

# **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 Kannaland Municipality set out on pages 5 to 78, which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets, the cash flow statement and the 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 the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP), 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, 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 Kannaland 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. With reference to note 38 to the financial statements, the municipality could be liable for penalties and other payments. The ultimate outcome of these matters cannot be reasonably determined and therefore no provision for any liability that may result has been made in the financial statements.

## **Restatement of corresponding figures**

9. As disclosed in note 40 to the financial statements, the corresponding figures for 30 June 2013 have been restated as a result of errors discovered during the 2013-14 financial year in the financial statements of Kannaland Municipality at, and for the year ended 30 June 2013.

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

10. Note 42 to the financial statements indicates that Kannaland Municipality has significant uncertainty with regard to the use of the going concern assumption due uncertainty whether payments for statutory obligations will be met, litigation against the municipality, a high level of water and electricity distribution losses, a high level of poverty in the community and skills shortages. The municipality has drafted a financial recovery plan on 6 December 2013.

## **Material losses**

11. As disclosed in note 19 to the financial statements the municipality incurred electricity losses of 16,7% or 5 717 544 units due to technical and non-technical losses.
12. As disclosed in note 19 to the financial statements the municipality incurred water losses of 41% or 614 557 kilo litres due to technical and non-technical losses. This amounted to R3 944 857 (2012-13: R3 505 038).

## **Material impairments**

13. As disclosed in notes 3 and 5 to the financial statements, respectively, the municipality has provided for an impairment of R15 million on receivables from non-exchange transactions and an impairment of R31,1 million on receivables from exchange transactions. The impairment on receivables from non-exchange transactions is mainly due the adoption of iGRAP 1, *Applying the probability test on the initial recognition of revenue*.

### **Additional matters**

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

### **Unaudited disclosure notes**

15. 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.

### **Unaudited supplementary schedules**

16. The supplementary information set out on page 79 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.

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

17. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings relevant to performance against predetermined objectives for selected 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**

18. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected objectives in the annual performance report of the municipality for the year ended 30 June 2014:
- Objective 1: Basic municipal services available to all clients on pages 50 to 52
  - Objective 2: Sufficient capacity available on page 51
  - Objective 3: Minimised distribution losses on pages 53 to 54
  - Objective 4: Reliable, safe and well operated and maintained municipal infrastructure on pages 51 to 54
19. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
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 is consistent with the planned objectives. I further performed tests to determine whether indicators and targets are 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 objectives are as follows:

**Objective 1: Basic municipal services available to all clients**

**Usefulness of reported performance information**

**Consistency of objectives, indicators and targets**

**Reported objectives, indicators and targets not consistent with planned objectives, indicators and targets**

23. Section 41(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) 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 80% of the reported objectives, a total of 60% of the reported indicators and a total of 100% of the reported targets were not consistent with those in the approved integrated development plan. This was due to an understaffed performance and compliance unit at the municipality. In addition to the lack of staff skills and training in the area of performance information, management lacked in their role to adequately review performance information documents.

**Measurability of indicators and targets**

**Performance targets not specific, measurable and indicators not well defined and verifiable**

24. The FMPPPI requires the following:

- Performance targets must be specific in clearly identifying the nature and required level of performance. A total of 60% of the targets were not specific.
- Performance targets must be measurable. I could not measure the required performance for 100% of the targets.
- 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. A total of 80% of the indicators were not well defined.
- Performance indicators must be verifiable, meaning that it must be possible to validate the processes and systems that produced the indicator. A total of 100% of the indicators were not verifiable.

25. This was due to an understaffed performance and compliance unit at the municipality. In addition to the lack of staff skills and training in the area of performance information, management lacked in their role to adequately review performance information documents.

**Reliability of reported performance information**

26. The FMPPPI requires municipalities 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 our work due to the fact that the municipality could not provide sufficient appropriate evidence in support of the reported performance information.

## **Objective 2: Sufficient capacity available**

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

#### **Consistency of objectives, indicators and targets**

##### **Reported objectives, indicators and targets not consistent with planned objectives, indicators and targets**

27. Section 41(c) of the MSA 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 100% of the reported objectives, a total of 100% of the reported indicators and a total of 75% of the reported targets were not consistent with those in the approved integrated development plan. This was due to an understaffed performance and compliance unit at the municipality. In addition to the lack of staff skills and training in the area of performance information, management lacked in their role to adequately review performance information documents.

#### **Measurability of indicators and targets**

##### **Performance targets not specific, measurable and indicators not well defined and verifiable**

28. The FMPPI requires the following:
- Performance targets must be specific in clearly identifying the nature and required level of performance. A total of 63% of the targets were not specific.
  - Performance targets must be measurable. I could not measure the required performance for 100% of the targets.
  - 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. A total of 38% of the indicators were not well defined.
  - Performance indicators must be verifiable, meaning that it must be possible to validate the processes and systems that produced the indicator. A total of 100% of the indicators were not verifiable.
29. This was due to an understaffed performance and compliance unit at the municipality. In addition to the lack of staff skills and training in the area of performance information, management lacked in their role to adequately review performance information documents.

#### **Reliability of reported performance information**

30. The FMPPI requires municipalities 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 our work due to the fact that the municipality could not provide sufficient appropriate evidence in support of the reported performance information.

### **Objective 3: Minimised distribution losses**

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

#### **Consistency of objectives, indicators and targets**

#### **Reported objectives, indicators and targets not consistent with planned objectives, indicators and targets**

31. Section 41(c) of the MSA 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 50% of the reported objectives, a total of 50% of the reported indicators and a total of 100% of the reported targets were not consistent with those in the approved integrated development plan. This was due to an understaffed performance and compliance unit at the municipality. In addition to the lack of staff skills and training in the area of performance information, management lacked in their role to adequately review performance information documents.

#### **Measurability of indicators and targets**

#### **Performance targets not specific, measurable and indicators not well defined and verifiable**

32. The FMPPI requires the following:
- Performance targets must be specific in clearly identifying the nature and required level of performance. A total of 100% of the targets were not specific.
  - Performance targets must be measurable. I could not measure the required performance for 100% of the targets.
  - 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. A total of 100% of the indicators were not well defined.
  - Performance indicators must be verifiable, meaning that it must be possible to validate the processes and systems that produced the indicator. A total of 100% of the indicators were not verifiable.
33. This was due to an understaffed performance and compliance unit at the municipality. In addition to the lack of staff skills and training in the area of performance information, management lacked in their role to adequately review performance information documents.

#### **Reliability of reported performance information**

34. The FMPPI requires municipalities 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 our work due to the fact that the municipality could not provide sufficient appropriate evidence in support of the reported performance information.

## **Objective 4: Reliable, safe and well operated and maintained municipal infrastructure**

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

#### **Consistency of objectives, indicators and targets**

#### **Reported objectives, indicators and targets not consistent with planned objectives, indicators and targets**

35. Section 41(c) of the MSA 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 29% of the reported objectives, a total of 71% of the reported indicators and a total of 57% of the reported targets were not consistent with those in the approved integrated development plan. This was due to an understaffed performance and compliance unit at the municipality. In addition to the lack of staff skills and training in the area of performance information, management lacked in their role to adequately review performance information documents.

#### **Measurability of indicators and targets**

#### **Performance targets not measurable and indicators not well defined and verifiable**

36. The FMPPI requires the following:
- Performance targets must be measurable. I could not measure the required performance for 100% of the targets.
  - 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. A total of 86% of the indicators were not well defined.
  - Performance indicators must be verifiable, meaning that it must be possible to validate the processes and systems that produced the indicator. A total of 100% of the indicators were not verifiable.
37. This was due to an understaffed performance and compliance unit at the municipality. In addition to the lack of staff skills and training in the area of performance information, management lacked in their role to adequately review performance information documents.

#### **Reliability of reported performance information**

38. The FMPPI requires municipalities 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 our work due to the fact that the municipality could not provide sufficient appropriate evidence in support of the reported performance information.

### **Additional matters**

39. I draw attention to the following matters.

### **Achievement of planned targets**

40. Refer to the annual performance report on pages 50 to 54 for information on the achievement of planned targets for the year. This information should be considered in the context of the conclusions expressed on usefulness and reliability of the reported performance information in the preceding paragraphs of this report.

### **Unaudited supplementary information**

41. The supplementary information set out on pages 1 to 49 and 55 to 65 does not form part of the annual performance report and is presented as additional information. I have not audited this information and, accordingly, I do not express a conclusion thereon.

### **Compliance with legislation**

42. I performed procedures to obtain evidence that the municipality had complied with legislation 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**

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

### **Annual performance report**

44. The local community was not afforded the opportunity to comment on the final draft of the integrated development plan (IDP) before adoption, as required by section 42 of the MSA and Municipal planning and performance management regulation 9, 13(1), 13(4)(c) and 15(3).
45. The municipality did not give effect to its IDP and conduct its affairs in a manner which was consistent with its IDP, as required by section 36 of the MSA, section 21(2)(a) of the MFMA and Municipal planning and performance management regulation 6.
46. The annual performance report for the year under review did not include measures taken to improve performance as required by section 46(1)(c) of the MSA.
47. The performance management system and related controls were not in place as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting and improvement 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.



48. The annual performance agreements for the municipal manager and all senior managers are not linked to the measurable performance objectives approved with the budget and to the service delivery budget implementation plan as required in terms of section 53(1)(c)(iii) of the MFMA and section 57(1)(b) of the MSA.

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

49. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by supply chain management (SCM) regulation 17(a) and (c).
50. 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 per required by SCM regulation 27(2)(a).
51. 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).
52. Bids were not always evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality as required by SCM regulation 28(2).
53. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
54. 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.
55. Awards were made to providers who are in the service of other state institutions, in contravention of section 112(j) of the MFMA and 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).

#### **Conditional grants**

56. 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.
57. The municipality did not evaluate its performance in respect of programmes or functions funded by the Local Government Financial Management Grant allocation, as required by section 12(5) of the DoRA.

#### **Consequence management**

58. 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 section 32(2)(a)(ii) of the MFMA.
59. Authorisation of unauthorised expenditure was not done through an adjustment budget, as required by section 32(2)(a)(i) of the MFMA.

### **Asset management**

- 60. 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.
- 61. An effective system of internal control for assets (including an adequate asset register) was not in place, as required by section 63(2)(c) of the MFMA.

### **Expenditure management**

- 62. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
- 63. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred for payments made, as required by section 65(2)(b) of the MFMA.
- 64. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
- 65. An effective system of expenditure control, including procedures for the authorisation of funds, was not in place, as required by section 65(2)(a) of the MFMA.

### **Revenue management**

- 66. An adequate management, accounting and information system which accounts for revenue and debtors was not in place, as required by section 64(2)(e) of the MFMA.
- 67. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

### **Internal control**

- 68. 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 findings on the annual performance report and the findings on non-compliance with legislation included in this report.

### **Leadership**

- 69. Leadership did not provide sufficient oversight over the implementation and monitoring of controls which has resulted in a breakdown in internal controls. 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 that were submitted for auditing containing pervasive material misstatements which, for the financial statements, could be corrected after audit findings were raised in this regard, but which were not detected by oversight and review processes. Leadership did not exercise sufficient oversight responsibility in monitoring compliance to laws and regulations.

70. Leadership 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 and other key legislation, 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, expenditure management, liability management and asset management.
71. 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.
72. Although the municipality developed an action plan to address past external audit findings, it did not adequately address the internal control deficiencies reported in the prior years, resulting in repeat findings in the areas of financial and performance reporting and compliance with laws and regulations. The municipality failed to implement the action plan prior to the commencement of the audit and no action had been taken in response to the key control visits throughout the 2014 year. This is also an indication that new appointments of staff have not yet taken responsibility to address areas of concern with regard to payables. The municipality does not have a sustainable plan to ensure that misstatements identified do not reoccur.

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

73. 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 submitting for audit. This was mainly due to the processes implemented for the preparation and finalisation of the financial statements and annual performance report being inadequate and quarterly financial statements and performance reports not being prepared to ensure the credibility of the financial statements and the annual performance report.
74. Daily transactions are not updated on a regular basis and underlying documentation is not adequately filed. This caused unexpected challenges and delays in retrieving information for audit purposes in a timely manner. This is mainly due to vacancies at the municipality and lower levels of staff not accepting accountability and responding to remedial action instituted by management. Management has also not monitored the action plans in this regard on a monthly basis. A thorough review was also not performed before documentation was submitted for audit purposes.
75. A lack of standard operating procedures and inadequate controls relating to the daily processing and reconciling of transactions has contributed to the lack of proper filing and maintaining of documents in support of valid, accurate and complete performance reporting.
76. Management did not review and monitor compliance with applicable laws and regulations, resulting in irregular expenditure and non-compliance with the MFMA and other key legislation.

## OTHER REPORTS

### Investigations

77. The Hawks are presently investigating allegations that they have received since 2011. The investigation is still pending and has not been concluded to date. The Hawks requested additional information for their investigation from the municipality on 12 August 2014. The municipality has complied with this request and has made copies of documents that were handed over to avoid limitations of scope experienced in prior audits.

*Auditor-General*

Cape Town

27 February 2015



AUDITOR - GENERAL  
SOUTH AFRICA

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