

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 was engaged to audit the financial statements of the Kannaland Municipality set out on pages 8 to 71, which comprise the statement of financial position as at 30 June 2016, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP), 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 conducting the audit in accordance with International Standards on Auditing. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.
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.

Basis for disclaimer of opinion

Property, plant and equipment

5. The municipality did not account for depreciation as required by GRAP 17 *Property plant and equipment*. Consequently, depreciation and amortization expense as disclosed in the statement of financial performance is understated by R1,9 million and property plant and equipment is overstated by R1,9 million.
6. The residual values and useful lives of property plant and equipment were not assessed in accordance with GRAP 17 as assets with zero values were still in use. I was unable to determine the impact on the net carrying amount of property, plant and equipment stated at R303,7 million in the financial statements, depreciation and amortisation stated at R11,8 million in the financial statements, impairment loss stated at R17 317 in the financial statements and the surplus for the year stated at R6,2 million in the financial statements as it was impracticable to do so.
7. The municipality did not disclose the amount of expenditure recognised for property, plant and equipment in the course of its construction as required in terms of GRAP 17 due to projects in progress that were not recognised as work-in-progress in note 9 to the financial statements. Furthermore, included in work in progress is a project to the value of R4,5 million that is confirmed to be complete at year-end. Consequently, work in progress as stated in note 9 to the financial statements is understated by R8,8 million, asset additions understated by 4,5 million, property plant and equipment and payables from exchange transactions are understated by 13,3 million respectively.

Payables from exchange transactions

8. The municipality did not recognise all outstanding amounts meeting the definition of a liability, in accordance with GRAP 1: *Presentation of financial statements*. Consequently, payables from exchange transactions are understated by R2,7 million and expenditure as disclosed in the statement of financial performance is understated by 2,7 million.
9. I was unable to obtain sufficient appropriate evidence that all accruals had been recorded as the municipality did not maintain adequate records of outstanding payments for goods and services received but not yet paid at year-end and as such did not record all expenses that was incurred but not paid at year end. I could not confirm the recording of all expenses and liabilities by alternative means. Consequently I was unable to determine whether any further adjustment to payables from exchange transactions stated at R61,9 million in the financial statements, expenditure stated at R164,9 million in the financial statements, property plant and equipment stated at R 303,7 in the financial statements and any other account balances were necessary.
10. I was unable to obtain sufficient appropriate audit evidence regarding payables from exchange transactions due to an unexplained difference between the general ledger and the financial statements. I was unable to confirm this difference by alternative means. Consequently I was unable to determine whether any further adjustment to payables from exchange transactions stated at R61,9 million in the statement of financial position was necessary.

Revenue from non-exchange transactions

11. The municipality did not recognise revenue from conditional grants and subsidies in the correct period as required by GRAP 23: *Revenue from non exchange transactions* due to expenditure on grants only being recognised when payment is made. Consequently revenue

from non exchange stated at R102,6 million in the financial statements is overstated by R5,1 million (2014-15 understated), expenditure stated at R164,9 million in the financial statements is overstated by R5,1 million (2014-15 understated), prior year unspent conditional grants stated at R10,8 million in the financial statements is overstated and payables from exchange transactions stated at R61,8 million in the financial statements understated by R5,1 million

12. I was unable to obtain sufficient appropriate evidence for revenue recognised from the spending of conditional grants due to poor record keeping at the municipality. I was unable to confirm these revenue transactions by alternative means. Consequently, I was unable to determine whether any adjustments to government grants and subsidies stated at R77,5 million in the financial statements, revenue from non exchange transactions stated at R102,6 million in the financial statements, unspent conditional grants stated at 17,2 million in the financial statements, expenditure stated at R164,9 million in the financial statements and surplus for the year stated R6,2 million in the financial statements, were necessary.
13. I was unable to obtain sufficient appropriate audit evidence for grants received due to unexplained differences between the general ledger, the grant register and the financial statements. I was unable to confirm these differences by alternative means. Consequently I was unable to determine whether any adjustments to government grants and subsidies stated at R77,5 million in the financial statements, revenue from non exchange transactions stated at R102,6 million in the financial statements, unspent conditional grants and receipts stated at R17,2 million in the financial statements expenditure stated at R164,9 million in the financial statements, surplus for the year stated R6,2 million in the financial statements and any other account balances and transactions were necessary.

Expenditure

14. The municipality did not recognise expenditure when it is incurred in accordance with GRAP 1: *Presentation of financial statements*. Consequently, expenditure relating to repairs and maintenance, bulk purchases, contracted services and general expenses was understated by a total amount of R20,8 million, payables from exchange transactions in the statement of financial position is understated by an amount of R23,7 million and VAT receivable is understated by R2,9 million.
15. I was unable to obtain sufficient appropriate evidence that expenditure transactions for the current year had been properly accounted for due to substantiating accounting records not provided. This was due to poor record keeping at the municipality. I was unable to confirm expenditure by alternative means. Consequently, I was unable to determine whether any adjustment to expenditure stated at R164,9 million in the financial statements, payables from exchange transactions stated at 61,9 million, VAT receivable stated at R11 million and surplus for the year stated at 6,2 million in the financial statements were necessary.
16. I was unable to obtain sufficient appropriate audit evidence to verify the journal entries relating to expenditure as the journals could not be substantiated by supporting evidence. This was due to poor record keeping at the municipality. It was not possible to confirm these journal entries by alternative means. Consequently, I was unable to determine whether any adjustment to expenditure stated at R164,9 in the financial statements, payables from exchange transactions stated at 61,9 million in the financial statements, VAT receivable stated at R11 million in the financial statements and any other account balances and transactions were necessary.

Employee costs

17. I was unable to obtain sufficient appropriate audit evidence for employee costs relating to appointments, terminations and acting and travel allowances. This was due to poor record keeping at the municipality. I was unable to confirm these transactions by alternative means.

Consequently, I was unable to determine whether any adjustments to employee costs stated at R50,7 million in the financial statements , operating surplus stated at 6,2 million in the financial statements , receivables from non-exchange transactions stated at R5 million and any other balances were necessary.

18. I was unable to obtain sufficient appropriate audit evidence to verify the journal entries relating to employee costs as the journals could not be substantiated by supporting evidence. This was due to poor record keeping at the municipality. It was not possible to confirm these journal entries by alternative means. Consequently, I was unable to determine whether any adjustment to employee cost stated at R50,7 million in the financial statements , operating surplus stated at R6,2 million in the financial statements , receivables from non-exchange transactions stated at R5 million and any other account balances or transactions were necessary.

Value Added Tax (VAT) receivable

19. I was unable to obtain sufficient appropriate audit evidence for VAT receivable due to an unexplained difference between the general ledger and the financial statements. I was unable to confirm this difference by alternative means. Consequently I was unable to determine whether any further adjustment to VAT receivable stated at R11 million in the statement of financial position was necessary.

Cash flow statement

20. The calculation of net cash flows from operating activities and cash flows from investing activities recognised in the cash flow statement, did not appropriately account for cash and non-cash items as required by GRAP 2 *Cash flow statements*. The municipality's system did not allow the performance of alternative procedures to determine the extent of this misstatement. Consequently, I was unable to obtain sufficient appropriate audit evidence to confirm the accuracy of the net cash flows from operating activities and cash flows from investing activities included in the cash flow statement and the notes thereto.

Contingent liabilities

21. I was unable to obtain sufficient appropriate audit evidence for contingent liabilities, as not all external confirmations were received. I was unable to confirm whether all contingent liabilities were recorded by alternative means. Consequently, I was unable to determine whether any adjustments to contingent liabilities stated at R1,5 million in note 43 to the financial statements was necessary.

Commitments

22. The municipality did not disclose contractual capital commitments as required by GRAP 17: *Property, plant and equipment*. The municipality incorrectly disclosed projects that have not yet been approved and completed projects as part of commitments. Consequently commitments as disclosed in note 42 to the financial statements are overstated by R361,8 million((2014-15: R12,9million).
23. I was unable to obtain sufficient appropriate evidence to substantiate commitments as the municipality did not maintain accurate and complete records for contractual commitments. I was unable to confirm commitments by alternative means. Consequently I was unable to determine whether any further adjustment to commitments stated at R469,4 million was necessary.

Unauthorised expenditure

24. The municipality did not include all unauthorised expenditure incurred in note 47 to the financial statements as required by section 125 of the MFMA. Unauthorised expenditure as disclosed in note 47 to the financial statements is understated by R24 million (2014-15: R1,6 million overstated). This was due to incorrect actual expenditure figures used in comparison to the approved budget.

Irregular expenditure

25. The municipality incurred expenditure in contravention of the supply chain management regulations and did not disclose all instances of irregular expenditure as required by section 125 of the MFMA. Consequently, irregular expenditure as disclosed in note 49 is understated by R 1,4 million (2014-15: R23,9 million) .
26. I was unable to obtain sufficient appropriate evidence to ensure that all instances of irregular expenditure were included as the municipality did not maintain accurate and complete records for irregular expenditure. I was unable to confirm that all irregular was recorded by alternative means. Consequently, I was unable to determine whether any further adjustment to irregular expenditure stated at R8,6 million was necessary.

Disclaimer of Opinion

27. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide to a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

Emphasis of matters

28. I draw attention to the matters below.

Restatement of corresponding figures

29. As disclosed in notes 52 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of errors discovered during the 2015-16 financial year in the financial statements of the Kannaland Municipality at, and for the year ended 30 June 2015.

Financial Sustainability

30. As disclosed in note 45 to the financial statements the municipality has significant uncertainty with regard to the use of the going concern assumption. The statement of financial position indicates that the Kannaland Municipality's current liabilities exceeded its current assets by R54,7 million (2014-15: R28,9 million). These conditions, along with other matters as set forth in the note 45 to the financial statements, 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/impairments

31. As disclosed in note 25.1 to the financial statements, the municipality suffered electricity distribution losses of 4 303 065 kilowatts during the year under review which represents 13% of the electricity purchased by the municipality.

32. As disclosed in note 4 to the financial statements, receivables from non-exchange transactions were significantly impaired. The impairment of receivables from non-exchange transactions amounts to R19,3 million.
33. As disclosed in note 6 to the financial statements, receivables from exchange transactions were significantly impaired. The impairment of receivables from exchange transactions amounts R33,2 million.

Material underspending of the budget

34. As disclosed in note 47 to the financial statements, the municipality underspent on its final approved capital budget by R10 million (20%) and the projects were rolled over to 2016-17 financial year. .

Additional matter

35. I draw attention to the matter below.

Unaudited disclosure notes

36. 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

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

38. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information of the following selected strategic objectives presented in the annual performance report of the municipality for the year ended 30 June 2016:
- KPA1: To provide access to reliable infrastructure that will contribute to a higher quality of life for Kannaland citizens on page 16 to 18.
 - KPA7: To strive towards a financially sustainable municipality on page 29 to 35.
39. I evaluated the usefulness of the reported performance information to determine whether it was consistent with the planned strategic objectives. 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).
40. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

41. The material findings in respect of the selected strategic objectives are as follows:

To provide access to reliable infrastructure that will contribute to a higher quality of life for Kannaland citizens

Usefulness of reported performance information

Consistency of objectives, indicators and targets

42. 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 88% of reported objectives, indicators and targets were not consistent with those in the approved service delivery budget and implementation plan.

Measurability of indicators

43. The FMPPI requires that performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use. A total of 50% of indicators were not well defined.

Reliability of reported performance information

44. The FMPPI 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. The reported performance information was not reliable when compared to the evidence provided.

To strive towards a financially sustainable municipality

Usefulness of reported performance information

Consistency of objectives, indicators and targets

45. 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 60% of reported objectives, indicators and targets were not consistent with those in the approved integrated development plan.

