorrectly disclosed.
35. Operating leases as reflected in note 9.2 to the financial statements have not included clarity as to the exact nature of the operating lease assets as required by GRAP 13.50 (d). As a result note 9.2 is not complete.
36. Intangible assets are reflected in note 11 to the financial statements, but no reference has been made to the accounting policy note 2.11 where the transitional provisions are explained. As a result note 11 is not complete.
37. Investment property is disclosed in note 12 to the financial statements, but has not disclosed the fair value in terms of GRAP 16.88(e) and no reference has been made to the accounting policy note 4.3 where the transitional provisions are explained. As a result note 12 is not complete.
38. Long-term receivables are disclosed in note 13 to the financial statements but the terms and interest have not been disclosed in terms of IFRS 7. As a result note 13 is not complete.
39. Consumer debtors are disclosed in note 14 to the financial statements but the terms has not been disclosed in terms of IFRS 7. As a result note 14 is not complete.
40. Current investment deposits are reflected in note 16.1 to the financial statements at an amount of R141 801. There is a difference of R17 556 between the disclosed amount and the sum of the amounts in the narrative which relates to a GRAP adjustment which was incorrectly not included in the narrative. As a result note 16.1 is not accurately disclosed.
41. Employee-related costs are reflected in note 25 to the financial statements. The final narrative incorrectly states that no compensation was payable to key management personnel in terms of IAS 19. As a result note 25 is not accurately disclosed.
42. Contracted services are reflected in note 31 to the financial statements but reference is incorrectly made to total bulk purchases instead of total contracted services. As a result note 31 is not accurately disclosed.
43. General expenses are reflected in note 33 to the financial statements. Note 33.2 refers to flood damage to the amount of R12,7 million and note 33.3 refers to drought relief to the amount of R4,9 million which could not be agreed to note 33.1. As a result note 33 is not accurately disclosed.
44. Financial instrument classification is reflected in note 44 to the financial statements. Bank, cash and cash equivalents have been incorrectly classified as available for sale financial assets instead of loans and receivables as per the definition in IAS 39 .9. The loans and receivables section incorrectly includes the staff loan provision for



impairment to the amount of R109 570 (2008: R122 985). As a result note 44 is not accurately disclosed.

45. Financial instrument classification is disclosed in note 44 to the financial statements. Unspent conditional grants and receipts to the amount of R19,9 million, which meets the definition of a financial liability as per IAS 32. 11, have been incorrectly excluded from the financial liabilities section. As a result note 44 is not complete.
46. Interest rate risk management with regard to financial instruments have been disclosed in note 44.6.2 to the financial statements. This note does not include an interest rate sensitivity analysis table for investments as per IFRS 7.40. As a result note 44.6.2 is not complete.
47. The financial statements do not disclose as per Directive 4 paragraph 8A(d) the information on the progress made by the municipality towards measuring the assets in accordance with the requirements of Standards of GRAP and recognising major classes of assets and liabilities that have not been recognised in full. As a result the disclosure is not complete.
48. Critical judgments, estimations and assumptions have been disclosed in accounting policy note 1.2. The key judgments note incorrectly implies that the municipality has appropriately applied GRAP 17 PPE when in fact they have taken the exemptions as per Directive 4 and also incorrectly implies that the municipality has inventory. As a result accounting policy note 1.2 is not accurate.
49. Standards, amendments to standards and interpretations issued but not yet effective have been disclosed in accounting policy note 1.6. The municipality has not disclosed the financial impact that these standards issued but not yet effective will have on the financial position, performance and cash flows in terms of the requirements of GRAP 3.3. This note is also not complete and should include reference to the following standards and interpretations in issue but not yet effective: IFRIC 18 – *Transfers of Assets from Customers* (effective 1 July 2009), IFRS 2 – *Share-based Payments: Group Cash-settled Share-based Payment Transactions* (effective 1 January 2010) and AC 504 – *The limit on a defined benefit asset, minimum funding requirements and their interaction in the South African Pension Fund environment* (effective 1 April 2009). Furthermore, note 54, *Standards and interpretations*, in issue not yet adopted does not agree to accounting policy note 1.6. As a result accounting policy note 1.6 is not complete.
50. An accounting policy for inventories has been disclosed in accounting policy note 7 which is not applicable as the municipality has no inventory. As a result the accounting policy note 7 is not accurate.
51. An accounting policy note for comparative information has been disclosed in note 27. Note 27.1 states that budgeted amounts have been included in the financial statements for the current year only. This policy is stated incorrectly as the budgeted figures have been included in the statement of financial performance for the current and prior year and has not been included in the statement of financial position. As a result accounting policy note 27.1 is not accurate.

