

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

### **REPORT ON THE FINANCIAL STATEMENTS**

#### **Introduction**

1. I have audited the financial statements of the Kouga Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2013, the statement of financial performance, statement of changes in net assets, cash flows statement, statement of comparison of budgets and actual amounts, 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 financial statements**

2. The accounting officer is responsible for preparation and the fair presentation of these 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 Division of Revenue Act. 2012 (Act No 5 of 2012) (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**

##### **Provisions and Non – current provisions**

6. Sufficient appropriate audit evidence was not available to support the provision and non – current provision for the rehabilitation of landfill sites disclosed in note 16 and 23 respectively, to the financial statements. Supporting documentation was not submitted for audit purposes. I was unable to confirm the provision and non – current provision by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the provision and non -current provision for rehabilitation of landfill sites of

R4.7 million (2012: R4.7 million) as disclosed in note 16 and R9.3 million (2012: R9.3 million) as disclosed in note 23 to the financial statements.

#### **Prior year comparative information**

7. During 2011-12 sufficient appropriate audit evidence was not available for payables from exchange and non - exchange transactions as disclosed in note 17 and 18 to the financial statements and I was unable to confirm the balance by alternative means. This amount relates to sundry deposits (building deposits) and creditors suspense accounts. Consequently, I was unable to determine whether any adjustments were necessary to payables from exchange transactions of R105.4 million and payables from non exchange transactions of R5.0 million as disclosed in note 17 and 18 to the financial statements. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.
8. Sufficient appropriate audit evidence was not available for the correction of error relating to unspent grants and subsidies disclosed in note 41.1 to the financial statements and I was unable to confirm the correction of error by alternative means. This amount relates to the clearing of conditional grant liabilities. Consequently, I was unable to determine whether any adjustments were necessary to the opening balance of accumulated surplus of R2.6 billion as disclosed in note 41.1 to the financial statements. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

#### **Qualified opinion**

9. In my opinion, except for the possible effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Municipality as at 30 June 2013 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:

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

10. As disclosed in note 41 to the financial statements, the prior period corresponding figures have been restated as a result of errors only corrected during the year ended 30 June 2013, that existed as at 30 June 2012.

#### **Material impairments/losses**

11. As disclosed in note 34 to the financial statements, an amount of R 5.4 million (2012: R29.7 million) was written off as impairment losses due to the non payment of consumer debtor accounts.
12. As disclosed in note 47.9 to the financial statements, the municipality incurred material losses relating to electricity of R5.5 million (2012: R9.9 million) as a result of tampering of meters, faulty meters and illegal electricity connections.
13. As disclosed in note 47.10 to the financial statements, the municipality incurred material losses relating to water of R9.1 million (2012: R8.2 million) as result of faulty meters.

### **Financial sustainability**

14. As disclosed in note 53 to the financial statements, the cash flow of the municipality is under strict cash management processes and is being closely monitored. The revenue is not always received in the form of actual cash receipts. This has resulted in significant cash flow constraints. This situation, along with other matters as set forth in the note, indicates that the municipality may encounter difficulty realising its assets and discharging its liabilities in the normal course of business.

### **Significant uncertainties**

15. As disclosed in note 50 to the financial statements, the municipality is a defendant in a number of lawsuits. The results of these lawsuits cannot be determined at present as litigation is still in progress.

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

16. 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**

17. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages 3 to 14 of the annual report.
18. 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)*.
19. 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).
20. The material findings are as follows:

### **Usefulness of information**

#### **Presentation**

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

21. Section 46 of the Municipal Systems Act requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved. Measures to improve performance for a total of 68% of the planned targets not achieved were not reflected in the annual performance report. This was due to the lack of adequately and sufficiently skilled resources in place to ensure that performance is monitored and accurately reported on.

## **Consistency**

### **Reported targets not consistent with planned targets**

22. The Municipal Systems Act, section 41(c) requires that the integrated development plan should form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 32% of the reported targets are not consistent with the targets as per the approved integrated development plan. This is due to the lack of an established performance management system which entails reviews from management, internal audit and the audit committee of the annual performance report against the integrated development plan.

## **Reliability of selected development priorities in the annual performance report**

### **Development Priority Two - Basic services and infrastructure**

23. The National Treasury *FMPI* requires that institutions should have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of information presented with respect to Provision of Basic Service Delivery. This was due to the fact that the institution could not provide sufficient appropriate evidence in support of the information presented with respect to the development priority.

