



AUDITOR-GENERAL
SOUTH AFRICA

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Audit Report

Kouga Municipality

For the Year ended 30 June 2012

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

REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

Introduction

1. I have audited the consolidated and separate financial statements of the Kouga Municipality set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2012, the consolidated and separate statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the consolidated financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these consolidated and separate financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2011 (Act No. 6 of 2011, as amended) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. My responsibility is to express an opinion on these consolidated and separate financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated and separate financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated and separate financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated and separate 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 consolidated and separate 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 consolidated and separate financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Property, plant and equipment

6. Property, plant and equipment is disclosed in the statement of financial position and note 11 to the financial statements at R2,9 billion (2011: R2,9 billion). Included in this amount are infrastructure assets of R1,8 billion (2011: R1,9 billion). Sufficient appropriate audit evidence was not available to support the reasonableness of the calculations performed and assumptions made in determining the deemed costs of infrastructure assets in the first-time adoption of GRAP 17: *Property, Plant and Equipment*, as well as the depreciation amounting to R77,3 million (2011: R78,8 million) as disclosed in note 31 to the financial statements. The municipality's records did not permit the application of alternative audit procedures.

Consequently, I was unable to determine whether any adjustment relating to the infrastructure assets and depreciation were necessary.

Creditors

7. I was unable to obtain sufficient appropriate audit evidence to confirm outstanding building deposits and creditor suspense accounts of R9,6 million included in the trade creditors and accruals of R105 million as disclosed in note 7 to the financial statements. The municipality's records did not permit the application of alternative audit procedures. In addition, the municipality did not have adequate systems to maintain records of accounts payable for goods and services received but not yet paid for, which resulted in trade creditors and accruals as disclosed in note 7 to the financial statements and expenditure as disclosed on the face of the statement of financial performance being understated by R2 million. Consequently, I did not obtain all the information and explanations I consider necessary to satisfy myself of the existence, obligations and completeness of trade creditors and accruals as well as expenditure.

Provisions

8. Sufficient appropriate audit evidence was not available to support the provision for the rehabilitation of landfill sites disclosed at R13,9 million (2011: R14,4 million) in note 4 to the financial statements. The municipality's records did not permit the application of alternative audit procedures. Consequently, I did not obtain all the information and explanations I considered necessary to satisfy myself of the valuation, obligation and completeness of provisions.

Value-added tax (VAT)

9. The municipality was unable to reconcile the VAT liability of R3,8 million (2011: R3,4 million) as disclosed in the statement of financial position to the VAT returns submitted to the South African Revenue Service, resulting in an unexplained difference of R5,4 million (2011: R4 million). The municipality's records did not permit the application of alternative audit procedures. Consequently, I was not able to verify the rights, completeness and valuation of the VAT liability.

Financial sustainability

10. The annual financial statements of the parent municipality have been prepared on the assumption that the municipality will continue to operate as a going concern for at least the next 12 months. However, the municipality is experiencing significant financial difficulty and the current liabilities are exceeding the current assets by R96,3 million (2011: R75,6 million). Furthermore, the revenue recorded is not always received in the form of actual cash receipts, as an amount of R72,4 million (2011: R38,9 million) has been raised as doubtful debts. This has resulted in significant cash flow constraints and it is uncertain if the municipality can settle its current liabilities in the normal course of business. I was unable to obtain a detailed formal assessment from management regarding the use of the going concern assumption, including a detailed forecast of the cash flow of the municipality for the next financial period. Consequently, I was not able to verify the use of the going concern assumption in the financial statements.

Prior year comparative information

11. The municipality did not have adequate systems to maintain records of accounts payable for goods and services received but not yet paid for. I was unable to obtain sufficient appropriate audit evidence supporting creditors and accruals to the value of R25,3 million included in the comparative amount of note 7 to the financial statements. In addition, the municipality could not provide sufficient appropriate audit evidence to support a journal entry decreasing creditors by R13 million in the comparative amount per note 7 to the financial statements. The municipality's records did not permit the application of alternative audit procedures. Consequently, I did not obtain all the information and explanations I consider necessary to satisfy myself of the existence, obligations and completeness of these creditors and accruals.

