

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

## REPORT ON THE FINANCIAL STATEMENTS

### Introduction

1. I have audited the financial statements of the Kou-Kamma 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 flow statement, statement of comparison of budgets and actual amounts and appropriation 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 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 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, 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 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 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

#### Revenue

6. The municipality did not recognise interest received and the associated receivables on long outstanding debt at each reporting date, in the financial statements as required by section 64(2)(g) of the MFMA. I have not determined the amount of the understatement of interest received and the associated receivables, as it was impracticable to do so.

7. The municipality did not charge all service debtors for water usage every month during the financial year ended 30 June 2013. Due to the lack of adequate systems in place, it was impracticable for me to determine the full extent of the understatement of the service charge revenue. I was unable to confirm the revenue by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary relating to the service charge revenue stated at R17,7 million (2012: R15,9 million) in the financial statements.

#### **Qualified opinion**

8. 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 Kou-Kamma 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**

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

#### **Significant uncertainties**

10. As disclosed in note 46 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 the litigation is still in progress.

#### **Financial sustainability**

11. The municipality's current liabilities exceeded its current assets. This situation, along with other matters as set forth in note 39, indicates that the municipality may encounter difficulty realising its assets and discharging its liabilities in the normal course of business.

#### **Material impairments**

12. As disclosed in note 7 to the financial statements, an amount of R19,6 million (2012: R11,3 million) in respect of receivables from exchange transactions was impaired as a result of the non-payment of consumer debtor accounts.
13. As disclosed in note 4 to the financial statements, an amount of R8,1 million (2012: R2,8 million) in respect of receivables from non-exchange transactions was impaired as a result of the non-payment of consumer debtor accounts.

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

14. 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**

15. 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 ....
16. The reported performance against predetermined objectives was evaluated against the

overall criteria of usefulness and reliability.

17. 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's *Framework for managing programme performance information* (FMPPi).
18. 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).
19. The material findings are as follows concerning the usefulness of the information.

### **Usefulness of information**

#### **Presentation**

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

20. Section 46 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved. Measures to improve performance for 57% of the planned targets not achieved were not reflected in the annual performance report. This was due to a lack of appropriate policies and procedures to ensure that performance reporting was adequate.

#### **Measures taken to improve performance not supported by adequate and reliable corroborating evidence**

21. Section 46 of the MSA requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved. Adequate and reliable corroborating evidence could not be provided for 21% of the measures taken to improve performance as disclosed in the annual performance report. The municipality's records did not permit the application of alternative audit procedures. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the reliability of the measures taken to improve performance.

#### **Consistency**

22. Section 41(c) of the MSA requires that the annual performance 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 30% of the reported indicators and 23% of the reported targets were not consistent with the indicators or targets as per the approved integrated development plan or service delivery and budget implementation plan. This was due to a lack of controls and review to ensure that performance reporting was appropriate.

## **Measurability**

### **Performance indicators not specific**

23. The FMPP requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 59% of the targets were not specific in clearly identifying the nature and the required level of performance. This was due to management not being aware of the requirements of the FMPP.

### **Performance indicators not measurable**

24. The FMPP requires that performance targets be measurable. The required performance could not be measured for 59% of the targets. This was due to management not being aware of the requirements of the FMPP.

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

25. The FMPP requires that indicators should have clear, unambiguous data definitions so that data can be collected consistently and is easy to understand and use. A total of 82% of the indicators were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was because management was aware of the requirements of the FMPP but did not receive the necessary training to enable application of the principles.

### **Performance indicators not verifiable**

26. The FMPP requires that it must be possible to validate the processes and systems that produce the indicator. A total of 64% of the indicators were not verifiable in that valid processes and systems that produced the information on actual performance did not exist. This was due to a lack of key controls in the relevant systems of collection, collation, verification or storage of actual performance information.

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

### **Development priority two – provision of basic service delivery**

27. The FMPP 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 the information presented with respect to the provision of basic service delivery. This was as a result of insufficient appropriate evidence in support of the information presented with respect to the development priority.

### **Additional matter**

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

### **Achievement of planned targets**

29. Of the total number of 93 targets planned for the year, 24 were not achieved in the year under review. This means that 26% of the total planned targets were not achieved during the year under review. This was mainly due to a lack of financial resources to implement targets.

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

30. 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**

31. The integrated development plan adopted by the municipality did not reflect and identify the municipal council's vision for the long-term development of the municipality.
32. 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), due to the committee not receiving information timeously.
33. 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), due to the committee not receiving information timeously.
34. 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).
35. The internal audit unit did not audit performance measurements on a continuous basis, as required by Municipal Planning and Performance Management Regulation 14(1)(c).
36. The annual performance report for the year under review did not include a comparison with the previous financial year and measures taken to improve performance, as required by section 46(1)(b) and (c) of the MSA.

### **Budget**

37. Expenditure was incurred 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.
38. 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.
39. Monthly budget statements were not submitted to the relevant provincial treasury within 10 working days after the end of each month, as required by section 71(1) of the MFMA.

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

40. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, current assets and irregular, unauthorised as well as fruitless and wasteful expenditure 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.
41. The 2011-12 annual report was not made public immediately after the annual report had been tabled in the council, as required by section 127(5) of the MFMA.
42. The council's oversight report on the 2011-12 annual report was not made public within seven days of its adoption, as required by section 129(3) of the MFMA.

### **Audit committee**

43. The audit committee did not advise the council on matters relating to performance management and performance evaluation, as required by section 166(2)(a) of the MFMA, due to the late or non-submission of documentation to the committee.

### **Procurement and contract management**

44. Sufficient appropriate audit evidence was not provided relating to procurement and contract management and therefore I could not determine whether the municipality had complied with the following:

- Goods and services with a transaction value below R200 000 were procured without obtaining the required price quotations, as required by Supply Chain Management (SCM) Regulation 17(a) and (c).
- Quotations were awarded 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 SCM Regulation 13(c).
- Contracts were awarded to bidders based on preference points that were not allocated in accordance with the requirements of the Preferential Procurement Policy Framework Act of South Africa, 2000 (Act No. 5 of 2000) and its regulations.
- Invitations for competitive bidding were not always advertised for the required minimum period, contrary to SCM Regulation 22(1) and 22(2).
- Quotations were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM Regulation 43.

### **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. Reasonable steps were not taken to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

### **Conditional grants received**

47. The municipality did not submit quarterly performance reports to the transferring national officer, provincial treasury and the National Treasury within 30 days after the end of each quarter, as required by section 12(2)(c) of DoRA.

48. The municipality did not submit the evaluation of its performance to the transferring national officer within two months after the end of the financial year, as required by section 12(5) of DoRA.

49. The municipality did not submit within 10 days after the end of each month its monthly expenditure reports to the national department (Cooperative Governance and Traditional Affairs (CoGTA)), as required by DoRA.

50. The municipality did not submit project implementation plans to the national department (CoGTA), as required by DoRA.

### **Revenue management**

51. An adequate management, accounting and information system was not in place to account for revenue, as required by section 64(2)(e) of the MFMA.
52. An effective system of internal control for revenue was not in place, as required by section 64(2)(f) of the MFMA.
53. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

### **Liability management**

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

### **Consequence management**

56. Unauthorised, irregular as well as 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**

57. 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 the qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

### **Leadership**

58. Management did not address all deficiencies during the year and the leadership did not exercise consequence management for poor performance and transgressions. Consequently, repeat audit findings occurred during the year under review. In addition, there was also a lack of monitoring and oversight by leadership.

### **Financial and performance management**

59. Daily and monthly processing and reconciling controls were not implemented for revenue, and not all the required reconciliations were performed on a monthly basis. Furthermore, there was no proper record management system. There was also a lack of monitoring and oversight by management.

## Governance

60. The risk assessment that took place during the year was inadequate and there was insufficient monitoring on the effective operation of internal controls. The internal audit unit was not in operation for the full year and there was insufficient time for the municipality to implement recommendations made as a result of the internal audit unit's findings. The audit committee was not provided with required information in a timely manner to allow them to adequately report on this information.

*Auditor - General*

East London

30 November 2013



AUDITOR - GENERAL  
SOUTH AFRICA

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