

# 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 2016, the statement of financial performance, statement of changes in equity, cash flow statement and statement of comparison of budget information with 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 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 the Division of Revenue Act of South Africa, 2015 (Act No. 1 of 2015) (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 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 2016 and its financial performance and cash flows for the year then ended, in accordance with applicable financial reporting framework and the requirements of the MFMA and the DoRA.

## Emphasis of matters

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

### Unauthorised expenditure

8. Unauthorised expenditure of R366 million (2015: R366 million) that has accumulated over the 2010 to 2014 financial year and has not been recovered, written off or condoned was disclosed in note 45.1 to the financial statements.

### Irregular expenditure

9. Irregular expenditure of R82,4 million (2015: R81,6 million) that has accumulated over the last seven years and has not been recovered, written off or condoned was disclosed in note 45.3 to the financial statements. Irregular expenditure of R0,8 million incurred during the year under review was included in the amount disclosed.

### Fruitless and wasteful expenditure

10. Fruitless and wasteful expenditure of R34,8 million (2015: R33,9 million) that has accumulated over the last seven years and has not been recovered, written off or condoned was disclosed in note 45.2 to the financial statements. Fruitless and wasteful expenditure of R0,86 million (2015: R 2,5 million) incurred during the year under review was included in the amount disclosed.

### Impairments

11. Cumulative debt impairment provisions of R98,4 million (2015: R82,8 million) are disclosed in note 3 and 4 to the financial statements.
12. As disclosed in the statement of financial performance and note 35 to the financial statements, debt impairments of R22,6 million (2015: R18,8 million) have been expensed.

## Significant uncertainties

13. The municipality was a defendant in a number of lawsuits to the amount of R109,5 million (2015: R47,7 million) as disclosed in note 50 to the financial statements, the outcome of these lawsuits could not be determined at the time of this report.

## Material losses

15. As disclosed in note 46.10 to the financial statements, the municipality incurred material water losses of R20 million (2015: R10,2 million) mainly as a result of faulty meters and illegal connections. The percentage of material losses incurred are 38.61 percent which is above the norm of 30 percent.

## Restatement of corresponding figures

14. As disclosed in note 41 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of errors discovered during the year ended 30 June 2016.

## Additional matters

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

## Unaudited supplementary information

16. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited this schedule and, accordingly, I do not express an opinion thereon.

## 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 the MFMA. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion thereon.

## Report on other legal and regulatory requirements

18. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives of 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

19. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for *Development priority 5: infrastructure and basic service delivery, on pages x to x*, presented in the annual performance report of the municipality for the year ended 30 June 2016.
20. 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 priorities. 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).
21. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
22. The material findings in respect of the selected development priority are as follows:

### **Development priority 5: infrastructure and basic service**

#### Usefulness of reported performance information

23. Section 41(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) requires the integrated development plan (IDP) to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 12 (86%) reported targets were not consistent with those in the approved IDP. This was due to a lack of review of planned targets per IDP and service delivery and budget implementation plan (SDBIP) and reported targets per annual performance report (APR).

24. Section 41(c) of the Municipal Systems Act requires actual achievements against all planned indicators and targets to be reported annually. The annual performance report submitted for auditing did not include the actual performance of five (36%) planned indicators specified in the IDP for the year under review. This was due to a lack of review of planned targets per IDP and SDBIP and reported targets per APR.

### Reliability of reported performance information

25. The FMPPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. For significant indicators, the reported performance information was not reliable when compared to the evidence provided. This was due to a lack of commitment by management to comply with the performance regulation requirements, lack of implementation of controls to ensure that reported performance is complete, correct, measurable and substantiated by verifiable performance evidence.

### Additional matters

26. I draw attention to the following matters:

#### Achievement of planned targets

27. 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 in paragraphs 23 to 25 of this report.

#### Unaudited supplementary information

28. The supplementary information set out on pages x to x 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 on them.

### Compliance with legislation

29. 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**

30. 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, commitments and contingent liabilities identified by the auditors in the submitted financial statements were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion.

## **Strategic planning and performance management**

31. The service delivery performance report for the year under review did not include a comparison to the previous financial year and measures taken to improve performance, as required by section 46(1)(a) of the Municipal Systems Act.
32. The service delivery performance of the municipality was not assessed during the first half of the financial year, as required by section 72(1)(a)(ii) of the MFMA.

## **Human resource management and compensation**

33. Appointments were made in posts which were not provided for in the approved staff establishment of the municipality, in contravention of section 66(3) of the Municipal Systems Act.
34. Job descriptions were not established for all posts in which appointments were made in the year under review, in contravention of section 66(1)(b) of Municipal Systems Act.

## **Expenditure management**

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

## **Consequence management**

37. Investigations on unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality were not finalised at year-end to determine if any person was liable for the expenditure, as required by section 32(2)(a)(ii) of MFMA.

## Asset management

38. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

## Internal control

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

## Leadership

40. The leadership did not adequately oversee the reporting of asset management, commitments and contingent liabilities. In addition, they did not adequately monitor the action plans to address the performance and compliance reporting. The accounting officer did not hold officials accountable for non-performance.

## Financial and performance management

41. 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 effective monitoring during the financial year resulted in key reconciliations for assets, commitments and contingent liabilities only being adequately performed after the financial year-end, resulting in material misstatements to the financial statements which were subsequently corrected.
42. Management has not ensured that performance reports are prepared and reviewed on a quarterly basis and are supported and evidenced by reliable information.

## Governance

43. A risk assessment was conducted by the municipality and a risk strategy was prepared; however, this did not include a fraud prevention plan. The risks identified by management were also not adequately matched with the appropriate internal controls of the municipality, which contributed to the internal control deficiencies identified during the audit.
44. Management has not ensured that all the reports requested by the audit committee are submitted timeously for consideration. In addition, not all internal audit and audit committee recommendations were implemented during the financial year.

*Auditor-General*

East London

30 November 2016



AUDITOR - GENERAL  
SOUTH AFRICA

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