12. The municipality did not have adequate systems in the prior year to maintain accurate leave records to support R3,1 million of the leave pay accrual disclosed at R9,7 million in the comparative amount in note 6 to the financial statements. The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to satisfy myself as to the valuation, obligation and completeness of the leave pay accrual.
13. The consumer debtors' balance as disclosed at R93,9 million in the comparative figures in note 16 to the financial statements did not agree to the consumer debtors' age analysis balance in the prior year. The municipality was unable to reconcile the difference of R4,6 million between the financial statements and the underlying accounting records. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of the comparative figure for consumer debtors. I could not determine the effect on other account balances or classes of transaction contained in the financial statements.
14. I was unable to obtain sufficient appropriate audit evidence on comparative account balances to support a journal entry decreasing the accumulated surplus by R5,9 million. The municipality's records did not permit the application of alternative audit procedures. Consequently, I did not obtain all the information and explanations I considered necessary to satisfy myself of the existence and valuation of the comparative figure of the accumulated surplus.
15. I was unable to obtain sufficient supporting documentation for the comparative figure for fruitless and wasteful expenditure to the value of R21,4 million as disclosed in note 40 to the financial statements. The municipality's records did not permit the application of alternative audit procedures. Consequently, I did not obtain all the information and explanations I considered necessary to satisfy myself as to the completeness as well as the valuation and allocation of fruitless and wasteful expenditure in the comparative figure.

Qualified opinion

16. In my opinion, except for the effects and possible effects of the matters described in the basis for qualified opinion paragraphs, the consolidated and separate financial statements present fairly, in all material respects, the financial position of the Kouga Municipality as at 30 June 2012 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

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

Restatement of corresponding figures

18. As disclosed in note 36 to the financial statements, the corresponding figures for 30 June 2011 have been restated as a result of errors discovered during the year ended 30 June 2012 in the financial statements of the municipality at, and for the year ended, 30 June 2011.

Material impairments

19. As disclosed in note 16 to the financial statements, the municipality's debtors were impaired in the current year by R 33,5 million, increasing the provision for doubtful debts to R72,4 million (2011: R38,9 million) at 30 June 2012.

ADDITIONAL MATTER PARAGRAPHS

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

Unaudited supplementary schedules

21. The supplementary information set out on pages ... to ... do not form part of the consolidated

and separate financial statements and is 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

22. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

23. The annual performance report included in the annual report was not presented in time for auditing and consequently my findings below are limited to the procedures performed on the strategic planning and performance management documents.

24. The information was assessed to determine whether performance indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury's *Framework for managing programme performance information*.

25. There were no material findings on the strategic planning and performance management documents concerning the measurability and relevance of the information.

Compliance with laws and regulations

26. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters.

Strategic planning and performance management

27. The parent municipality with shared control of a municipal entity did not ensure that annual performance objectives and indicators for the municipal entity were established by agreement with the municipal entity, as required by section 93C(a)(iv) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA).

28. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.

29. The municipality did not measure and review performance at least once per year, with regard to each development priority and objective and against the key performance indicators and targets set, or did not take steps to improve performance with regard to those development priorities and objectives where performance targets had not been met, as required by section 41 of the MSA.

30. The performance of the Kouga Development Agency was not monitored and annually reviewed as part of the annual budget process, as required by section 93C(a)(v) of the MSA.

Budgets

31. Expenditure was incurred that had not been budgeted for and that was in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

32. Quarterly reports were not submitted to the council on the implementation of the budget and the financial state of affairs of the municipality within 30 days after the end of each quarter, as required by section 52(d) of the MFMA.

33. The accounting officer did not assess the municipality's performance for the first half of the financial year, as required by section 72(1) of the MFMA.

Annual financial statements

34. The consolidated financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA.
35. Material misstatements of non-current assets, current assets, liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were subsequently provided, but the uncorrected material misstatements and supporting records that could not be provided resulted in the consolidated financial statements receiving a qualified audit opinion.
36. The municipal council did not adopt an oversight report, containing comments on the annual report, within two months from the date on which the 2010-11 annual report had been tabled, as required by section 129(1) of the MFMA.
37. The accounting officer did not make public the council's oversight report on the 2010-11 annual report within seven days of its adoption, as required by section 129(3) of the MFMA.

Audit committee

38. The audit committee did not advise the council, political office-bearers, accounting officer and management staff on matters relating to internal financial control and internal audits, risk management, accounting policies, effective governance, performance management and performance evaluation, as required by section 166(2)(a) of the MFMA.
39. The audit committee did not advise the council, political office-bearers, accounting officer and management staff on matters relating to the adequacy, reliability and accuracy of financial reporting and information, as required by section 166(2)(a)(iv) of the MFMA.
40. The audit committee did not advise the council, political office-bearers, accounting officer and management staff on matters relating to compliance with the MFMA, DoRA and the MSA, as required by section 166(2)(a)(vii) of the MFMA.
41. The audit committee did not review the annual financial statements to provide the council with an authoritative and credible view of the financial position of the entity, its efficiency and effectiveness, and its overall level of compliance with the MFMA, DoRA and the MSA, as required by section 166(2)(b) of the MFMA.
42. The audit committee did not respond to the council on the issues raised in the audit reports of the Auditor-General, as required by section 166(2)(c) of the MFMA.
43. The audit committee did not meet at least four times a year, as required by section 166(4)(b) of the MFMA.
44. A performance audit committee was not in place and the audit committee established in terms of section 166(1) of the MFMA was not used for this function, as required by Municipal Planning and Performance Management Regulation 14(2)(a).

Internal audit

45. An internal audit unit was not established, as required by section 165(1) of the MFMA.

Human resource management

46. The municipal manager did not sign a performance agreement, as required by section 57(2)(a) of the MSA.
47. An approved staff establishment was not in place, as required by section 66(1)(a) of the MSA.
48. Appointments were made in posts that were not provided for in the approved staff establishment of the municipality, in contravention of section 66(3) of the MSA.
49. Job descriptions were not established for all posts in which appointments had been made in the current year, in contravention of section 66(1)(b) of the MSA.

Expenditure management

50. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
51. An adequate management, accounting and information system was not in place to account for creditors and payments made, as required by section 65(2)(b) of the MFMA.
52. The accounting officer did not take effective steps to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
53. Unauthorised, irregular as well as fruitless and wasteful expenditure was not recovered from the liable person, as required by section 32(2) of the MFMA.

Asset management

54. An adequate management, accounting and information system to account for assets was not in place, as required by section 63(2)(a) of the MFMA.
55. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

Transfers and conditional grants

56. The municipality did not evaluate its performance in respect of programmes funded by the allocation or submit the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(6) of DoRA.

Internal control

57. I considered internal control relevant to my audit of the financial statements, performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for the qualified opinion, the findings on the performance report and the findings on compliance with laws and regulations included in this report.

Leadership

58. The leadership failed to maintain the integrity of its system of internal control by not ensuring its enforcement, as a result of vacancies at management level. Employees in acting positions did not necessarily have the necessary skills and knowledge and were often not in the position long enough to install the values of the municipality within the function they were managing.
59. This lack of stable leadership contributed to the significant amount of irregular as well as fruitless and wasteful expenditure incurred.
60. There was a lack of commitment by the leadership to monitor the implementation of action plans to address internal control deficiencies identified by external audit.
61. The leadership failed to ensure that there were adequately approved policies and procedures within the municipality. This resulted in control deficiencies and errors.

Financial and performance management

62. The municipality did not have proper record keeping and record management, resulting in documents supporting the amounts in the financial statements not being properly filed and easily retrievable. There were some delays by the municipality in providing the requested information for audit purposes and in some instances documentation could not be provided, resulting in a scope limitation being placed on the audit.

63. Suspense accounts and accruals were not reconciled, suppliers were not reconciled to statements, commitment registers were not maintained, fixed asset registers were not reconciled to the ledger, and VAT reconciliations were not performed adequately.
64. Creditors were not reconciled due to a lack of receipt of statements. There were inadequate supervisory checks over the creditors' reconciliations, as a number of errors were identified.
65. Controls were weak around the preparation of regular, accurate and complete financial and performance reports, supported by reliable evidence. A number of accounts could not be explained or reconciled and there was a lack of knowledge around the financial reporting framework, which led to deviations from the accounting standards and the fair presentation of the financial statements as well as non-compliance with laws, rules and regulations.
66. The financial statements were not subject to a detailed independent review prior to submission for auditing.
67. The review and monitoring of compliance with laws and regulations were not effective, as numerous instances of non-compliance were noted in the following areas: annual financial statements, performance and annual reports, budgets, audit committee, internal audit, human resource management, conditional grants, expenditure management and asset management.
68. The design and implementation of formal controls over information technology systems need constant improvement to ensure the reliability of the system and the availability, accuracy and protection of information. Control weaknesses related mainly to a lack of disaster recovery plans, security management, user access controls and environmental controls.

Governance

69. The municipality did not implement appropriate risk management activities to ensure that regular risk assessments, including information technology risks and fraud prevention, were conducted and that a risk strategy to address these risk were developed and monitored. No risk assessment was performed during the year and no fraud prevention plan was in place for the financial year under review. The lack of these actions exposed the municipality to increased fraudulent activities.
70. The municipality did not ensure that there was an adequately resourced and functioning internal audit unit to identify control deficiencies and recommend corrective actions effectively. Although the function was outsourced, no internal audit work was performed and no risk assessment was made in the current year.
71. The activities of the audit committee, namely to promote accountability and service delivery through evaluating and monitoring responses to risk and to provide oversight over the effectiveness of internal controls, were hampered as a functioning internal audit unit did not exist. The audit committee did not meet during the year, did not receive sufficient reports from the internal audit unit to assess risks and compile responses thereto, and did not review the annual financial statements prior to submission for the external audit.

Auditor General.

East London

7 December 2012



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