



A U D I T O R - G E N E R A L
S O U T H A F R I C A

The Accounting Officer

Kouga Municipality

P.O. Box 21

Jeffreys Bay

6330

Date: 24 February 2011

Reference: 60046REG09/10

Dear Sir

Report of the Auditor-General on the financial statements and other legal and regulatory requirements of Kouga Municipality for the year ended 30 June 2010

1. The above-mentioned report of the Auditor-General is submitted herewith in terms of section 21(1) of the Public Audit Act (PAA) of South Africa read in conjunction with section 188 of the Constitution of the Republic of South Africa section 121(3) of the Municipal Finance Management Act of South Africa (MFMA)
2. Refer **attached annexure** for material inconsistencies identified between the information contained in the draft annual report dated 1 February 2011 and the audited financial statements and the reported performance against pre-determined objectives. You are requested to make the necessary corrections to the draft annual report. Should the corrections not be made we will have to amend and reissue the audit report to reflect the material inconsistencies.
3. In terms of section 121(3) of the MFMA you are required to include the audit report in the municipality's annual report to be tabled.
4. Until the annual report is tabled as required by section 127(2) of the MFMA the audit report is not a public document and should therefore be treated as confidential. However in the event of delay with the tabling of the audit report, section 21(3) of the PAA empowers my office to promptly publish the report.
5. Prior to printing or copying the annual report which will include the audit report you are required to do the following:
 - Submit the final printer's proof of the annual report to the relevant senior manager of the Auditor-General of South Africa for verification of the audit-related references in the audit report and for confirmation that the financial statements and other information are those documents that have been read and audited. Special care should be taken with the page references in your report, since an incorrect reference could have audit implications.

- The signature *Auditor-General* in the handwriting of the auditor authorised to sign the audit report at the end of the hard copy of the audit report should be scanned in when preparing to print the report. This signature, as well as the place and date of signing and the Auditor-General of South Africa's logo, should appear at the end of the report, as in the hard copy that is provided to you. The official logo will be made available to you in electronic format.
6. Please notify the undersigned Senior Manager well in advance of the date on which the annual report containing this audit report will be tabled in council so that attendance can be scheduled.
 7. Your cooperation to ensure that all these requirements are met would be much appreciated.

Kindly acknowledge receipt of this letter.

Yours sincerely

Signed



.....
Senior Manager: Eastern Cape

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ACKNOWLEDGEMENT:

DATE:

Annexure

The following MATERIAL differences were identified between the Draft Annual Report 2009/2010 (dated 1 February 2011) and the Annual Financial Statements (AFS):

1. Page 79 point 4.2 of the Draft Annual report:

Actual Revenue per the Draft Annual Report:	R 337 769 379
Actual Revenue per the AFS:	R 366 921 654
Difference	R 29 152 275

2. Page 79 point 4.3: Grants and Transfers:

MIG funds received and expenditure made per the table does not agree to note 29 of the AFS.


3. Page 95 of the Draft Annual Report

Actual Revenue per the Draft Annual Report:	R 359 716 657
Actual Revenue per the AFS:	R 366 921 654
Difference	R 7 204 997

Actual expenditure per the Draft Annual Report:	R 312 307 347
Actual expenditure per the AFS:	R 397 459 752
Difference	R 85 152 405

4. Page 95 & 96 of the Draft Annual Report

Debtor analysis: The figures per the draft annual report do not agree to the figures per note 19 of the Annual Financial Statements.



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1.1.2011

AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS OF KOUGA MUNICIPALITY

REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying consolidated financial statements of the Kouga Municipality, which comprise the consolidated and separate statement of financial position as at 30 June 2010, the consolidated and separate statement of financial performance, consolidated and separate statement of changes in net assets and cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory information, and the accounting officer's report, as set out on pages xx to xx.