52. Other debtors are reflected in note 15 to the financial statements. Note 15 is out of balance by R114 190 which relates to a GRAP adjustment for an insurance claim.
53. Government grants and subsidies are reflected in note 22 to the financial statements. The notes included in note 22 reflect amounts transferred to deferred revenue, which is incorrect as no deferred revenue account exists. As a result the notes within note 22 are not accurate.

#### **Related-party relationships**

54. Related-party transactions are disclosed in note 46. In terms of IPSAS 20.34(b) – *Related-party disclosures*, the municipality must disclose the remuneration of the family of key management personnel and councillors who are employed at the municipality. The municipality has not disclosed the remuneration of the family of key management personnel and councillors in the notes to the financial statements. Furthermore, not all related parties have been disclosed in the financial statements. As a result the completeness of disclosure of related-party transactions is understated.

#### **Disclaimer of opinion**

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

#### **Emphasis of matters**

I draw attention to the following matters:

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

56. As disclosed in notes 35 and 36 to the financial statements of the Kou-Kamma Municipality, the corresponding figures for the year ending 30 June 2008 have been restated as a result of a change in the accounting standard from IMFO to GRAP for the year ended 30 June 2009.

#### **Going concern**

57. The financial statements indicate that the municipality incurred a net loss of R863 901 during the year ended 30 June 2009 and, as of that date, the entity's current liabilities exceeded its total assets before taking the above adjustments into account. These conditions, along with other matters listed below, indicate the existence of a material uncertainty that may cast significant doubt on the entity's ability to continue as a going concern.
58. The municipality has serious cash-flow problems which impacted on its ability to provide uninterrupted services to its community. The figures in the statement of financial position combined with previous year audit results indicated that there was an immediate financial and cash-flow problem. Factors supporting this are listed below:

- a) Debtors' days recoverability has increased from 933 days in 2007-08 financial year to 1 038 days in 2008-09.
  - b) The municipality is in a possible net liability position after all the debts of 90 days and older are written off. It is unlikely that the municipality will be able to collect these debtors.
  - c) Assets are at the end of their useful lives.
  - d) The municipality is largely dependent on government grants to fund their activities, especially with regard to any replacement or improvement of service capacity.
  - e) Inability of the council to pay creditors as the ratio was 178 days in 2008-09 (2007-08: 268 days) which was above norm of 30 days.
  - f) The salaries and wages bill was not covered by the cash flow generated from operations of the municipality.
  - g) The financial support from the provincial government was insufficient to pay the backlogs of creditors.
  - h) Certain service providers have suspended service to the municipality due to non-payment.
  - i) Certain suppliers are now on the cash basis.
  - j) Inventory is not kept on hand due to the cash-flow problem which has affected service delivery.
  - k) The community is refusing to pay for services due to the lack service delivery.
  - l) Financial institutions will not provide long-term financing to the municipality for asset replacement
59. Management has not implemented plans to elevate the cash-flow problems other than to try and implement a credit collection policy. The credit collection policy has not been adequately implemented.
60. Management has not assessed the going concern of the municipality nor has management disclosed the going concern principles in the annual financial statements.
61. The municipality appears to be technically insolvent due to the factors as mentioned above and due to the liquidity problems as indicated through the inability to collect debtors and pay creditors. There is significant uncertainty that the municipality will continue as a going concern without significant improvement in the collection of debtors and increased government financial support.
62. In addition, the MEC responsible for Local Government and Traditional affairs in the Eastern Cape issued on the 9<sup>th</sup> April 2009 a Notice to assume responsibility for the administration in terms of section 139(1)(b) of the Constitution of the Republic of South Africa, (Act no 108 of 1996) on the 9<sup>th</sup> April 2009. The intervention was for an initial period of three (3) months subject to review and has subsequently been extended. The MEC has designated a person to act as an Administrator.