## **Compliance with laws and regulations**

24. 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:**

25. The performance management system of the municipality did not provide for the monitoring of performance and for the measuring and review of performance at least once per year, with regard to each of those development priorities and objectives and against the key performance indicators and targets set, as required by section 41 of the Municipal Systems Act (MSA).
26. Revisions to the service delivery and budget implementation plan were not approved by the council after the approval of the adjustments budget, as required by section 54(1)(c) of the MFMA.
27. The annual performance report for the year under review does not include the performance of the municipality and of each external service provider as required by section 46 (1)(a) of the MSA.
28. The municipality did not have and maintain effective, efficient and transparent systems of financial and risk management and internal controls as required by section 62(1)(c)(i) of the MFMA.

29. The audit committee did not submit, at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by Municipal planning and performance management regulation 14(4)(a)(iii).
30. The audit committee did not review the municipality's performance management system and make recommendations to the council, as required by Municipal planning and performance management regulation 14(4)(a)(ii).
31. The audit committee did not review all the quarterly internal audit reports on performance measurement, as required by Municipal planning and performance management regulation 14(4)(a)(i).
32. The internal audit did not audit the results of performance measurements, as required by section 45(1)(a) of the Municipal Systems Act and Municipal planning and performance management regulation 14(1)(a).
33. The internal audit unit did not assess the functionality of the performance management system, as required by Municipal planning and performance management regulation 14(1)(b)(i).
34. The internal audit unit did not assess the extent to which the performance measurements were reliable in measuring the performance of the municipality on key and general performance indicators, as required by Municipal planning and performance management regulation 14(1)(b)(iii).
35. The internal audit unit did not audit the performance measurements on a continuous basis and/or submitted quarterly reports on their audits to the municipal manager and the performance audit committee], as required by Municipal planning and performance management regulation 14(1)(c).

#### **Budgets**

36. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 87(8) of the MFMA.

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

37. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the Municipal Finance Management Act. 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, but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.
38. The 2011/12 annual report was not tabled in the municipal council within seven months after the end of the financial year, as required by section 127(2) of the MFMA.
39. A written explanation was not submitted to council setting out the reasons for the delay in the tabling of the 2011/12 annual report in the council, as required by section 127(3) and 133(1)(a) of the MFMA.
40. The annual report for the year under review does not include an assessment by the accounting officer of any arrears on municipal taxes and service charges and the report of the audit committee, as required by section 121(3)(e), 121(4)(c) and 121(3)(j) and 121(4)(g) of the MFMA respectively.

### **Audit committee**

41. An audit committee was not in place for the full financial year with a full complement of members as required by section 166(1) of the MFMA.
42. The audit committee did not advise the council nor accounting officer 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.
43. The audit committee did not advise the council nor accounting officer 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.
44. The audit committee did not advise the council nor accounting officer on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.
45. 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.
46. The audit committee did not meet at least four times a year, as required by section 166(4)(b) of the MFMA.
47. 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 legislation, as required by section 166(2)(b) of the MFMA.

### **Internal Audit**

48. The internal audit unit did not function as required by section 165(2) of the MFMA, in that :
  - it did not report to the audit committee on the implementation of the internal audit plan.
  - it did not advise the accounting officer and/or report to the audit committee on matters relating to internal audit, internal controls, accounting procedures and practices, risk and risk management and loss control.
49. The internal audit unit did not advise the accounting officer and report to the audit committee on matters relating to compliance with the MFMA, the Division of Revenue Act and other applicable legislation, as required by section 165(2)(b)(vii) of the MFMA.

### **Expenditure management**

50. Money owing by the municipality was not always paid within 30 days or an agreed period, as required by section 65(2)(e) of the MFMA.
51. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, in accordance with the requirements of section 62(2) of the MFMA

### **Human Resources**

52. The municipality did not develop and adopt appropriate systems (policies) and procedures to monitor measure and evaluate performance of staff in contravention of MSA sec 67(d).

### **Liability Management**

53. An adequate management, accounting and information system which accounts for liabilities was not in place, as required by section 63(2)(a) of the MFMA.

54. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the MFMA.

#### **Consequences management**

55. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.

#### **INTERNAL CONTROL**

56. 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**

57. Management did not address all deficiencies during the year and leadership does not exercise consequence management for poor performance and transgressions. In addition here is a lack of monitoring and oversight by the leadership.

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

58. Management did not maintain a proper filing system for payables and did not effectively manage and monitor daily and monthly processing. In addition, they did not fully understand the requirements of the financial reporting framework and there is no formal documented system over information technology. Furthermore, management did not comply with all laws and regulations due to a lack of appropriate monitoring.

#### **Governance**

59. No risk assessments were performed during the year under review in order to manage risks within the control environment. In addition, the audit committee and internal audit did not function throughout the year.

*Auditor-General*

East London

29 November 2013



**AUDITOR - GENERAL  
SOUTH AFRICA**

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