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**AUDITOR - GENERAL  
SOUTH AFRICA**

# **Audit Report**

## **Kou Kamma Municipality**

For the Year ended 30 June 2012

# REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON KOU-KAMMA MUNICIPALITY

## REPORT ON THE FINANCIAL STATEMENTS

### Introduction

1. I was engaged to audit the financial statements of the Kou-Kamma Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2012, and the statement of financial performance, statement of changes in net assets and statement of cash flows for the year then ended, a summary of significant accounting policies and other explanatory information, and appendix A.

### Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for preparation and the fair presentation of these financial statements in accordance with the 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 Division of Revenue Act, 2011 (Act No 6 of 2011) (DoRA), 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.

### Auditor-General's responsibility

3. My responsibility is to express an opinion on these 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 2001) (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 financial statements are free from material misstatement.
4. 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.
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 (PPE) are disclosed in the statement of financial position and note 7 to the financial statements at R218 million (2011: R212,8 million). Included in this amount are infrastructure assets of R189,9 million (2011: R182,8 million). The municipality did not unbundle infrastructure assets in accordance with the Standard of Generally Recognised Accounting Practice, GRAP 17, *Property, plant and equipment*, and

consequently did not review the residual values and useful lives of infrastructure assets at each reporting date. I was unable to confirm or verify by alternative means the value of infrastructure assets due to inadequate record keeping by the municipality. I did not obtain sufficient appropriate audit evidence to satisfy myself as to the valuation of infrastructure assets. Consequently, I was unable to determine whether any further adjustments relating to infrastructure assets were necessary.

#### **Revenue**

7. The municipality did not charge all service debtors for water usage, refuse and sewerage every month during the financial year ended 30 June 2012. Due to the lack of adequate systems in place, it was impracticable for me to determine the full extent of understatement in service charge revenue. Consequently, I was unable to determine whether any further adjustments were necessary for service charge revenue amounting to R15,9 million (2011: R14,5 million) as disclosed in the statement of financial performance.

#### **Correction of error**

8. Prior period errors should be corrected in accordance with the Standard of Generally Recognised Accounting Practice, GRAP 3, *Accounting policies, changes in accounting estimates and errors*, which requires that material prior year errors be corrected retrospectively in the first set of financial statements authorised to be issued after discovery of these errors, by restating the comparatives for the prior period(s) presented in which the error occurred. Sufficient appropriate audit evidence could not be provided for all the prior period errors as disclosed in note 36 to the financial statements in respect of the following elements making up the statement of financial position and statement of financial performance:

- Current assets – R5,3 million
- Current liabilities – R47,5 million
- Non-current assets – R11,4 million
- Revenue – R2,3 million
- Expenses – R1 million

9. I was unable to confirm these adjustments by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary.

#### **Unauthorised expenditure**

10. Included in note 38.1, Unauthorised expenditure are amounts approved by the council totalling R39,1 million. Of this amount, R7,7 million was not approved by council. Consequently, the unauthorised expenditure awaiting authorisation is understated by R7,7 million.

#### **Material losses of water and electricity**

11. Section 125(2)(d)(i) of the MFMA requires the disclosure of any material losses in the annual financial statements. The municipality did not have a system in place for the identification and recognition of material losses of water and electricity. Due to the lack of systems in place, it was impracticable to determine the full extent of the losses.

### **Aggregation of immaterial uncorrected misstatements**

12. The financial statements as a whole are materially misstated due to the cumulative effect of various individually immaterial uncorrected misstatements in the following elements making up the statement of financial position and the statement of financial performance:
- Current assets reflected as R37,4 million are understated by R1,7 million
  - Current liabilities reflected as R14,5 million are overstated by R156 350
  - Total revenue reflected as R106 million is understated by R1,5 million
  - Total expenditure reflected as R87 million is overstated by R582 323

### **Qualified opinion**

13. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraphs, the financial statements presents fairly, in all material respects, the financial position of the Kou-Kamma 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**

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

### **Significant uncertainties**

14. The municipality is a defendant in a number of lawsuits as disclosed in note 42 to the financial statements. The outcome of these lawsuits cannot be determined at present and no provision has been made for any liability that may result.

### **Financial sustainability**

15. While the municipality has prepared financial statements on a going concern basis, there are a number of indicators that its financial sustainability is under threat which was disclosed in note 37 to the financial statements.

### **Material underspending of operating budget**

16. As disclosed in appendix A, the municipality has materially underspent its materials and bulk purchases, repairs and maintenance, grant expenditure and other expenditure budget to the amount of R22,9 million. This under-spending contributed to the under-achievement of the municipality's planned targets as reported in paragraph 28 below.

### **Additional matters**

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

### **Unaudited supplementary schedules**

17. The supplementary appendices B to E set out on pages ... to ... do not form part of the financial statements and are presented as additional information. We have not audited these schedules and accordingly we do not express an opinion thereon.

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

18. 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**

19. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages ... to ... of the annual report.

20. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned development objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury *Framework for managing programme performance information* (FMPPI).

21. The reliability of the information in respect of the selected development objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

22. The material findings are as follows concerning the usefulness of the information.

### **Usefulness of information**

#### **Presentation**

##### **Measures taken to improve performance not disclosed**

23. The municipality did not disclose measures taken to improve performance in its annual performance report for any of the 56 (100%) planned targets that were not achieved as required by section 46 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA). This was due to inadequate internal policies and procedures over the processes pertaining to the reporting of performance information.