### **Other matter(s)**

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

### **Unaudited supplementary schedules**

63. The supplementary information set out on pages 97 to 106 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.
64. The municipality provided supplementary information in the financial statements on whether resources were obtained and used in accordance with the legally adopted budget, in accordance with GRAP 1 *Presentation of Financial Statements*. The supplementary budget information set out on pages 6 to 10 does not form part of the financial statements and is presented as additional information. Accordingly I do not express an opinion thereon.

### **Non-compliance with applicable legislation**

#### **Municipal Finance Management Act, 2003 (Act No. 56, 2003)**

65. Contrary to section 131(1) of the MFMA, the mayor did not ensure that all the issues raised during the prior year audit were addressed.
66. Contrary to section 126 of the MFMA, the municipality did not submit their annual financial statements to the AGSA on 31 August 2009 as required. The Auditor General of South Africa (AGSA) received the annual financial statements on 29 January 2010.
67. Contrary to section 122(2) of the MFMA, the municipality did not prepare consolidated annual financial statements incorporating the annual financial statements of the municipal entity KEDC.
68. Contrary to section 166 of the MFMA, the audit committee did not advise the council or the accounting officer on risk management, accounting policies, performance management and effective governance of the municipality.
69. Contrary to section 14(1) to (4) of the MFMA, asset disposals which resulted in a loss to the amount of R488 378 as per the statement of financial performance, were not authorised by the council.
70. Contrary to sections 14(1) to (4) of the MFMA, asset write-offs (impairments) to the amount of R281 067 as per note 28 to the financial statements were not authorised by the council.
71. Contrary to section 9 of the MFMA, the municipality did not submit details containing the name, type and numbers of bank accounts in the entity's name to the relevant Provincial Treasury and Auditor-General of South Africa.

72. Contrary to section 125(2)(d)(i) of the MFMA, the municipality did not disclose material losses with regard to bulk purchases of water and electricity.
73. Contrary to section 166 (4) of the MFMA the audit committee did not consist of at least three members with appropriate experience. The audit committee only comprised the chairperson and one other member.
74. Contrary to section 121 of the MFMA, which states that the annual report should be adopted within nine months after the end of the financial year, the municipality has not yet adopted the annual report for 2007-08.
75. Contrary to section 65(2)(e) of the MFMA, which states that payments for goods and services should be made within 30 days of receiving the relevant invoice or statement, the municipality has exceeded its payment terms. It was noted during the preliminary analytical review that the average payment period was 178 days. Note 5 to the financial statements incorrectly states that all payments are made within 30 days and that the municipality has financial risk policies in place to ensure that all payables are paid within the credit time frame.
76. Contrary to section 69(3) of the MFMA, the accounting officer did not implement and submit within 14 days the draft service delivery and budget implementation plan and the draft annual performance agreements
77. Contrary to section 64(2)(a) of the MFMA, the accounting officer has not implemented an effective revenue collection system. Ratepayers have boycotted the payment for municipal services to the municipality due to inaccurate municipal accounts. Furthermore, the municipality has not taken any action to disconnect services for long-outstanding consumer debtors.
78. Section 117 of the MFMA bars councillors from serving on municipal tender committees. Minutes of tender committee meetings and attendance registers could not be obtained to verify that councillors were not members of the committee and that no councillors attended as an observer.
79. Contrary to section 74(1) of the MFMA, the municipality did not submit electronic and signed returns on their conditional grants spending for the period ended 30 June 2009 to the National Treasury. This also resulted in non-compliance with section 71 of MFMA (monthly budget statements) as per a National Treasury report dated 28 August 2009.
80. Contrary to section 19(1) of the MFMA, commitments as disclosed in note 43 to the financial statements have not been approved by a council resolution.
81. Contrary to section 65(2)(e) and (f) of the MFMA, the municipality did not pay medical aid, UIF, SAMWU, bargaining council and retirement fund timeously (within seven days of month-end), for July, August, October, November, December 2008, February, April and May 2009.

#### **Municipal System Act, 2000 (Act No.32 of 2000)**

82. Contrary to section 96(b) of the MSA, the municipality has not implemented a credit control and debt collection policy.

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

83. Contrary to section 28(1) of the VAT Act, the municipality did not submit their VAT returns on time for the July, August, September and October 2008 as well as May 2009.
84. Contrary to section 2 of the VAT Act input VAT was claimed on the provision of financial services, being VAT claimed on Eskom interest payments.
85. Contrary to section 18(3) of the VAT Act no output VAT was charged on fringe benefits derived by municipal employees. The mayor has the use of a municipal car and no output VAT was levied on the fringe benefit.

#### **Basic Conditions of Employment Act, 1997 (Act No. 75 of 1997)**

86. Contrary to section 34(1)(a) of the BCEA, there is no written approval from the employees authorising the deductions of miscellaneous items and municipal services from their monthly payroll amounts.
87. Contrary to section 31 of the BCEA an employer must keep employees' records and these records must be kept for at least three years from the date of last entry. A number of unpaid leave forms and employee files could not be provided during the course of our audit.
88. Contrary to section 10(1)(b) of the BCEA, employees worked more than 10 hours of overtime in a week.

#### **Water Services Act (Act No. 108 of 1997)**

89. Contrary to the Water Services Act, section 21(2), water meters are not installed for every property which is supplied with water.

#### **Division of Revenue Act (Act No. 2 of 2008)**

90. Contrary to section 43 (read with section 24(2)) of DoRA, transfers were made from the call accounts (which should be ring-fenced against the unspent conditional grant liability). There was no supporting documentation (other than the remittance advice) to support these transfers.

### **Income Tax Act (Act No. of 85 of 1962)**

91. Contrary to the 4<sup>th</sup> schedule of the Income Tax Act, the municipality has not submitted the EMP201 forms from July 2008 to January 2009 timeously. Furthermore, the municipality did not make the payment on time for July, August, October, November and December 2008 and February 2009.
92. Contrary to section 96(b) of the Income Tax Act, the municipality has not raised a fringe benefit on municipal housing used by an employee. Furthermore, no rental agreement could be provided by the municipality at the time of the audit.

### **Pension Fund Act (Act No. 24 of 1956)**

93. Contrary to section 13A(3)(a)(ii) of the Pension Fund Act, 1956 (Act No. 24 of 1956), contributions from the municipality were not paid over within seven days of month-end.

### **Municipal Supply Chain Management Regulations (Government Gazette no 27636 of 30 May 2005)**

94. Regulation 14 requires that an accounting officer keeps a list of accredited prospective providers. A document to confirm this could not be provided.
95. Regulations 26 – 29 require that a bid committee system be provided for by the municipality. SCM minutes, constitutions, attendance registers and committee reports could not be obtained to verify that the municipality has provided for the bid committee system.

### **Municipal Property Rates Act (Act No.6 of 2004)**

96. Contrary to section 32 and 89(3) of the Municipal Property Rates Act, the municipality did not obtain a valuation of properties in its area within a period of four years from the date of the commencement of this act.

### **Internal control deficiencies**

97. 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 that gave rise to the deficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. (The number listed per component can be followed with the legend below the table.) In some instances deficiencies exist in more than one internal control component.

Par. no.	Basis for disclaimer of opinion	CE	RA	CA	IC	M
4 – 5	PPE	3;6;7				
6 – 7	Expenditure	5;7		5;6		
8 – 9	Employee Costs	7				
10	VAT	5;7				
11 – 12	Creditors	7			1	
13	Grants Paid	5;7		3;4	1	
14 -15	Unspent Grants	5				
16 – 17	Accumulated Surplus	5				
18	Provisions	5;7		6		
19	Bank			2		
20 - 22	Revenue	5		2		
23	Government Grants	2				
24 – 25	Consumer Debtors	5				
26	Long Term Receivables	5				
27	Consumer Deposits	6		3		
28– 53	Disclosure notes	5;6;7		3;6	1	
54	Related-party relationships	5				

<b>Legend</b>	
<b>CE = Control environment</b>	
The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.	1
Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.	2
Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.	3
Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting.	4
The accounting officer/accounting authority does not exercise oversight responsibility over financial reporting and internal control.	5
Management's philosophy and operating style do not promote effective control over financial reporting.	6
The entity does not have individuals competent in financial reporting and related matters.	7
<b>RA = Risk assessment</b>	
Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting.	1
The entity does not identify risks to the achievement of financial reporting objectives.	2
The entity does not analyse the likelihood and impact of the risks identified.	3
The entity does not determine a risk strategy/action plan to manage identified risks.	4
The potential for material misstatement due to fraud is not considered.	5
<b>CA = Control activities</b>	
There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.	1
General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.	2
Manual or automated controls are not designed to ensure that the transactions have	3



occurred, are authorised, and are completely and accurately processed.	
Actions are not taken to address risks to the achievement of financial reporting objectives.	4
Control activities are not selected and developed to mitigate risks over financial reporting.	5
Policies and procedures related to financial reporting are not established and communicated.	6
Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system.	7
<b>IC = Information and communication</b>	
Pertinent information is not identified and captured in a form and time frame to support financial reporting.	1
Information required to implement internal control is not available to personnel to enable internal control responsibilities.	2
Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel.	3
<b>M = Monitoring</b>	
Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting.	1
Neither reviews by internal audit or the audit committee nor self -assessments are evident.	2
Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken.	3

### Governance framework

98. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below:

### Key governance responsibilities

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 financial statements and related management information</b>			
2.	The 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 financial statements and management information</b>			
4.	The annual financial statements were submitted for auditing as per the legislated deadlines section 126 of the MFMA.		✓

No.	Matter	Y	N
<b>Availability of key officials during audit</b>			
5.	Key officials were available throughout the audit process.		✓
<b>Development and compliance with risk management, effective internal control and governance practices</b>			
6.	Audit committee		
	<ul style="list-style-type: none"> <li>The Kou-Kamma Municipality had an audit committee in operation throughout the financial year.</li> </ul>	✓	
	<ul style="list-style-type: none"> <li>The audit committee operates in accordance with approved, written terms of reference.</li> </ul>	✓	
	<ul style="list-style-type: none"> <li>The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.</li> </ul>		✓
7.	Internal audit		
	<ul style="list-style-type: none"> <li>The Kou-Kamma Municipality had an internal audit function in operation throughout the financial year.</li> </ul>	✓	
	<ul style="list-style-type: none"> <li>The internal audit function operates in terms of an approved internal audit plan.</li> </ul>	✓	
	<ul style="list-style-type: none"> <li>The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.</li> </ul>		✓
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(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 committee 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 municipality against its mandate, predetermined objectives, outputs, indicators and targets section 68/87 of the MFMA.		✓
18.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those		✓

No.	Matter	Y	N
	charged with governance.		

