

REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE ON THE FINANCIAL STATEMENTS OF THE BLUE CRANE ROUTE MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2007

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Blue Crane Route Municipality which comprise the balance sheet as at 30 June 2007, income statement and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, and the accounting officer's report, as set out on pages [xx] to [xx].

Responsibility of the accounting officer for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the entity-specific basis of accounting, as set out in accounting policy note 1 and in the manner required by the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). This responsibility includes:
 - designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
 - selecting and applying appropriate accounting policies
 - making accounting estimates that are reasonable in the circumstances.

Responsibility of the Auditor-General

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with the International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.
5. 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.
6. An audit also includes evaluating the:

- appropriateness of accounting policies used
 - reasonableness of the accounting estimates made by management
 - overall presentation of the financial statements.
7. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis of accounting

8. The municipality's policy is to prepare financial statements on the entity specific basis of accounting, as set out in accounting policy note 1.

Basis for adverse opinion

9. Statutory funds

The total amount of statutory funds as at 30 June 2007 as reflected in the financial statements amounted to R7 113 619, whereas total cash and investments to support the existence of the statutory funds amounted to R4 392 771. This implies that cash and investments at 30 June 2007 could only finance 62% of statutory funds.

10. Trust funds

The total amount of trust funds as at 30 June 2007 as reflected in the financial statements amounted to R2 703 857, whereas total cash to support the existence of the trust funds amounted to R147 152. This implies that at 30 June 2007 cash could only finance 5% of trust funds.

11. Fixed assets

In terms of the entity-specific basis of accounting as set out in accounting policy note 1, assets are written off to the extent that they have been financed by way of public contributions, grants and subsidies, contributions from operating income or loans redeemed and advances repaid. The effect of this is that the net fixed asset balance at year-end is comprised only of fixed assets acquired by way of external loans or advances to the extent that these have not been repaid at year-end. The net fixed asset balance at year-end should and did agree with the balance of external loans at year-end. However, the municipality's fixed asset register only reflected details of the cost of fixed assets amounting to R119 924 828 and not the details pertaining to those assets that have been written off as described above amounting to R104 312 793. Consequently, the municipality's fixed asset register did not identify those specific assets that comprise the balance of net fixed asset amounting to R15 612 035. As a result of this lack of detail:

- 11.1 the existence of fixed assets as per the fixed asset register with a cost of R47 013 762, could not be verified due to the inadequate description of these assets in the fixed asset register.
- 11.2. The valuation of land in accordance with the municipality's accounting policy as described in the financial statements could not be verified.
- 11.3 The existence, valuation and completeness of fixed assets written off with a value of R3 604 664 could not be verified.

The municipality's rights to land with a cost amounting to R9 485 148 could not be verified as, based on the results of a title deed search, this land was not registered in the name of the municipality.

The valuation of fixed asset additions and creditors was understated by an amount of R489 324 due to additions being recorded on a cash basis and not on an accrual basis as described in the basis of preparation accounting policy note to the financial statements.

As a result of the above the existence, valuation, rights and completeness of fixed assets amounting to R15 612 035 as per the financial statements (including appendix C to the financial statements) could not be verified.

12. Provision for bad debts

The provision for bad debts based on the outstanding consumer debtor balances and the age of debtors at 30 June 2007 amounted to R15 995 524. The provision for bad debts as calculated and recorded by the municipality amounted to R12 649 035 therefore resulting in an understatement of the bad debt provision and bad debt expense of R3 346 488.

13. Credit balances in receivables

Information relating to credit balances in receivables could not be supplied for audit purposes and, as such, the existence and valuation of credit balances in receivables could not be verified.

14. Trade creditors

14.1 Trade creditors and expenditure were understated by R707 545 as a result of inadequate cut-off procedures at year-end.

14.2 Cheque payments dated prior to year-end with a value of R226 149 in respect of goods and/or services received prior to year-end were not included in either the outstanding cheque list or the creditors balance at 30 June 2007 and therefore did not appear to have been recorded.

14.3 Cheques dated post-year-end with a value of R131 849 have been recorded as being paid prior to year-end and, as such, have been incorrectly recorded in the outstanding cheque list and general ledger bank account balance at year-end.

14.4 The entity-specific basis of accounting used by the municipality to prepare financial statements, as set out in accounting policy note 1 to the financial statements, is an accrual basis of accounting. However, testing of creditors and expenditure revealed that a cash basis of accounting was being used for expenditure and that not all accruals were being raised at year-end. This represented a significant departure from the basis of accounting disclosed in the financial statements. The total effect of this departure could not be quantified.

As a result of the above the completeness of trade creditors amounting to R7 892 496 as per the financial statements could not be verified.

15. Provision for leave pay

The occurrence, accuracy and completeness of the provision for leave pay amounting to R1 969 622 could not be verified due to the unsatisfactory state of the leave records used for calculating the provision.

16. Assessment rates income

16.1 A ratable valuation reconciliation between the valuation roles and rates charged in support assessment rates income amounting to R3 171 274 for the year was not performed.

16.2 The 1999 valuation rolls applied for the purpose of calculating and levying assessment rates for the financial year ended 30 June 2007 were not the valuation rolls as per the most recent general valuation performed in 2006.

16.3 The valuation rolls applied for the purpose of calculating and levying assessment rates for the financial year ended 30 June 2007 have not been updated for improvements made to properties over the past two years.

The occurrence and completeness of assessment rates income could therefore not be verified.

17. Rental expense

The occurrence, completeness and accuracy of the rental expense could not be verified due to the fact that the municipality did not have lease agreements available for all rentals, and those that were available were outdated.

18. Employee costs

The occurrence, accuracy and completeness of the salaries, wages and allowances expense amounting to R26 544 557 per the financial statements could not be verified due to the lack of documentation on employee files in respect of gross salaries or wages, allowances and deductions.

In addition, information relating to vacancies, promotions and severance pay could not be supplied for audit purposes.

19. Fruitless and wasteful expenditure

Penalties and interest amounting to R321 250 were paid by the municipality in respect of late payment on accounts. This constituted fruitless and wasteful expenditure as defined in section 1 of the MFMA and was not disclosed in the financial statements as required in terms of section 125 (2)(d)(i) of the MFMA.

The above amount was identified through audit testing. Therefore the completeness of fruitless and wasteful expenditure could not be verified.

20. Irregular expenditure

Goods and services amounting to R505 271 were acquired without following established supply chain management policies and procedures. This constituted irregular expenditure as defined in section 1 of the MFMA and has not been disclosed in the financial statements as required in terms of section 125(2)(d)(i) of the MFMA.

21. Internal advances

The existence, valuation and completeness of internal advances to borrowing services amounting to R8 119 132 as per appendix B of the financial statements could not be verified due to a lack of supporting documentation.

Adverse opinion

22. In my opinion, because of the significance of the matters described in the Basis for adverse opinion paragraphs, the financial statements of the Blue Crane Route Municipality as at 30 June 2007 and its financial performance and cash flows for the year then ended have not been prepared, in all material respects, in accordance with entity-specific basis of accounting, as set out in accounting policy note 1 and in the manner required by the MFMA.

Emphasis of matter

I draw attention to the following matter:

23. Going concern

The going concern concept assumes that the municipality will continue in operational existence for the foreseeable future. It further implies that the municipality has neither the intention nor the need to discontinue or curtail materially the scale of its operations or the services rendered in terms of its mandate. The financial statements have been prepared on the going concern basis which assumes that it will be able to meet its future obligations and commitments as they occur in the ordinary course of business. However, certain matters came to our attention that placed uncertainty on the municipality's ability to continue as a going concern. The aforementioned factors included the following:

- 23.1 The municipality's total liabilities exceeded its total assets by R7 398 466.
- 23.2 The municipality had traded at a loss for a number of years and the accumulated deficit amounted to R14 524 085.
- 23.3 An inability to service the biannual interest payments on the long-term loan with the Development Bank of South Africa (DBSA). The interest payments due for the financial year were in arrears.
- 23.4 An inability to settle creditors as and when they fall due. Creditors were not settled within 30 days as required in terms of section 65(2)(e) of the MFMA.

The municipality may therefore be unable to realise its assets and discharge its liabilities in the normal course of business. The financials did not disclose this fact.

OTHER MATTERS

I draw attention to the following matters that are ancillary to my responsibilities in the audit of the financial statements:

24. Non-compliance with applicable legislation

24.1 Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA)

- 24.1.1 All monies owing by the municipality were not paid within 30 days of receiving the relevant invoice or statement as required in terms of section 65(2)(e) of the MFMA. Bank account details were not submitted in writing to the relevant provincial treasury and the Auditor-General annually before the start of the financial year as required in terms of section 9(b) of the MFMA.

- 24.1.2 Details of the bank overdraft were not submitted to the National Treasury in the prescribed format as required in terms of section 70(2) of the MFMA.
- 24.2 Municipal Property Rates Act, 2004 (Act No. 6 of 2004)
 - 24.2.1 The municipality has not compiled and maintained a register of properties situated within the municipality and updated it with supplementary valuation rolls as required in terms of section 23 of the act.
 - 24.2.2 The municipality has not caused a supplementary valuation to be made in respect of any ratable property of which the market value has substantially increased or decreased for any reason since the last general valuation as required in terms of section 78(1) of the act.
- 24.3 Value-Added Tax Act, 1991 (Act No. 89 of 1991) (VAT Act)
 - 24.3.1 The municipality's VAT number was not reflected on all supplier invoices as required in terms of section 20(4) of the VAT Act.
 - 24.3.2 The municipality did not submit and pay all VAT returns within 25 days after the tax period-end as required in terms of section 28(1) of the VAT Act.
- 24.4 Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA)
 - 24.4.1 The municipality has not adopted and implemented a tariff policy on the levying of fees for municipal services as required in terms of section 74 (1) of the said act.
- 24.5 Basic Conditions of Employment Act, 1997 (Act No. 75 of 1997)
 - 24.5.1 The municipality has not complied with the overtime limits as set out in section 10 (1) of the said act as some employees have worked more than 10 hours' overtime a week.
- 24.6 Skills Development Levies Act, 1999 (Act No. 9 of 1999)
 - 24.6.1 The municipality did not pay skills development levies (SDL) to the commissioner within seven days after month-end as required in terms of section 6(2) of the said act.
- 24.7 Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000)
 - 24.7.1 The municipality has not established a preference point system as required in terms of section 2(1)(a) of the said act.
- 24.8 National Environmental Management Act, 1996 (Act No. 108 of 1996)
 - 24.8.1 The municipality did not have an environmental policy, detailed plans or clear strategies relating to environment management and/or achieving a sustainable environment as required by section 16(1)(1).
- 24.9 Environment Conservation Act, 1989 (Act No. 73 of 1989) and the National Water Act, 1998 (Act No. 36 of 1998)
 - 24.9.1 Permit conditions and the minimum requirements for waste disposal were not complied with at the Pearsten landfill site and the animal offal site in Kirkwood as required by section 20(1) of the Environment Conservation Act, 1989 (Act No. 73 of 1989).

24.9.2 Cleaning of sewer buckets into the immediate environment at Pearston did not conform to the requirements stated in the National Environmental Management Act and the National Water Act.

25. Matters of governance

The municipality did not have a risk management policy and fraud prevention plan in place for the 2006-07 financial year.

26. Internal control

Section 62(1) (c) (i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes of the matters indicated, as they relate to the five components of internal control. In some instances deficiencies existed in more than one internal control component.

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
Basis for adverse opinion					
Statutory funds					X
Trust funds					X
Fixed assets			X		X
Provision for bad debts					X
Credit balances in receivables				X	
Trade creditors			X		
Provision for leave pay			X		
Assessment rates income			X		
Traffic fine revenue			X		
Rental expense			X		
Employee costs			X		
Fruitless and wasteful expenditure					X
Irregular expenditure			X		
Internal advances					X
Emphasis of matter					
Going concern					X
Other matters					
Non-compliance with applicable legislation					X

27. Investigations in progress or completed

The council has initiated a forensic investigation into various matters and activities of the municipality. The investigation, which has been outsourced to a third party, has been ongoing and had not been finalised at the time of the audit. The matters under investigation included the following:

- 28.1.1 Activities and conduct of the previous municipal manager, including the transaction with suppliers in contravention of supply chain management policies.
- 28.1.2 Acquisition of computer and office equipment from Pinnolta and Virtual Data, respectively.

28. Unaudited supplementary schedules

The supplementary statistical information set out in appendix E 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 on it.

OTHER REPORTING RESPONSIBILITIES

Reporting on performance information

29. I was engaged to audit the performance information

Responsibility of the accounting authority

30. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the MSA.

Responsibility of the Auditor-General

- 31. I conducted my engagement in accordance with section 13 of the Public Audit Act, 2004 (Act No. 25 of 2004) read with *General Notice 646 of 2007*, issued in *Government Gazette No. 29919 of 25 May 2007*.
- 32. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate audit evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgment.
- 33. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Audit findings

34. Non-compliance with regulatory requirements

The integrated development plan of Blue Crane Route Municipality did not include an organogram as required by section 26, regulation 2(a), of the MSA and the key performance indicators and performance targets in terms of the performance management system as required by section 26(i) of the MSA.

35. Lack of sufficient appropriate audit evidence

Performance information was not received in time and consequently I was unable to determine whether a performance management system was in place as required by chapter 6 of the MSA. I was also unable to verify whether the IDP adoption process was in compliance with chapter 4 of the MSA.

APPRECIATION

36. The assistance rendered by the staff of the Blue Crane Route Municipality during the audit is sincerely appreciated.

Port Elizabeth

30 November 2007



A U D I T O R - G E N E R A L