#### **Measurability**

##### **Performance indicators not specific**

24. The FMPPI requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 36% of the targets were not specific in clearly identifying the nature and the required level of performance. This was due to the fact that management was not aware of the requirements of the FMPPI.

##### **Performance indicators not well defined**

25. The FMPPI requires that indicators/measures should have clear unambiguous data



definitions so that data is collected consistently and is easy to understand and use. A total of 35% of the indicators relevant to the annual performance report were not well defined in that clear, unambiguous data definitions was not available to allow for data to be collected consistently. This was due to the fact that management was not aware of the requirements of the FMPPI.

#### **Reliability of information**

26. There were no material findings on the annual performance report of the Kou-Kamma Municipality concerning the reliability of the information.

#### **Additional matter**

27. I draw attention to the following matter. This matter does not have an impact on the predetermined objectives audit findings reported above.

#### **Achievement of planned targets**

28. As reported in the annual performance report, only 53% of the planned targets were achieved during the year under review. The main reason for the under-achievement is the lack of financial resources to implement targets.

#### **Compliance with laws and regulations**

29. 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. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the general notice issued in terms of the PAA are as follows:

#### **Strategic planning and performance management**

30. The municipality did not afford the local community at least 21 days to comment on the final draft of its integrated development plan (IDP) before the plan was submitted to the council for adoption, as required by regulation 15(3) of the Municipal Planning and Performance Management Regulations.
31. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.

#### **Budgets**

32. The municipality incurred expenditure that was not budgeted for and incurred expenditure in excess of the limits of the amounts provided for in the votes in the approved budget, in contravention of section 15 of the MFMA.
33. Quarterly reports were not submitted to the council on the implementation of the budget and 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.
34. The accounting officer did not always submit the monthly budget statements to the mayor and the relevant provincial treasury, as required by section 71(1) of the MFMA.
35. The accounting officer did not assess the first half of the financial year performance of the

municipality, as required by section 72(1) and 72(1)(a)(ii) of the MFMA.

#### **Annual financial statements, performance and annual report**

36. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA.
37. 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 provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.
38. The accounting officer did not make the 2010-11 annual report public immediately after the annual report was tabled in the council as required by section 127(5) of the MFMA.
39. 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.

#### **Internal audit**

40. The municipality did not have an internal audit unit in place for the full year as required by section 165(1) of the MFMA and as a result did not function throughout the year as required by section 165(2) of the MFMA, MSA and the Municipal Planning and Performance Management Regulations.

#### **Procurement and contract management**

41. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by regulation 17(a) & (c) of the supply chain management regulations (SCM).
42. Bid specifications were not always drafted by bid specification committees which were composed of one or more officials of the municipality as required by regulation 27(3) of the SCM.
43. Construction contract projects were not registered with the CIDB within 21 working days as required by section 22(3) of the Construction Industry Development Board Act, 2000 (Act No. 38 of 2000).
44. Awards to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by regulation 13(c) of the SCM.

#### **Expenditure management**

45. 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.
46. The accounting officer did not take reasonable steps to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
47. The municipality did not recover unauthorised, irregular or fruitless and wasteful



expenditure from the liable person, as required by section 32(2) of the MFMA.

#### **Revenue management**

48. Interest was not charged on all arrear accounts as required by section 64(2)(g) of the MFMA.
49. Revenue received by the municipality was not always reconciled at least on a weekly basis, as required by section 64(2)(h) of the MFMA.
50. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which recognised revenue when it is earned and accounted for debtors as required by section 64(2)(e) of the MFMA.

#### **Asset management**

51. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which accounts for the assets of the municipality as required by section 63(2)(a) of the MFMA.
52. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained an effective system of internal control for assets (including an asset register) as required by section 63(2)(c) of the MFMA.

#### **INTERNAL CONTROL**

53. I considered internal control relevant to my audit of the financial statements, annual 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 qualification of opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

#### **Leadership**

54. Management did not exercise effective oversight responsibilities over financial and performance reporting, compliance with laws and regulations and internal control. Consequently, the accounting officer did not evaluate whether management has implemented effective policies, procedures and internal controls. As a result, the municipality did not have adequate controls and processes in place to ensure compliance with applicable legislation. Although management developed and monitored the implementation of the action plan to address internal control deficiencies, all deficiencies were not addressed during the year. Consequently repeat audit findings occurred during the year under review. There were no formal policies and procedures manual for the information technology function.

#### **Financial and performance management**

55. The financial statements and other information to be included in the annual report are not adequately reviewed for completeness and accuracy prior to submission for audit purposes. Pertinent information required for the preparation of accurate financial reports are not identified and properly captured in a timely manner to ensure that financial information is credible. Daily and monthly processing and reconciling controls were not implemented. Various reconciliations, such as the bank, creditors and fixed assets were not performed and acted upon in a timely manner. As a result, the financial statements

submitted for audit contained material errors and were subject to numerous amendments.

56. The controls over the information technology systems to ensure the reliability, availability, accuracy and protection of information were found to be weak.

#### **Governance**

57. No risk assessment had taken place during the year and there was thus also insufficient oversight over the effective operation of internal controls. This contributed to the above findings mentioned in the preceding paragraphs.
58. The internal audit unit was not in operation for the full year and has not produced any audit programmes and reports for the year under review.
59. The audit committee has made numerous recommendations during the year under review to council relating to the evaluation and monitoring of responses to risk and weaknesses in the internal control environment. These recommendations were however not adequately acted upon.

#### **OTHER REPORTS**

60. Five investigations related to supply chain management transgressions and financial misconduct were completed during the year. There were no investigations in progress at year-end.

*Auditor General.*

East London

30 November 2012



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