Accounting officer's responsibility for the consolidated financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and in the manner required by the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2007 (Act No. 1 of 2007) (DoRA). 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; and making accounting estimates that are reasonable in the circumstances.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of South Africa, 1996 (Act No. 108 of 1996), section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and 126(3) of the Municipal Finance Management Act of South Africa (MFMA), my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with International Standards on Auditing and *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*. 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. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis for qualified opinion

Expenditure

7. Sufficient appropriate audit evidence could not be provided for awards to the value of R15,7 million. No satisfactory alternative audit procedures could be performed to obtain reasonable assurance that expenditure incurred were made in accordance with the requirements of the supply chain management policy and regulations. The limitation experienced was as a result of incomplete bid documentation and tender files.

Fruitless and wasteful expenditure

8. The fruitless and wasteful expenditure balance at the end of the financial year is disclosed in note 43.2 to the financial statements to the amount of R5,2 million (2009: R3,4 million). Fruitless and wasteful expenditure related to incorrect overtime payments during the year, estimated at R469 085, was identified during the audit but not disclosed by management. Consequently, the fruitless and wasteful expenditure amount for the current year in the note is understated by R469 085.
9. In addition, prior year identified fruitless expenditure amounting to R21,4 million is disclosed in note 43.2 to the financial statements as condoned or written off by council. The incident relates to tender 20/2009 which was awarded to a contractor to do remedial work on the Kruisfontein and Kwanozamo housing projects due to poor workmanship by the original contractor. Contrary to section 32(2) read with Section 32(4) of the MFMA the council approval to support the disclosed finalisation of this incident was not provided for audit purposes.

Qualified opinion

10. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the consolidated and separate financial position of the Kouga Municipality as at 30 June 2010 and its consolidated and separate financial performance and its consolidated and separate cash flows for the year then ended in accordance with the GRAP reporting framework and in the manner required by the MFMA and DORA.

Emphasis of matter

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

Material under-spending of the capital budget

12. As disclosed in note 12 to the financial statements, additions to Property Plant and Equipment (PPE) via actual capital expenditure amounting to R35,8 million were incurred during the year. This actual capital expenditure represents an under-spending of R32 million or 53% of the original capital budget which amounted to R68,2 million.

Material impairments

13. Contrary to section 64(2)(a) and (g) of the MFMA, the municipality did not implement an effective revenue collection system and as a result not all revenue due was collected. This led to the impairment of debtors (provision for doubtful debt) by R40,1 million (2009: R14,2 million) which is disclosed in note 19 to the financial statements. Furthermore, the municipality had not taken the necessary action in terms of the council's credit control policy to disconnect services

for long-outstanding consumer debtors.

Significant uncertainties

14. 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. As reported previously, three of the municipality's landfill sites have still not been issued with a permit by the Department of Economic and Environmental Affairs. The municipality may incur a fine, per landfill site, for this contravention. The ultimate outcome of these matters cannot be determined at this stage and as such a contingent liability of R15 million has been disclosed in note 46.2 of the annual financial statements.

Matters important to the users of the financial statements:

Unauthorised, fruitless and wasteful and irregular expenditure

15. As disclosed in note 43.1 to the financial statements, unauthorised expenditure to the amount of R75,1 million (2009: R2 million) was incurred in the year due to over spending of the approved operating budget. The operating expenditure in excess of the budget relates mainly to bad debts provided (not budgeted for), overspending on employee related costs, grants and subsidies paid as well as interest charges. Council approval for the over expenditure per vote as required by section 15 read with section 32(4) of the MFMA has not been provided for audit purposes.
16. As disclosed in note 43.3 to the financial statements, the balance at year end in respect of irregular expenditure amounted to R27 million which related to incidents identified in the 2008-2009 financial year and on which there has been no progress since then.

Additional matter

17. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited supplementary schedules

18. The supplementary annexures do not form part of the financial statements and are presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

19. As required by the PAA and in terms of *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*, I include below my findings on the report on predetermined objectives and compliance with key laws and regulations, namely The MFMA, Municipal Regulations (Regulations – GNR/GN), DoRA, Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA), the Municipal Structures Act, 1998 (Act No. 117 of 1998) and regulations and financial management (internal control).