Reliability of reported performance information

46. The FMPPI 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. The reported performance information was not reliable when compared to the evidence provided.

Additional matters

47. I draw attention to the following matters:

Achievement of planned targets

48. Refer to the annual performance report on pages 16 to 34 for information on the achievement of 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 42 to 46 of this report.

Adjustment of material misstatements

49. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of the reliable infrastructure that will contribute to higher quality of life of Kannaland citizens objective. As management subsequently corrected only some of the misstatements, I identified material findings on the usefulness and reliability of the reported performance information.

Compliance with legislation

50. 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:

Strategic planning and performance management

51. The amendments to the integrated development plan (IDP) were not adopted by the council only after the proposed amendment has been published for public comment; as required by the Municipal planning and performance management regulations, 2001, regulation 3(4).

Annual financial statements and annual reports

52. 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 identified by the auditors in the submitted financial statements were not adequately corrected and the supporting records could not be provided subsequently, which resulted in the financial statements receiving disclaimer of audit opinion.

Expenditure management

53. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
54. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred and accounting for creditors as required by section 65(2)(b) of the MFMA.
55. Reasonable steps were not taken to prevent unauthorised, irregular and fruitless and wasteful expenditure as required by section 62(1)(d) of the MFMA.

Procurement and contract management

56. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of the Municipal Supply Chain Management (SCM) Regulations, 2005, regulations 17(a) and (c).

57. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
58. Awards were made to providers who were in the service of other state institutions, in contravention of section 112(j) of the MFMA and SCM regulation 44. Similar awards were identified in the previous year and no effective steps were taken to prevent or combat the abuse of the SCM process, as required by SCM regulation 38(1).
59. Contracts were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, in contravention of SCM regulation 43.

Grant management

60. Conditional Grants were utilised for purposes other than those stipulated in the grant framework in contravention of section 17(1) of the DoRA.
61. The municipality did not evaluate its performance in respect of programmes funded by the Municipal Infrastructure Grant allocation and Municipal Systems Improvement Grant allocations, as required by section 12(5) of the DoRA.

Internal control

62. 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 disclaimer of opinion, the findings on the performance report and the findings on compliance with legislation.

Leadership

63. Leadership did not provide adequate oversight regarding the implementation of action plans to address prior year audit findings and internal control deficiencies which has resulted in repeat audit findings in the area of financial reporting, the report on pre-determined objectives and compliance with laws and regulations. Sufficient oversight over the processes for the preparation of the underlying supporting schedules in support of the annual financial statements and annual performance report did not occur resulting in numerous pervasive material misstatements in the financial statements and the annual performance report. Leadership furthermore did not facilitate the implementation of adequate compliance monitoring processes resulting in numerous non-compliance findings being reported with key applicable legislation.

Financial and performance management

64. 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 frameworks, are prepared as the internal review procedures were inadequate to identify and correct pervasive material 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.
65. Deficiencies in review processes and the ineffective implementation of compliance monitoring controls to ensure compliance with key applicable legislation resulted in non-

compliance with the MFMA and other applicable legislation and irregular expenditure being incurred.

Governance

66. The municipality did not implement effective systems of risk management to achieve the objectives of a strengthened internal control environment and mitigate the risks of pervasive material misstatements in the financial statements and annual performance report in non-compliance with the prescribed reporting frameworks. The audit committee further did not provide adequate oversight over financial and performance reporting and compliance with laws and regulations. Internal audit did not adequately follow up the implementation of internal controls regarding the reliability and integrity of financial and performance information, as well as the evaluation of compliance with laws and regulations in the areas of expenditure, assets and supply chain management.

Other reports

67. I draw attention to the following engagements that could potentially impact on the municipality's financial, performance and compliance related matters.
68. The Directorate for Priority Crime Investigation is investigating allegations that they received in 2011. The investigation is still pending and has not been concluded to date.
69. Subsequent to year end the municipality initiated and approved an investigation into alleged financial misconduct. The investigation is still pending and has not been concluded to date.

Auditor-General

Cape Town

8 December 2016



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence