

Report of the auditor-general to the Eastern Cape provincial legislature and the council on 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 2015, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts 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, 2014 (Act No. 10 of 2014) (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 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 municipality'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 municipality'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 2015 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.

Impairments

8. As disclosed in note 3 to the financial statements, an amount of R65,6 million (2014: R47,6 million) in respect of receivables from exchange transactions has been impaired.
9. As disclosed in note 4 to the financial statements, an amount of R18.9 million (2014: R27,8 million) in respect of receivables from non-exchange transactions has been impaired.
10. As disclosed in the statement of financial performance and note 37 to the financial statements, debt impairments totalling R17.3 million (2014: R33,2 million) have been expensed.

Material losses

11. As disclosed in note 48.9 to the financial statements, the municipality incurred material water losses amounting to R10,2 million (2014: R11,9 million) mainly as a result of faulty meters and illegal connections.
12. As disclosed in note 48.9 to the financial statements, the municipality incurred material electricity losses amounting to R8,1 million (2014: R9,3 million) mainly as a result of technical and non-technical losses.

Fruitless and wasteful expenditure

13. As disclosed in note 47.2 to the financial statements, fruitless and wasteful expenditure amounting to R2,3 million (2014: R2,3 million) was incurred largely due to penalties and interest on late payment of creditors.

Significant uncertainty

14. The municipality is the defendant in a number of lawsuits to the amount of R53.8 million (2014: R20.5 million) as disclosed in note 52 to the financial statements, the outcome of these lawsuits cannot be determined at present.

Restatement of corresponding figures

15. As disclosed in note 43 to the financial statements, the corresponding figures for 30 June 2014 have been restated as a result of errors discovered during the year ended 30 June 2015.

Additional matters

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

Unaudited disclosure notes

17. 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

18. 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

19. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, compliance with legislation and 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

20. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priority presented in the annual performance report of the municipality for the year ended 30 June 2015:
 - Development priority 5: Infrastructure and the provision of basic services on pages x to x.
21. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
22. 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 priority. 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).

23. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

24. The material findings in respect of the selected development priority are as follows:

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

Usefulness of reported performance information

25. Section 41(c) of the Municipal Systems Act requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 27% of the reported targets were not consistent with those in the approved integrated development plan. This was due to a lack of review of planned targets per integrated development plan and service delivery and budget implementation plan and reported targets per annual performance report.

Reliability of reported performance information

26. 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 ourselves as to the reliability of the reported performance information. This was due to limitations placed on the scope of our work due to the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information.

Additional matters

27. I draw attention to the following matters:

Achievement of planned targets

28. Refer to the annual performance report on page(s) x to x and x to x 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 priority reported in paragraphs 25 and 26 of this report.

Unaudited supplementary information

29. The supplementary information set out on pages XX to XX 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

30. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on 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

31. 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 disclosure items were identified by the auditors in the submitted financial statements. These were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion.

Strategic planning and performance management

32. The performance management system and related controls were inadequate as it did not describe and represent the processes of performance planning, monitoring review and reporting and how it is conducted, organised and managed, as required by sections 38 of the MSA and regulation 7 of the municipal planning and performance management regulations.
33. 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)(a) of the MSA.

Audit committee

34. 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.
35. 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).
36. 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).
37. The audit committee was not constituted, in the manner required by section 166(4)(a) of the MFMA as there were only 2 audit committee members for the majority of the financial year.
38. The audit committee did not meet at least four times a year, as required by section 166(4)(b) of the MFMA.

Procurement and contract management

39. Persons in service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e).

Human resource management

40. 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).
41. Senior managers did not sign performance agreements, as required by section 57(2)(a) of the Municipal Systems Act.

Expenditure management

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

Consequence management

44. Investigations on fruitless and wasteful expenditure incurred by the municipality was not finalised at year end to determine if any person is liable for the expenditure, as required by sections 32(2)(a)(ii) of the MFMA.

Internal control

45. 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 compliance with legislation included in this report.

Leadership

46. Leadership did not fulfil its oversight responsibilities with regards to the monitoring and reporting of performance information as well as compliance with laws and regulations. In addition, the accounting officer has not held officials accountable for non-performance of their functions.

Financial and performance management

47. The municipality did not consistently implement and monitor the required monthly disclosure requirements, to ensure that transactions were appropriately recorded and reported as required by the financial reporting framework. In addition, performance information was not adequately supported and reported throughout

the year. Furthermore, compliance with laws and regulations was not sufficiently reviewed and monitored during the year.

Governance

48. 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.
49. The recommendations made by internal audit and the audit committee were not adequately followed up and responded to, by management as improvements in the control environment did not resolve all the control deficiencies identified.

Auditor-General

East London

30 November 2015



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence