

REPORT OF THE AUDITOR-GENERAL TO THE WESTERN CAPE PROVINCIAL PARLIAMENT AND THE COUNCIL ON THE 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 2013, the statement of financial performance, statement of changes in net assets, statement of comparison of budget and actual amounts and the 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 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, 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 adverse audit opinion.

Basis for adverse opinion

Property plant and equipment

6. Included in the carrying value of property, plant and equipment of R228 758 703, as disclosed in note 11 to the financial statements, are assets that could not be physically verified due to deficiencies in the asset register. The entity's records did not permit the application of alternative audit procedures. Consequently I was unable to determine

whether any adjustment relating to property, plant and equipment of R27 605 492, included in the carrying value of property, plant and equipment stated at R228 758 703 in the financial statements, was necessary.

7. Included in the carrying value of property, plant and equipment of R228 758 703, as disclosed in note 11 to the financial statements, are assets that could not be traced to the fixed asset register. Consequently, the property, plant and equipment and accumulated surplus balances are understated by R138 470.
8. The SA Standards of GRAP, GRAP 17, *Property plant and equipment*, requires that an item of property, plant and equipment be derecognised when no future economic benefit or service potential is expected from its use or disposal. Included in the carrying value of property, plant and equipment of R228 758 703, as disclosed in note 11 to the financial statements, are assets that are no longer in working order. These assets were still reflected on the fixed asset register and were not derecognised as per the requirements of GRAP 17. Consequently, the property, plant and equipment and accumulated surplus balances are overstated by R1 052 520.
9. The amount as disclosed in the cash flow statement for purchases of property, plant and equipment differs from the additions amount as disclosed in note 11 to the financial statements, by R8 217 528 and R7 168 155 for the 2012-13 and 2011-12 financial years, respectively. Consequently, the purchases of property, plant and equipment disclosed in the cash flow statement is overstated.
10. 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 R4 622 237. Note 11 to the financial statements is therefore understated by R4 622 237.
11. The loss on derecognition of assets in the statement of financial performance differs from the amount disclosed in note 34 by R2 033 169 and R1 895 939 for the 2012-13 and 2011-12 financial years, respectively. Consequently note 34 to the financial statements is overstated by R2 033 169 and R1 895 939 for the 2012-13 and 2011-12 financial years, respectively.

Accumulated surplus

12. Accumulated surplus reflected as R188 584 989 is overstated by R76 695 263. This is due to uncorrected misstatements identified while performing the audit of the 2012-13 financial year for intercompany revenue transactions that were not eliminated, expenditure recognised in the incorrect period and unreconciled differences between the general ledger and the financial statements.

General expenses

13. General expenses disclosed as R12 613 024 in note 33 to the financial statements are understated by R23 245 576. This was due to uncorrected misstatements that were identified due to differences between the general ledger and the financial statements. In addition, I was unable to obtain sufficient appropriate evidence for certain amounts disclosed as general expenses in note 33. Consequently, I was unable to determine whether there were any further adjustments to general expenses stated at R12 613 024 in the financial statements were necessary.

Bulk purchases

14. Bulk purchases reflected as R22 642 460 in note 32 to the financial statements are overstated by R1 039 448. This was due to uncorrected misstatements resulting from expenditure that was recorded in the incorrect period.

Unauthorised expenditure

15. Unauthorised expenditure is reflected as R53 354 017 in note 41.1 to the financial statements. Sufficient appropriate audit evidence could not be provided for the current year movement of R11 592 706 for unauthorised expenditure. The entity's records did not permit the application of alternative audit procedures regarding the valuation of unauthorised expenditure.

Provisions

16. Non-current and current provisions reflected as R2 152 412 and R2 889 390 in notes 4 and 7, respectively, to the financial statements are overstated by R5 041 802. This was due to uncorrected misstatements resulting from differences between the general ledger and the financial statements.

Investments

17. Investments reflected as R4 043 791 in note 15 to the financial statements are overstated by R3 871 395. This was due to uncorrected misstatements resulting from differences between the balances for investments in the bank confirmation received and the amount that was disclosed in the financial statements.

Cash and cash equivalents

18. Cash and cash equivalents reflected as R9 410 053 in note 21 to the financial statements are understated by R298 713. This was due to uncorrected misstatements resulting from unreconciled differences between the balance for cash and cash equivalents in the bank confirmation received and the amount that was disclosed in the financial statements.

Receivables

19. Receivables from exchange transactions reflected as R13 561 095 in note 18 to the financial statements are overstated by R3 377 974. This was due to uncorrected misstatements resulting from differences in the balance in the debtors' age analysis and the financial statements.

Payables

20. Payables reflected as R39 784 577 in note 8 to the financial statements are overstated by a net amount of R1 961 889. This was due to unreconciled differences between the payables listing and the financial statements.

Irregular expenditure

21. Irregular expenditure reflected as R1 966 283 in note 41.3 to the financial statements is understated by R3 513 403, arising from payments made by the municipality in contravention of the supply chain management regulations. These were identified during the audit of procurement and contract management and were not included in the irregular expenditure disclosure note 41.3, resulting in irregular expenditure being understated by R3 513 403.
22. In addition, I was unable to obtain sufficient appropriate evidence for the amounts disclosed for the current year movement in irregular expenditure amounting to R1 966 283. Consequently, I was unable to determine whether any further adjustments to the irregular expenditure disclosed as R1 966 283 in the financial statements were necessary.

Revenue from exchange transactions

23. Service charges reflected as R45 740 570 in note 24 to the financial statements are overstated by a net amount of R1 421 791. This was due to uncorrected misstatements relating to intercompany transactions that were not eliminated by the municipality.

Fruitless and wasteful expenditure

24. Fruitless and wasteful expenditure is reflected as R3 649 209 in note 41.2 to the financial statements. Sufficient appropriate audit evidence could not be provided for the current year movement of R852 841 for fruitless and wasteful expenditure. This was due to unreconciled differences between the financial statements originally submitted for auditing and the adjusted financial statements. The entity's records did not permit the application of alternative audit procedures regarding the valuation of fruitless and wasteful expenditure.

Material losses

25. 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.

Inventory

26. SA 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.

Budget disclosure

27. The municipality did not disclose explanations for material differences between the final budget amounts and the actual amounts in the budget comparison as required by the SA Standards of GRAP, GRAP 24, *Presentation of budget information in financial statements*.

Comparative figures

28. Property, plant and equipment reflected as R216 237 882 is overstated by R69 561 634. This is due to uncorrected misstatements carried forward from the 2010-11 and 2011-12 financial years. The misstatements were identified in the corresponding figures while performing the audit of the 2011-12 financial year. The misstatements regarding the valuation and ownership of property, plant and equipment remained uncorrected. My opinion on the 2012-13 financial year's financial statements is also modified because of the effect of this matter on the comparability of the 2012-13 financial year's figures.
29. Accumulated surplus reflected as R181 900 263 is overstated by a net amount of R32 466 313. This is due to uncorrected misstatements carried forward from the 2010-11 and 2011-12 financial years. The misstatements were identified in the corresponding figures while performing the audit of the 2011-12 financial year. My opinion on the 2012-13 financial year's financial statements is also modified because of the effect of this matter on the comparability of the 2012-13 financial year's figures. Included in the misstatement is an amount of R10 223 084, as disclosed in note 35 to the financial statements, in respect of correction of errors, for which I was unable to

- obtain sufficient appropriate evidence to confirm the accuracy and completeness of the corrections.
30. Payables reflected as R24 139 074 are overstated by R4 142 291. This is due to uncorrected misstatements carried forward from the 2010-11 and 2011-12 financial years. The misstatements were identified in the corresponding figures while performing the audit of the 2011-12 financial year. My opinion on the 2012-13 financial year's financial statements is also modified because of the effect of this matter on the comparability of the 2012-13 financial year's figures.
 31. Receivables from exchange transactions reflected as R7 807 629 are overstated by R5 640 474. This is due to uncorrected misstatements carried forward from the 2010-11 and 2011-12 financial years. The misstatements were identified in the corresponding figures while performing the audit of the 2011-12 financial year. My opinion on the 2012-13 financial year's financial statements is also modified because of the effect of this matter on the comparability of the 2012-13 financial year's figures.
 32. The comparative amount reflected for unauthorised expenditure in note 41.1 is overstated by R5 280 292. This is due to the prior year's closing balance that was not brought forward. My opinion on the 2012-13 financial year's financial statements is also modified because of the possible effect of this matter on the comparability of the 2012-13 financial year's figures.
 33. The comparative amount reflected for fruitless and wasteful expenditure in note 41.2 is understated by R1 084 610. This is due to the prior year's closing balance that was not brought forward. My opinion on the 2012-13 financial year's financial statements is also modified because of the possible effect of this matter on the comparability of the 2012-13 financial year's figures.

