

# **REPORT OF THE AUDITOR-GENERAL TO THE WESTERN CAPE PROVINCIAL PARLIAMENT AND THE COUNCIL ON KANNALAND MUNICIPALITY**

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Introduction**

1. I have audited the financial statements of the Kannaland Municipality set out on pages 3 to 82, which comprise the statement of financial position as at 30 June 2012, and the statement of financial performance, statement of changes in net assets and cash flow 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 Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2011 (Act No. 6 of 2011) (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 adverse audit opinion.

## **Basis for adverse opinion**

### **Property, plant and equipment**

6. Included in the carrying value of property, plant and equipment of R219 587 213, as disclosed in note 11 to the financial statements, are negative carrying values that were identified in the fixed asset register. Consequently, the property, plant and equipment balance is understated by R979 874.
7. Included in the carrying value of property, plant and equipment of R219 587 213, as disclosed in note 11 to the financial statements, are reversals of accumulated depreciation for which I was unable to obtain sufficient appropriate audit evidence. The entity's records did not permit the application of alternative audit procedures regarding the valuation of property, plant and equipment. Consequently, the property, plant and equipment and accumulated surplus balances are overstated by R18 799 823.
8. Included in the carrying value of property, plant and equipment of R219 587 213, as disclosed in note 11 to the financial statements, are assets that could not be physically verified. The entity's records did not permit the application of alternative audit procedures regarding the existence of property, plant and equipment. Consequently, the property, plant and equipment and accumulated surplus balances are overstated by R28 194 580.

### **Material inconsistencies in the financial statements**

9. The closing balance of property, plant and equipment, as disclosed in note 11 to the financial statements, does not agree to the fixed asset register by R941 905.

### **Inventory**

10. Standards of GRAP, GRAP 12, *Inventory*, requires disclosure of information about the carrying amounts held in different classifications of inventory and the extent of the changes in these assets, which is useful to financial statement users. The municipality was unable to measure its water inventory at year-end. The entity's records did not permit the application of alternative audit procedures regarding the valuation and completeness of water inventory. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the valuation and completeness of water inventory. Furthermore, the amount of inventories recognised as an expense was not disclosed.

### **Revenue from exchange transactions**

11. Included in service charges revenue of R35 983 058, as disclosed in note 24 to the financial statements, are adjustments that were made to revenue for errors noted in prior period billings amounting to R3 489 172, which were incorrectly recognised in the 2011-12 financial year instead of the 2010-11 financial year. Had the service charges been recognised in the correct period, services charges would have been reduced and opening retained earnings would have increased by R3 489 172.

### **Material losses**

12. Section 125(2)(d) of the MFMA requires that the particulars of all material losses that occurred during the financial year be disclosed. As disclosed in note 41.4 to the financial statements, the municipality was unable to determine the water losses for the

financial year under review. The municipality's records did not permit the application of alternative audit procedures regarding the completeness and accuracy of the disclosure for material losses. Consequently, I was unable to satisfy myself as to the completeness and accuracy of the material losses disclosure in respect of water losses.

### **Comparative figures**

13. Property, plant and equipment reflected as R213 222 343 is overstated by R20 204 884. This is due to uncorrected misstatements carried forward from the 2010-11 financial year and misstatements identified in the corresponding figures while performing the 2011-12 financial year's audit for accumulated depreciation reversals for which sufficient appropriate audit evidence could not be provided, as well as land and buildings which were found not to be in the name of the municipality. The entity's records did not permit the application of alternative audit procedures regarding the valuation and ownership of property, plant and equipment. My opinion on the 2011-12 financial year's financial statements is also modified because of the possible effect of this matter on the comparability of the 2011-12 financial year's figures.
14. Accumulated surplus reflected as R179 115 398 is overstated by R22 030 512. This is due to uncorrected misstatements carried forward from the 2010-11 financial year and misstatements identified in the corresponding figures while performing the audit of the 2011-12 financial year for accumulated depreciation reversals for which sufficient appropriate audit evidence could not be provided, as well as land and buildings which were found not to be in the name of the municipality and unreconciled differences between the financial statements submitted for audit and the final publishable financial statements. The entity's records did not permit the application of alternative audit procedures regarding the valuation of accumulated surplus. My opinion on the 2011-12 financial year's financial statements is also modified because of the possible effect of this matter on the comparability of the 2011-12 financial year's figures.