99. The financial statements were not submitted for auditing as per the legislated deadline and significant difficulties were experienced concerning the delays or availability of requested information due to management being dependent on consultants to finalise the financial statements and providing requested information.
100. The underlying accounting records of the municipality did not facilitate the preparation of the financial statements to comply with the basis of accounting. This is due to no risk assessment being performed, weaknesses in the design and implementation of internal control in respect of financial management and financial reporting and weaknesses in the information systems of the municipality.
101. Prior year issues were not substantially addressed in the current year due to insufficient monitoring of recording and reconciliation of the financial records. Management did not develop sufficient control measures to address the qualifications reported in the prior years.

## REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

### Report on performance information

102. I was engaged to review the performance information.

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

103. 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).

### The Auditor-General's responsibility

104. 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 MSA.
105. 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.
106. 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**

107. The municipality did not implement a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players, as required in terms of regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001. Furthermore, contrary to section 38 of the MSA, the municipality does not have a performance management system in place.
108. The annual report of the 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
109. The municipality did not appoint a performance audit committee, nor was another audit committee utilised as the performance audit committee, as required by regulation 14(2) of the Municipal Planning and Performance Management Regulations, 2001.
110. Contrary to section 76(b) of the MSA, there is no service level agreement between the parent municipality and the municipal entity KEDC to regulate the performance of the municipal entity.
111. Contrary to section 57 the MSA, the performance agreements in place for senior management could not be provided for audit purposes.
112. Contrary to Section 53(2) of the MFMA, the mayor did not report to council and the Provincial MEC for Finance, the delay in the signing of the annual performance agreements.

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

113. The municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal audit processes, as required in terms of section 45 of the MSA.

## **OTHER REPORTS**

### **Special investigations in progress or completed**

114. An investigation was conducted during February 2009 by the council based on the allegation of possible cash shortage at certain cash points at the municipality. It was found that an amount of R25 344 was misappropriated by an employee who has subsequently resigned. A second investigation during the 2010 year revealed that another employee has misappropriated cash and a disciplinary hearing has been scheduled for June 2010. The employment of this employee is currently suspended.
115. An investigation was conducted during January 2009 by the council based on the allegation of possible non-compliance with the constitution and the MFMA by the

municipal manager and a municipal official in senior management. These two municipal officials have subsequently been dismissed after legal action was taken.

116. An internal remuneration audit was conducted by management on the January 2009 payroll into the payment of allowances. It was reported that the allowances paid to employees were too high and not in line with current municipal policies. It was also found that salary increases were implemented without authorisation by the council. Management is currently in the process of revising the remuneration policies and negotiations to take place with labour forums with regard to vehicle allowances. Management will also assess the re-appointment of staff in terms of their current positions.
117. There was an investigation conducted in September 2007 by an external audit firm with regard to irregularities at the municipality's vehicle testing centres and activities related to the traffic management system. The external audit firm presented a draft report to the municipal manager during April 2010 and this report was subsequently approved by the council. The Department of Local Government and Traditional Affairs will send a staff member from their legal department to follow up on the issues raised by the external audit firm.
118. The special investigating unit (SIU) conducted an investigation in February 2010 into the tender and supply chain management processes and salary payments at the municipality. The SIU report was tabled before the council and recommendations have been made which will be followed up by an appointed legal advisor from the Department of Local Government and Traditional Affairs and the municipality. The matters raised in the investigation reports are of a serious nature and the municipality is required to continuously update the Department of Local Government and Traditional Affairs with the remedial actions taken.
119. An investigation was initiated during March 2010 by the bank and SAPS with regard to the misappropriation of funds from the main bank account to the amount of R1,4 million. This amount was, however, recovered subsequently but the municipality was still in the process of reconciling the amount to ensure the full amount was recovered. The investigation by the bank and SAPS was still ongoing at the reporting date.

## APPRECIATION

120. The assistance rendered by the staff of the Kou-Kamma Municipality during the audit is sincerely appreciated.

*Auditor-General*  
East London

30 June 2010