Aggregation/accumulation of immaterial uncorrected misstatements

34. 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:
 - Fines reflected as R604 508 are overstated by R604 508.
 - Repairs and maintenance reflected as R1 660 298 are overstated by R86 805.
 - Contracted services reflected as R4 217 466 are overstated by R206 897.
 - Operating grant expenditure reflected as R18 738 191 is overstated by R24 155.
 - Current employee benefits reflected as R4 677 918 are overstated by R76 394.
 - Long-term liabilities reflected as R10 028 505 are understated by R86 400.
 - Consumer deposits reflected as R559 519 are overstated by R106 398.
 - Current assets: Taxes reflected as R5 240 909 are understated by R858 452.
 - The opening balance of long-term liabilities reflected at R9 692 843 is understated by R80 083.
 - The opening balance of receivables from non-exchange transactions reflected as R2 945 581 is overstated by R151 930.
 - The opening balance of irregular expenditure is overstated by R100 000.

Adverse opinion

35. In my opinion, because of the significance of the matters described in the basis for adverse opinion paragraphs, these financial statements do not present fairly the financial position of the Kannaland Municipality as at 30 June 2013 and its financial performance, budget comparison 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

36. I draw attention to the matters below.

Significant uncertainties

37. As disclosed in note 49 to the financial statements, the municipality is the defendant in a potential third party claim for the amount of R1 500 000, which was received from the Western Cape High Court in respect of a community member in Calitzdorp. The ultimate outcome of this lawsuit cannot presently be determined and no provision for any liability that may result has been made in the financial statements.
38. As disclosed in note 49 to the financial statements, the trade union, IMATU, contested the implementation of a wage curve agreement in the labour court and the court ruled in favour of IMATU. The employers' organisation, SALGA, resolved to take the ruling of the labour court on review. The effect of the ruling is a general 2% increase in remuneration as from October 2009. The ultimate outcome of the matter cannot presently be determined and no provision for any liability that may result has been made in the financial statements.

Restatement of corresponding figures

39. As disclosed in note 35 to the financial statements, the corresponding figures for 30 June 2012 have been restated as a result of errors discovered during the 2012-13 financial year in the financial statements of Kannaland Municipality at, and for the year ended 30 June 2012.

Funding of operations/financial sustainability/going concern

40. Note 52 to the financial statements indicate that Kannaland Municipality does not have enough cash reserves to fund working capital requirements and to honour possible obligations under contingent liabilities. This condition indicates the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern.

Material losses/impairments

41. As disclosed in note 41.4 to the financial statements, the municipality incurred significant electricity losses of 19,47% or 6 505 358 kilowatts, respectively, due to technical and non-technical losses.
42. As disclosed in notes 18 and 19 to the financial statements the municipality has provided for impairments of trade receivables from exchange and non-exchange transactions of R31 952 010 due to objective evidence that these debtors would default on their respective accounts.

Additional matters

43. I draw attention to the matters below.

Material inconsistencies in other information included in the annual report

44. The annual report has not yet been received at the date of this report. As a result, it has not yet been reviewed for any inconsistency with the financial statements. The final printer's proof of the annual report will be reviewed and any material inconsistencies identified will be communicated to management. Should the inconsistencies identified not be corrected, it may result in the matter being included in the audit report.

Unaudited supplementary schedules

45. 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

46. 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

47. 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 ■ of the annual report.
48. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability for the programmes selected for auditing.
49. 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 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 *Framework for managing programme performance information (FMPPI)*.
50. The reliability of the information in respect of the selected programmes is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).
51. The findings are as follows:

Usefulness of information

52. The Local Government: Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA), section 41(c) requires that the integrated development plan should form the basis for the annual report, therefore requiring the consistency of objectives, indicators and targets between planning and reporting documents. A total of 75% of the reported indicators and targets are not consistent with the indicators and targets as per the approved integrated development plan. This is due to the lack of staff capacity at the performance information unit.

53. The National Treasury *FMPPI* requires that performance targets be specific in clearly identifying the nature and required level of performance, be measurable, have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use and must be possible to validate the processes and systems that produce the indicator. A total of 75% of the targets were not specific in clearly identifying the nature and the required level of performance, could not be measured, were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently and were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to the lack of sufficient management attention and focus on the performance reporting.

Reliability of information

54. The National Treasury *FMPPI* 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. The information presented with respect to the strategic objectives for the effective management of housing development to ensure the availability of housing to low income groups, was not reliable when compared to the source information and evidence provided.
55. This was due to the lack of sufficient management attention and focus on the performance reporting.

Compliance with laws and regulations

56. I performed procedures to obtain evidence that the entity had 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

57. 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, expenditure, irregular, unauthorised and fruitless and wasteful expenditure and material losses identified by the auditors in the submitted financial statements remained uncorrected, resulting in the financial statements receiving an adverse audit opinion.
58. The 2011-12 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.
59. The integrated development plan did not comply with the requirements of section 26 of the MSA, as it did not reflect all the key performance indicators and performance targets determined by section 41 of the MSA, as required by section 26(i) of the MSA.
60. 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 sections 121(3)(e) and (f) of the MFMA, respectively.

Procurement and contract management

61. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were only awarded to service providers whose tax matters have been declared by the South African Revenue Service to be in order as required by Supply Chain Management (SCM) Regulation 43.
62. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act, 2000 (Act No. 38 of 2000) and CIDB regulation 18.
63. Sufficient appropriate audit evidence could not be obtained that contracts were awarded to bidders based on points given for criteria that were stipulated in the original invitation for bidding, as required by SCM Regulations 21(b) and 28(1)(a) and Preferential Procurement Regulations.
64. Bid specifications were not always drafted by bid specification committees which were composed of one or more officials of the municipality, as required by SCM Regulation 27(3).
65. Sufficient appropriate audit evidence could not be obtained that 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).
66. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM Regulations 17(a) and (c).
67. Awards were made to service providers who are persons in service of other state institutions or whose directors/principal shareholders are persons in service of other state institutions, in contravention of SCM Regulations 44. Similar awards were identified in the prior year and effective steps were not taken to prevent or combat the abuse of the SCM process in accordance with SCM Regulation 38(1).
68. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding were advertised for a required minimum period of days, as required by SCM Regulations 22(1) and (2).
69. Sufficient appropriate audit evidence could not be obtained that all a contract and quotations were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as supporting documents were misplaced.

Human resource management and compensation

70. 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 MSA.
71. 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.

Revenue management

72. 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.
73. Interest was only charged on arrear property rates and not on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

Asset management

- 74. 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.
- 75. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

Expenditure management

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

Internal control

- 77. I considered internal control relevant to my audit of the financial statements, the 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

- 78. The leadership did not exercise sufficient 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, resulting in the financial statements and annual performance report containing pervasive material misstatements. The leadership did not exercise sufficient oversight responsibility of monitoring compliance with laws and regulations.
- 79. 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 and revenue, asset and expenditure management.
- 80. The municipality did not have documented and approved internal policies and procedures to address the process of collection, recording, processing, monitoring and reporting of performance information.
- 81. 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 that were prevalent in the prior year's management report and not the internal control deficiencies that have not adequately been addressed over the past few years. This resulted in repeat findings in the areas of financial reporting relating to revenue, asset management and compliance with laws and regulations. Since only two months elapsed since the completion of the audit of the late submitted financial statements for the 2011-12 financial year and the audit of the 2012-13 financial year, the municipality had insufficient time to develop and implement a properly designed action plan to address the internal control deficiencies identified in the 2011-12 audit.

Financial and performance management

- 82. Management did not put adequate processes in place to ensure that a credible set of financial statements and annual performance report, in compliance with the reporting framework, are prepared as the internal review procedures were inadequate to identify and correct material pervasive misstatements in the financial statements and performance report and underlying records before it was submitted for auditing.
- 83. Regular asset counts were not conducted to ensure that the information reflected in the asset register and the financial statements is valid and accurate. The municipality does not have sufficient funds to ensure that their asset register is adequately updated.
- 84. Transactions that are processed daily are not adequately filed and updated on a regular basis. This has caused unexpected challenges and delays in retrieving information for audit purposes in a timely manner. This is mainly due to vacancies at the municipality, as well as lower levels of staff not accepting accountability and not responding to remedial action instituted by management. Management has also not monitored the action plans on a monthly basis.
- 85. Management did not review and monitor compliance with applicable laws and regulations, resulting in irregular expenditure and non-compliance with the MFMA and MSA.

OTHER REPORTS

Investigations

- 86. The following investigations, which relate to the municipality have been completed:
- 87. A formal forensic investigation was performed by the South African Police Service in connection with the fire that occurred during August 2011 at the supply chain management department. The cause of the fire could not be determined. The investigation has been concluded.
- 88. An investigation into the adequacy of data capturing of electricity meter readings at Kannaland Municipality was conducted by a firm of attorneys. This investigation has been concluded. Disciplinary action that was recommended in the report is still in progress.

Auditor General

Cape Town

29 November 2013



AUDITOR - GENERAL
SOUTH AFRICA

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