### **Aggregation/accumulation of immaterial uncorrected misstatements**

15. The financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements making up the statement of financial position, the statement of financial performance and the notes to the financial statements:
  - Receivables from exchange and non-exchange transactions' opening balance reflected as R4 824 517 is overstated by R498 667.
  - Payables opening balance reflected as R11 306 480 is understated by R65 492.
  - Current and non-current provisions opening balance reflected as R4 593 800 is overstated by R78 896.
  - Inventory opening balance reflected as R741 431 is overstated by R38 132.
  - Accumulated depreciation opening balance reflected as R89 529 547 is overstated by R115 177.
  - Investment property opening balance reflected as R1 648 435 is understated by R251 362.
  - Service charges revenue reflected as R35 983 058 is overstated by R274 025.
  - Bulk purchases reflected as R20 378 611 are overstated by R17 029.
  - General expenses reflected as R11 549 158 are understated by R323 504.
  - Depreciation and amortisation reflected as R9 364 077 is overstated by R619 155.
  - Loss on derecognition of assets reflected as R2 079 463 is understated by R31 236.

- Debt impairment reflected as R3 907 545 is overstated by R93 339.
- Receivables reflected as R7 714 123 are overstated by R227 890.
- Payables reflected as R22 020 731 are understated by R382 537.
- Property, plant and equipment reflected as R219 587 513 is understated by R113 531.
- Accumulated surplus reflected as R184 321 487 is overstated by R706 965.
- Provision for doubtful debts from exchange and non-exchange transactions reflected as R46 064 174 is overstated by R93 339.
- Accumulated depreciation reflected as R98 024 231 is understated by R16 858.
- Intangible assets reflected as R308 856 are overstated by R157 988.
- Current employee benefits reflected as R3 441 857 are understated by R38 723.
- Disclosure note 26 – provision for leave reflected as R1 514 663 is overstated by R319 608.
- Disclosure note 26 – salaries and wages reflected as R18 933 093 are understated by R319 608.
- Disclosure note 6 – bonuses reflected as R612 877 are overstated by R10 403.
- Disclosure note 3 – actuarial loss from post retirement health care benefits and long service awards reflected as R122 956 is overstated by R72 469.

16. In addition, I was unable to obtain sufficient appropriate audit evidence and I was unable to confirm or verify the following elements by alternative means:

- Payables opening balance reflected as R11 306 480.
- Inventory opening balance reflected as R741 431.
- Rental of facilities and equipment reflected as R220 089.

As a result, I was unable to determine whether any further adjustments to these elements were necessary.

### **Adverse opinion**

17. In my opinion, because of the significance of the matters described in the basis for adverse opinion paragraphs, the financial statements do not present fairly the financial position of the Kannaland Municipality as at 30 June 2012 and its financial performance and cash flows for the year then ended in accordance with the SA Standards of GRAP and the requirements of the MFMA and DoRA.

### **Emphasis of matters**

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

### **Significant uncertainties**

19. With reference to note 49 to the financial statements, the municipality does not have a permit or license for any of the landfill sites currently in use and could be liable for a penalty in terms of section 24G of the Environmental Conservation Act of South Africa, 1989 (Act No. 73 of 1989) to the amount of R10 million.

20. Furthermore, the municipality is the defendant on the following claims, which have been instituted against the municipality:

- A claim of R125 000 instituted by an engineering firm
- A civil claim instituted for R500 000, which has been pending since 2010

- A potential third party claim for the amount of R1 098 887, which was received from the Western Cape High Court in respect of a community member in Calitzdorp
21. The ultimate outcome of these matters cannot presently be determined and no provision for any liability that may result has been made in the financial statements.

### **Restatement of corresponding figures**

22. As disclosed in note 35 to the financial statements, the corresponding figures for 30 June 2011 have been restated as a result of errors discovered during the 2011-12 financial year in the financial statements of Kannaland Municipality at, and for the year ended, 30 June 2011.

### **Funding of operations/financial sustainability/going concern**

23. Note 52 to the financial statements indicates that Kannaland Municipality does not have enough cash reserves to fund working capital requirements. This condition, along with the withholding of the municipality's equitable share funding by the National Treasury, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

### **Material losses**

24. As disclosed in note 41.4 to the financial statements, the municipality incurred significant electricity losses of 18,32% or 5 707 292 kilowatts due to technical and non-technical losses.
25. As disclosed in note 41.4 to the financial statements, the municipality incurred significant revenue losses of R9 891 579 due to inadequate meter management.

### **Material impairments**

26. As disclosed in notes 18 and 19 to the financial statements, the municipality provided for impairment of trade receivables from exchange and non-exchange transactions totalling R46 064 174, due to objective evidence that these debtors would default on their respective accounts.
27. As disclosed in the statement of financial performance, the municipality impaired property, plant and equipment that was destroyed during a fire that took place in August 2011 and further assets that were not found during the asset verification process by R2 079 463.

### **Additional matter**

28. I draw attention to the matter below. My opinion is not modified in respect of this matter:

### **Unaudited supplementary schedules**

29. The supplementary information set out on pages 83 to 84 does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

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

30. 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**

31. I was unable to report on the usefulness and reliability of the annual performance report of Kannaland Municipality as it was not prepared in terms of the requirements of section 46(1)(a) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) and section 121(3)(c) of the MFMA.

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

32. 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:

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

33. 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, accumulated surplus, inventory, revenue and material losses identified by the auditors in the submitted financial statements remained uncorrected, resulting in the financial statements receiving an adverse audit opinion.
34. The accounting officer did not submit the financial statements for auditing within two months after the end of the financial year, as required by section 126(1)(a) of the MFMA.
35. The 2010-11 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.
36. 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 or the accounting officer's assessment of the municipality's performance against measurable performance objectives for revenue collection from each revenue source and for each budget vote, as required by section 121(3)(e) and section 121(3)(f) of the MFMA, respectively.

### **Procurement and contract management**

37. Quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and do not meet the listing requirements prescribed by the supply chain management (SCM) policy in contravention of SCM regulations 16(b) and 17(b).
38. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite

competitive bids, in contravention of SCM regulation 36(1).

39. The procurement of services was deliberately split into parts of lesser value merely to avoid complying with the requirements of the SCM policy and SCM regulations.
40. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were only awarded to providers whose tax matters have been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.
41. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded only to bidders who submitted 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).
42. Sufficient appropriate audit evidence could not be obtained that bid specifications for procurement of goods and services through competitive bids were drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services, as required by SCM regulation 27(2)(a).

#### **Human resource management and compensation**

43. 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 MSA.
44. Job descriptions were not established for all posts in which appointments were made during the 2011-12 financial year, in contravention of section 66(1)(b) of the MSA.
45. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies, as required by the Regulations on Minimum Competency Levels, regulation 14(2)(b).

#### **Conditional grants**

46. Unspent conditional grant funds not committed to identifiable projects and not approved by the National Treasury for retention were not surrendered to the National Revenue Fund, as required by section 20(1) of DoRA.
47. The municipality did not table a three-year capital budget as part of its 2010-11 financial year's budget, as required by the Division of Revenue Grant Framework, Gazette No. 34280.

#### **Revenue management**

48. An adequate management, accounting and information system was not in place, which recognised revenue when it was earned, as required by section 64(2)(e) of the MFMA.
49. Interest was only charged on accounts in respect of property rates and not on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

## **Asset management**

- 50. An adequate management, accounting and information system, which accounts for assets, was not in place, as required by section 63(2)(a) of the MFMA.
- 51. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

## **Internal control**

- 52. 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 adverse opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

## **Leadership**

- 53. Leadership did not exercise oversight responsibility to ensure that regular and accurate financial statements and annual performance reports are prepared. Oversight responsibility was also not extended to the processes underlying the preparation of these reports, causing the late submission of the financial statements and the annual performance report.
- 54. Although the municipality developed an action plan, it did not adequately address the internal control deficiencies reported in the prior years because it only focused on findings prevalent in the prior year management report and not on the internal control deficiencies that have not adequately been addressed over the past few years, resulting in repeat findings in the areas of financial reporting relating to revenue, asset management and compliance with laws and regulations.
- 55. Management did not have adequately documented policies and procedures to guide the operations of the municipality, resulting in numerous instances of non-compliance with the MFMA, relating to the annual financial statements, annual performance report and annual report, procurement and contract management, human resource management and compensation, conditional grants, revenue management and asset management.
- 56. Management did not ensure that adequate sufficiently skilled resources are in place to ensure the effective management of the performance information process during the year under review, resulting in an annual performance report being produced which had no consistency or correlation with the municipality's strategic and detailed planning documents.

## **Financial and performance management**

- 57. Management did not put adequate processes in place to ensure that credible financial statements in compliance with the reporting framework are prepared as the internal review procedures were inadequate to identify and correct material misstatements in the financial statements and underlying records before submitting it for audit.
- 58. Management did not ensure that reconciling differences identified for property, plant and equipment were addressed in a timely manner to ensure the asset register



supporting the financial statement disclosures is complete, relevant and accurate. Furthermore, regular asset counts were not conducted to ensure that the information reflected in the asset register and the financial statements is valid and accurate.

## **Governance**

59. The municipality established an internal audit function and audit committee during the year under review. Any positive impact on the outcomes arising from the activities of these two bodies on the activities of the municipality would only be evident in the following financial year.

## **OTHER REPORTS**

### **Investigations completed during the financial year**

60. A formal forensic investigation was performed by the Port Elizabeth division of the South African Police Service in connection with the fire that occurred during August 2011 at the SCM department of the municipality. The origin of the fire could not be determined.

*Auditor-General*

Cape Town

4 September 2013

