

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

## REPORT ON THE FINANCIAL STATEMENTS

### Introduction

1. I have audited the financial statements of the Kouga Local Municipality set out on pages ...to... which comprise, the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual information for the year then ended, as well as 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, 2013 (Act No. 2 of 2013) (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 audit opinion.

### Opinion

6. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Kouga Local Municipality as at 30 June 2014 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**

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

### **Significant uncertainties**

8. As disclosed in note 52 to the financial statements, the municipality is the defendant in a number of lawsuits to the amount of R28,9 million (2013: R41,5 million). The outcome of these lawsuits cannot be determined at present as litigation is still in progress.

### **Restatement of corresponding figures**

9. As disclosed in note 43 to the financial statements, the corresponding figures for 30 June 2013 have been restated as a result of errors discovered during the year ended 30 June 2014.

### **Impairments**

10. As disclosed in note 4 to the financial statements, an amount of R47,6 million (2013: R46,7 million) in respect of receivables from exchange transactions has been impaired as a result of non-payment of consumer debtor accounts.
11. As disclosed in note 5 to the financial statements, an amount of R27,8 million (2013: R18,1 million) in respect of receivables from non-exchange transactions has been impaired as a result of non-payment of consumer debtor accounts.
12. As disclosed in note 36 to the financial statements, an amount of R33,1 million has been written off during the year as impairment losses due to the non-payment of consumer debtor accounts.

### **Material losses**

13. As disclosed in note 48.8 to the financial statements, the municipality incurred material losses relating to water of R11,8 million (2013: R9,1 million) as a result of non-billed water or billable water not been metered.

### **Unauthorised expenditure**

14. As disclosed in note 47.1 to the financial statements, unauthorised expenditure amounting to R24,0 million (2013: R30,0 million) was incurred due to overspending of the budget per vote.

### **Fruitless and wasteful expenditure**

15. As disclosed in note 47.2 to the financial statements, fruitless and wasteful expenditure amounting to R2,3 million (2013: R9,4 million) was incurred due to penalties and interest on late payment of creditors.

### **Irregular expenditure**

16. As disclosed in note 47.3 to the financial statements, irregular expenditure of R1,1 million (2013: R20,07 million) was incurred due to the municipality not adhering to SCM regulations and procedures.

### **Material under-spending of the capital budget**

17. As disclosed in the statement of comparison of budget and actual amounts, the municipality has materially underspent on its capital budget by R66,6 million.

### **Additional matter**

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

### **Unaudited disclosure notes**

19. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion.

### **Unaudited supplementary schedules**

20. The supplementary information set out on pages ... to ... does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I will not express an opinion thereon.

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

21. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected development objectives presented in the annual performance report, non-compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

### **Predetermined objectives**

22. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development objectives presented in the annual performance report of the municipality for the year ended 30 June 2014:

Development priority 5: Infrastructure and the provision of basic services

23. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
24. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development objectives. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
25. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
26. The material findings in respect of the selected development objectives are as follows:

#### **Development priority 5: Infrastructure and the provision of basic service delivery**

##### **Usefulness of reported performance information**

##### **Measurability**

##### **Performance targets were not specific, sufficiently measurable and verifiable**

27. The FMPPI requires the performance targets to be specific in clearly identifying the nature and required level of performance, performance targets must be measurable, performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use and Performance measures must be verifiable, meaning that it must be possible to validate the processes

and systems that produced the measure. A total of 56% of the targets in relation to infrastructure and the provision of basic services were not specific. We could not measure the required performance for 50% of the targets in relation to infrastructure and the provision of basic services. A total of 56% of the indicators in relation to infrastructure and the provision of basic services were not well defined. A total of 61% of the measures in relation to infrastructure and the provision of basic services were not verifiable. This was due to management did not adhere to the requirements of the FMPPI due to a lack of processes and technical indicator descriptions.

## **Relevance**

### **Strategic objective cannot be logically linked to performance measure**

28. The FMPPI requires indicators to relate logically and directly to an aspect of the auditee's mandate and the realisation of strategic goals and objectives. 44% of the significantly important indicators in relation to infrastructure and the provision of basic services development priority did not relate logically and directly to an aspect of the auditee's mandate and the realisation of strategic goals and objectives as per the five-year strategic service delivery and budget implementation plan. This was due to proper performance planning and management practices not being developed and/or implemented to provide for the development of performance indicators and targets included in the service delivery and budget implementation plan. The planned indicators were too vague, too broad and there were not processes and systems in place to produce the indicator.

## **Reliability of reported performance information**

### **No supporting documentation provided to substantiate reported measures**

29. The FMPPI requires auditees to 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 reported performance information. This was due to limitations placed on the scope of my work due the fact that the institution could not provide sufficient appropriate evidence in support of the information presented with respect to the development objective.

## **Additional matter**

30. I draw attention to the following matters.

### **Achievement of planned targets**

31. Refer to the annual performance report on pages ... to ... for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected development objective reported in paragraphs 26 to 29 of this report.

### **Unaudited supplementary information**

32. The supplementary information set out on pages ... to ... does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not report thereon.

---



### **Compliance with legislation**

33. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

#### **Annual Financial statements**

34. 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, liabilities, revenue, expenditure and disclosure items were identified by the auditors in the submitted financial statements. These were subsequently corrected and/or the supporting records were provided resulting in the financial statements receiving an unqualified audit opinion.

#### **Budgets**

35. Expenditure was approved as unforeseen and unavoidable which was not included in the approved annual budget, in contravention of Municipal Budget and Reporting Regulation 71(2).
36. The total unforeseen and unavoidable expenditure incurred exceeded R15 million, in contravention of Municipal Budget and Reporting Regulation 72.
37. Expenditure was incurred 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.

#### **Audit committee**

38. The audit committee did not advise the council on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.
39. The audit committee did not review the municipality's performance management system or make recommendations to the council, as required by Municipal planning and performance management regulation 14(4)(a)(ii) due to annual performance reports not being submitted timeously.
40. 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).

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

41. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
42. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act and CIDB regulation 18.
43. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.

#### **Human resource management**

44. An updated staff establishment was not in place, as required by section 66(1)(a) of the MSA.

45. Job descriptions were not established for all posts in which appointments were made in the current year, in contravention of section 66(1)(b) of MSA.
46. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury as required by the Regulations on Minimum Competency Levels regulation 14(2)(a).

#### **Expenditure management**

47. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
48. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by sections 62(1)(d) of the MFMA.

#### **Conditional grants**

49. The municipality did not evaluate its performance in respect of programmes or functions funded by the Municipal Systems Improvement Grant allocation, as required by section 12(5) of the DoRA.

#### **Consequence management**

50. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by sections 32(2)(a)(ii) of the MFMA.

#### **Internal control**

51. I considered internal control relevant to my audit of the financial statements, the annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for opinion, the findings on the annual performance report and the findings on non-compliance with legislation included in this report.

#### **Leadership**

52. Leadership did not fulfil its oversight responsibilities with regards to the implementation and monitoring of internal controls. The lack of instilling basic disciplines and providing a strong leadership tone to ensure sound financial management and compliance with laws and regulations, has resulted in inaccurate and incomplete financial reporting as well as contravention of laws and regulations.

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

53. The municipality did not consistently implement and monitor the required daily and monthly financial disciplines to ensure that transactions were appropriately recorded and reported, as required by the financial reporting framework. The lack of financial discipline and monitoring during the financial year resulted in key reconciliations and processing only being performed after the financial year-end, and led to material adjustments required to the financial statements during the audit process.

#### **Governance**

54. A risk assessment was conducted by the municipality and a risk strategy which included a fraud prevention plan was prepared. The risks identified by management were

however not adequately matched with the appropriate internal controls of the municipality, which contributed to the internal control deficiencies identified during the audit.

55. The recommendations made by internal audit and the audit committee were not adequately responded to, as improvements in the control environment did not resolve all control deficiencies identified.

*Auditor - General*

East London

30 November 2014



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*