Predetermined objectives

20. Material findings on the report on predetermined objectives, as set out on pages ... to ..., are reported below:

Non-compliance with regulatory and reporting requirement

21. The municipality did not review the key performance indicators affected by the amendment to

the Integrated Development Plan (IDP) as required by section 11(2) of the Local Government: Municipal Planning and Performance Management Regulations 2001 (Local Govt: MP&PMR).

22. The municipality did not establish a Performance Management System (PMS) as required by section 38 read with section 41 of the Municipal Systems Act, 2001 (Act No. 32 of 2001) (MSA).
23. The PMS implemented by the municipality does not provide for the monitoring of performance and measurement and review of performance at least once per year with regards to each of the development priorities and objectives and against the key performance indicators and targets set in the IDP, as required by section 41(1)(c) of the MSA.
24. The PMS implemented by the municipality does not provide for policies and procedures to take steps to improve performance with regard to those development priorities and objectives where performance targets were not met, as required by section 41(1)(d) of the MSA. The municipality did not establish adequate mechanisms to monitor and review its PMS, as required by section 40 of the MSA.
25. The PMS implemented by the municipality does not entail a framework that describes the frequency of reporting and the lines of accountability for performance, as required by section 7(2)(e) of the Local Govt: MP&PMR.
26. The municipality did not set key performance indicators (KPIs), including input indicators, output indicators and outcome indicators, in respect of each of the development priorities and objectives set out in the IDP, as required by section 9 of the Local Govt: MP&PMR.
27. The municipality did not review its KPIs on an annual basis as part of the performance review process, as required by section 11 of the Local Govt: MP&PMR. The performance targets set do not correspond with available resources and with the municipality's capacity, as required by section 12(2)(c) & (d) of the Local Govt: MP&PMR.
28. The municipality did not develop and implement mechanisms, systems and processes for timely auditing the results of performance measurement as part of its internal processes, as required in terms of section 45 of the MSA and section 14(1) of the Local Govt: MP&PMR.
29. Kouga Municipality did not assess the priorities and objectives of its municipal entity (Kouga Development Agency) as required by section 87(2) of the MFMA. The budget projections for some of the developments were not done for a three-year period, as required by section 26(h) of the MSA.
30. Contrary to section 25 of the MSA, council gave notice of the adoption of its new/amended IDP to the public within 22 days (not 14 days as required) after the adoption of the IDP.
31. We could not obtain evidence that the municipal manager submitted a copy of the amended IDP to the MEC of local government within 10 days after the adoption of the amended IDP by the municipal council, as required by section 32 of the MSA.

Usefulness of information

32. The following criteria were used to assess the usefulness of the planned and reported performance:
 - Consistency: Has the department/entity/municipality/municipal entity reported on its performance with regard to its objectives, indicators and targets in its approved strategic plan/corporate plan/annual performance plan/integrated development plan, i.e. are the objectives, indicators and targets consistent between planning and reporting documents?

- **Relevance:** Is there a clear and logical link between the objectives, outcomes, outputs, indicators and performance targets?
- **Measurability:** Are objectives made measurable by means of indicators and targets? Are indicators well defined and verifiable, and are targets specific, measurable and time bound?

The following audit findings relate to the above criteria:

33. The municipality has not reported throughout on its performance against predetermined objectives which are consistent with the approved IDP.

Compliance with laws and regulations

Municipal Finance Management Act, Act No. 56 of 2003 (MFMA)

The financial statements were not prepared in accordance with applicable legislation

34. In order for the financial statements to meet the requirements of section 122(1) of the MFMA, material misstatements identified during the audit were corrected by management.
35. The municipality did not take all reasonable steps to ensure that unauthorised, irregular or fruitless and wasteful expenditure and other losses were prevented, as required by section 62(1)(d) of the MFMA.
36. The municipality recognised overpayments made to employees as a long-term receivable in the annual financial statements. This is in contravention of section 164(1)c of the MFMA as loans to councillors and employees are prohibited. The municipality did not take all reasonable steps to ensure that spending of funds is in accordance with the budget and that revenue and expenditure are properly monitored, as required by section 69(1) of the MFMA.

Supply Chain Management legislative requirements were not implemented or not adhered to (not resulting in irregular expenditure)

37. The municipality did not draw up contracts in respect of certain goods/services procured through the supply chain management system, as required by section 116 of the MFMA.

Municipal officials did not adhere to their statutory responsibilities

38. The municipality did not submit the bank account details to the Auditor-General, as required by section 9 of the MFMA.
39. The accounting officer of the municipality did not promptly notify the National Treasury in the prescribed format of the amount by which the accounts are overdrawn and the reason for it, as required by section 70(2) of the MFMA.
40. Contrary to section 65(2)(e), the municipality did not settle invoices within 30 days after receipt thereof. This includes not settling the audit fees timeously.
41. Evidence that unauthorised, irregular as well as fruitless and wasteful expenditure (as also disclosed in the notes to the financial statements) was reported to the MEC, the mayor as well as the Auditor-General, as required in terms of section 32(4) of the MFMA, could not be provided.
42. Contrary to section 75(1) of the MFMA, the accounting officer did not place on the website the

annual report, all long-term borrowing contracts, all supply chain management contracts above a prescribed value and all quarterly reports tabled to council in terms of section 52(d).

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

43. The municipality has not implemented an effective revenue collection management system to enforce fines on the municipality's by-laws, as required by sections 95, 98 and 99(a)(ii) of the MSA read with section 64(2)(a) of the MFMA.
44. Contrary to section 66(1)(b) of the MSA, job descriptions, roles and responsibilities were not completed for all the positions held by employees of the municipality.

Municipal Supply Chain Management Regulations: GNR 868 of 30 May 2005 (MSCMR)

45. The municipality did not in all cases ensure that the winning bidder's account for municipal rates and taxes and municipal service charges were not in arrears for more than three months, as required by MSCMR 28(1)(c) and 38(1)(d)(i).
46. The municipality did not have a Bid Specification Committee in place during the period under review, as required by MSCMR 27(1), (3) and (4).
47. A senior supply chain (SCM) management practitioner was not present at all bid adjudication meetings, as required by MSCMR 19(2).
48. The accounting officer did not submit to the council within 30 days after the municipality's financial year-end a report on the implementation of the SCM policy of the municipality and of any municipal entity under its sole or shared control, as required by MSCMR (6)(2)(a) and 6(3).
49. The municipality does not have a formal process for the accounting officer or the chief financial officer to be notified in writing on a monthly basis of all written and verbal quotations and formal written price quotations accepted by an official acting in terms of a sub-delegation, as required by MSCMR 18(d).
50. The municipality did not perform a risk assessment for the SCM system, as required by MSCMR 41(2).
51. Contrary to section 22(3) of the Construction Industry Development Board (CIDB) Act and CIDB Regulation 18(1A)(1), the suppliers of construction contracts were not registered on the register of construction contracts with the CIDB within 21 working days.
52. Contrary to the SCM Regulation 17(2), there is not a formal reporting structure in place for an official delegated by the CFO to approve fewer than three quotations obtained for awards between R2 000 and R10 000 and report such approvals to the CFO within three days of the end of each month.

Basic Conditions of Employment Act

53. 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 10 hours overtime a week. This matter was also reported in the previous audit.

Environment Conservation Act (Act 73 of 1989) (ECA)

54. The minimum requirements and permit conditions for the municipality's landfill sites as

required by section 20(1) of the ECA were not always complied with.

National Water Act, 1998 (Act No. 36 of 1998) (NWA)

55. Sewerage spills from the Humansdorp Sewer Treatment Works (Polla Park) into the immediate environment (water sources) were not dealt with in terms of the NWA. The municipality did not take all reasonable measures initially to prevent pollution and subsequently to prevent such pollution from continuing and recurring, as required by section 19 of the NWA.

INTERNAL CONTROL

56. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the MFMA, but not for the purpose of expressing an opinion on the effectiveness of internal control.
57. The matters reported below are limited to the significant deficiencies regarding the basis for qualified audit opinion paragraph, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

- **Leadership**

Effective oversight over the compliance with laws and regulations, in all instances was not evident in view of the repetitive external audit findings from the prior year audit. Notwithstanding being reported in the prior year, the appropriate approach towards reporting against predetermined objectives was not yet fully implemented during the year. The performance management system was still in the implementation phase and was not completely operational during the year under review. The Performance information required for audit was not submitted on time and there was no risk management policy in place to assess the risks directly relating to performance management. As a result, there were inadequate controls to ensure that reporting of actual performance against targets is valid.

Management did not ensure that incidents of abnormal expenditures (irregular, fruitless and wasteful and unauthorised) were promptly reported to the relevant external roleplayers in terms of the MFMA. As such the accounting officer did not exercise effective oversight of reporting against predetermined objectives, compliance with laws and regulations and internal control.

- **Financial and performance management**

The financial and performance management control objective relates mainly to the preparation of quality financial statements and performance reports which are supported by appropriate record keeping and information systems.

Manual and automated controls, although designed, were not in all instances adequately implemented to ensure that all transactions occurred, are authorised and are completely and accurately processed. Documented policies and procedures were not in place in respect of the capturing of transactions, resolving incorrect processing, overrides and bypasses of the system and non-standard journal entries.

This resulted in material amendments to the financial statements resulting from the audit. In addition to the material corrections required to fairly state the actual operating deficit for the year, material amendments were made to the account balances for current assets, provisions and the post-employment health care benefit liability.

The controls implemented by management over the financial systems and the procedures used for disclosure notes were not adequate. Amendments were required to the disclosure notes in respect of related party transactions, irregular expenditure, contingent liabilities and property, plant and equipment - capital under construction.

There were inadequate controls over activities performed by service organisations that have a direct impact on the annual financial statements most notably related to prepaid electricity and traffic fines.

- **Governance**

The governance control objective relates mainly to the involvement of the audit committee and internal audit in the identification and management of risk (including information technology) and fraud prevention. Since the prior year, a number of investigations remained in progress related to procurement irregularities. Notwithstanding this, there was no risk assessment performed for the Supply Chain Management System as required by the objectives and requirements of the SCM regulations. In addition there is neither a risk committee nor IT committee in place at the municipality

The Council only adopted a fraud prevention plan towards the end of the financial year. Management's own processes to identify, disclose and finalize actions in respect of incidents of irregular, fruitless and wasteful expenditure have not been effective. In addition, the process to investigate the incidents and act against officials (disciplining/criminal charges) has not been efficient in view thereof that the notes to the financial statements reveal a number of incidents already identified in the prior year which has not been certified and concluded on by Council as required by the MFMA.

Cognisance is taken of the work done by both the internal audit and the audit committee, however it is noted that the audit committee only met on two occasions during the financial year because of delays with finalizing the appointments and contracts of the audit committee members. The material amendments required to the financial statements as well as the findings on reporting against predetermined objectives show that there is still room for improvement. One specific area that is cause for concern is that, notwithstanding the use of consultants, the original financial statements submitted for audit had to be materially amended.

OTHER REPORTS

Investigations

58. An external auditing firm appointed by council conducted an investigation into the awarding of the prepaid electricity tender. The investigation was completed during June 2010 and the report was tabled to council where the recommendation was made that the accounting officer should take corrective action against the official concerned. The matter has been referred to council's attorneys to advise the accounting officer of corrective action to be taken. As at 31 December 2010, six months since the aforementioned report, no confirmation of any corrective action against any official has been provided.

Auditor-General

East London

9 February 2011



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence