



The Chairperson
The Audit Committee of Baviaans Municipality
PO Box 15
Willowmore
6680

Reference: 60044REG07/08
Enquiries: Naude Kotze

22 February 2008

Dear Madam

Audit committee meeting – 11 March 2008

I hereby submit the following items for discussion and deliberation by the audit committee:

1. Baviaans Municipality audit report 2006-07:

The audit report dated 31 November 2007 is attached for your attention.(Annexure A) I also include a document that explains the various audit terminology used and an overview of the audit communication process. (Annexure B & C)

Recommended Saction:

The Audit Committee should formulate a written response to the Council on the issues raised in the audit report as required by Section 166(2)(c) of the MFMA.

2. Baviaans Municipality - Audit process: 2007/08

To ensure a timely audit report for 2007/8 we have started with our pre-engagement activities and planning on a strategic level.

The following documentation relates to the pre-engagement activities and the strategic planning for the 2007/8 audit:

- (a) A copy of our audit engagement letter is attached. (Annexure D)
- (b) Audit schedule for the year (Refer to Annexure C, E and F)
- (c) Audit budget for 2007/08 (Refer to Annexure F)
- (d) Risks identified (Refer to Annexure G)

Related to the above the following issue is highlighted:

Paragraph 43-46 of ISA240 require that the auditor should make inquiries of those charged with governance to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity.

Recommended action:

It is recommended that the audit committee review the documentation provided and to provide inputs/comments to the audit team to guide the audit process at its inception.

Specific focus should be given to the identification of any additional risk area's, including matters related to fraud (as indicated above) for inclusion in the audit plan.

3. Outstanding audit fee

A matter that is impacting on the Office of the Auditors-general's independence is the level of defaulting by municipalities in paying the audit fees when due. Payment of the audit fees are due within 30 days of the invoice as stipulated in the audit engagement letter (par.38) and as also required by section 65(2)(e) of the MFMA .

The outstanding audit fee at 18 February 2008 amounted to R385 850.66, of which R340 763.54 was outstanding for longer than 60 days and constitutes non-compliance with the MFMA.

Please note that the municipality entered into a down-payment agreement with this office for the outstanding audit fee and to date has honored the conditions of the agreement.

Recommended action:

It is recommended that the Audit Committee take the matter of outstanding audit fees up with the Council as provided for in section 166(2)(a)(vii) of the MFMA.

Any queries can be directed either to myself or the audit manager - Naude Kotze.

Yours sincerely



Christo van Dyk

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Annexure's attached:

- Annexure A: Audit Report 2006/07
- Annexure B: Glossary on audit terminology used
- Annexure C: Outline of audit communication process
- Annexure D: Engagement letter
- Annexure E: Audit schedule for the 2007/08 financial year
- Annexure F: Audit budget for the 2007/08 financial year.
- Annexure G: Risk assessment for the 2007/08 financial year (work in progress)
- Annexure H: Extract: Section 166 of the MFMA

REPORT OF THE AUDITOR-GENERAL TO THE COUNCIL OF BAVIAANS MUNICIPALITY (AND THE EASTERN CAPE PROVINCIAL LEGISLATURE) ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF BAVIAANS MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2007.

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Baviaans 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 1 to 24.

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 determined by the National Treasury as set out in accounting policy note 1, to the financial statements and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). This responsibility includes:
 - designing, implementing and maintaining internal control 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 accounting estimates made by management

- overall presentation of the financial statements.
7. Paragraph 11 et seq. of the Statement of Generally Recognised Accounting Practice, GRAP 1 Presentation of Financial Statements requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is still in the process of being developed, I have determined that my audit of any disclosures made by Baviaans Municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.
 8. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis of accounting

9. The Municipality's policy is to prepare financial statements on the entity specific basis of accounting determined by the National Treasury as set out in accounting policy note 1, to the annual financial statements.

Basis for adverse opinion

Income

10. Included in total income of R 13, 2 million (2006: R 12, 2 million) as disclosed in the income statement is an amount of R 3, 6million in respect of the sale of electricity. This amount could not be evaluated for completeness, classification, accuracy, occurrence or cut - off due to the municipality not being able to submit all receipts for audit purposes. This is a contravention of section 19 of the Public Audit Act, 2004 (Act No. 25 of 2004) that requires the municipality to render assistance to the authorised auditor in executing his/her general auditing powers. Section 15(1) of the Public Audit Act ,2004 (Act No. 25 of 2004) empowers the auditor to have full and unrestricted access to any document, book or record that relates to the finances of the municipality. The audit team was unable to audit the receipts from consumers due to the required supporting documentation not being readily available. This was as a result of documentation having been misfiled, inadequate information systems and inadequate monitoring of control activities of the municipality.

Current Liabilities

11.1 Trade creditors unrecorded

Expenditure in the amount of R 2, 2 million was not accounted for at year-end, resulting in the understatement of Creditors and Expenditure and the overstatement of surplus/ (deficit) for the period. This is in contravention with Section 65(2)(b) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) which requires "the accounting officer of a municipality to take all reasonable steps to ensure that the municipality has and maintains a management, accounting and information system, which recognises expenditure when it is incurred, accounts for creditors of the municipality and accounts for payments made by the municipality".

Included in Creditors, note 14 to the annual financial statements totalling to R1, 2 million (2006: R 1, 4 million) is an amount in respect of receipts from housing projects. It was noted that these funds had been incorrectly described as motor vehicle registration fees and included as part of Creditors. Receipts in respect of housing projects should be recognised as part of Trust Funds. The effect of this is the overstatement of Creditors in the amount of R338 738 and the understatement of Trust Fund's at year-end.

11.2 Motor vehicle registration fees

Included in Creditors, note 14 to the financial statements is an amount of R 338 798 of which R 337 798 was due in respect of motor vehicle registration fees, collected during the 2002 – 03 financial year and still not paid over at 30 June 2007.

As reported in prior audit reports the non-payment of these amounts due to the department of transport was contrary to the stipulations of provincial circular 6/98 dated 4 May 1998. Interest as a result of the late payment of amounts collected on behalf of the province will be regarded as fruitless and wasteful expenditure and should be dealt with by the Municipal Manager in terms of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA).

11.3 Receipts included in creditors

Included in the Creditors balance of R1,2 million as per note 14 to the annual financial statements are amounts incorrectly allocated in respect of proceeds from the disposal of redundant assets amounting to R 108 934, salary advances and refunds from councillors in respect of medical aid contributions amounting to R 59 702 and the unspent portion of Trust Funds in respect of the Municipality's Integrated Development Plan (IDP) in the amount of R 35 176. The effect of this is an overstatement of Creditors by R 203 812, the overstatement of employee costs by R 59 702, the understatement of Revenue by R 108 934 and the understatement of Trust Funds by R 35 176 at year end.

11.4 Creditors showing no movement

It was noted that Creditors, as disclosed in the annual financial statements, included an amount of R36 127. This creditor's balance has shown no movement since the 2003-04 financial year. We were unable to establish whether the liability actually existed at year-end.

11.5 Payments incorrectly allocated to creditors

It was noted that creditors at year-end included payments made during July 2006, which had not been accrued for at the previous year-end. The effect of this is the overstatement of Creditors and Expenditure and the understatement of Surplus /(Deficit) for the period under review by R48 210 at year-end.

Debtors

12.1 Consumer debtors – provision for bad debts

It was noted that the Municipal Council has not introduced a policy for the handing over of long-outstanding debts. This is a contravention of Section 98(1) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) which states :“(1) A municipal council

must adopt by – laws to give effect to the municipality’s credit control and debt collection policy, its implementation and enforcement.”

The total Consumer Debtors disclosed in note 10 to the financial statements at 30 June 2007 amounted to R 8, 8 million (2006: R 7, 1million). Payments by consumer debtors subsequent to year-end revealed a recovery rate of 29%.

Based on a 29% recovery rate, the provision for bad debts are overstated and consumer debtors understated by approximately R1,5 million (2006: overstatement R435 673).

The above was due to inadequate control activities combined with inadequate monitoring of controls related to debtors (a financial management discipline issue).

12.2 Overstatement of debtors

Debtors were overstated and accordingly Accumulated Deficit understated in the balance sheet by R 157 218. The following issues were as a result of the Municipality not having implemented financial policies and procedures to enable proper monitoring over control activities by management.

- (a) An amount of R400 000 disclosed in note 10 to the financial statements as being “IGG to be received from Bisho”. This amount had been brought forward from the accounts of the former Willowmore TLC and had been due to council since the 1998-99 year-end. We are unable to ascertain the recoverability of this amount. No provision has been made in the annual financial statements for the non-recovery thereof.
- (b) Note 10 to the financial statements reflects advances made to certain municipal staff members and councillors at the former Steytlerville Municipality to the amount of R168 267. These debtors has been outstanding since 1997. It should be noted that in terms of the MFMA, the Municipality must recover any advances made to political office bearers and that such amounts advanced may not be written off.
- (c) A difference between the debtor’s age analysis and the book of accounts amounting to R594 224 could not be explained as management was unable to determine the reason for the difference.
- (d) Note 10 to the financial statements includes suspense accounts with a balance of R32 125. However, management failed to identify who was responsible for the repayment and therefore the recoverability of these amounts was extremely doubtful. The municipality failed to make provision for the non-payment of these amounts.
- (e) Included in note 10 is an amount of R151 050 in respect of the council’s portion of the medical aid contributions relating to retired councillors and were incorrectly disclosed as debtors as opposed to being expensed.

12.3 Value-Added Tax return

Included in Debtors in note 10 to the financial statements is an amount of R 1, 6 million (2006: R 281 914) in respect of “VAT – Net SARS claims at year-end”. The municipality has not complied with the Value Added Tax Act, Section 28 (1)(a) and (b), as it has neither compiled nor submitted the required VAT returns (form VAT 201s)

since August 2006. We were unable to satisfy ourselves as to the accuracy and completeness of the balance as disclosed in the financial statements, due to the non-availability of the necessary documentation in support of the balance. The non-rendering of the returns is considered an offence and any penalty and interest charges that may emanate from this would be considered fruitless and wasteful expenditure, which is in contravention with the MFMA and should be dealt with by the municipal manager in terms of the applicable legislation.

Investments

13. It was found that Short Term Investments disclosed as R8, 6 million (2006: R2, 3 million) in the Balance Sheet did not include all Municipal Investments at year-end. The amount held by the Municipality exceeded the amount disclosed in the financial statements by R284 326, resulting in the misstatement of Investments and accumulated deficit at year-end by this amount. This was due to the fact that the municipality had failed to implement procedures to ensure that their accounting records and those of the financial institutions reconcile.

Bank and cash

14. Bank and Cash balances as disclosed in the Balance sheet in the amount of R2,68 million (2006: R2, 6 million) was found to be understated due to the following:
 - (a) The accounting records maintained by the Municipality reflected a balance of R583 724 while the bank reconciliation prepared in support of this reflected the balance as being R688 705, resulting in a unexplained difference of R 104 981.
 - (b) It was noted that the Municipality had maintained no cash book in respect of the housing current account. In addition it was noted that this account was not reconciled, therefore an unexplained difference of R 126 627 existed between the balance as reflected in note 5 to the financial statements of R 2,1 million and the balance as per the bank statement.

The net effect of the above was the understatement of bank and cash balances at the year-end by R176 354, while overstating expenditure and other balances by R198 000 and R21 646, respectively.

Fixed assets

15. Fixed Assets in the Balance sheet totalling R337 435 (2006: R443 456) was understated due to assets totalling R232 363 being incorrectly classified as repairs and maintenance expenses for the year. This further resulted in an overstatement of repairs and maintenance expenditure for the year and an understatement of the Surplus/ (Deficit) and Fixed assets balances for the period. This was the result of inadequate policies and procedures implemented by the Municipality for the identification and recording of assets.

Unauthorised expenditure

16. It was noted that, that the actual expenditure for the following expenditure items exceeded the authorised budget. This is a contravention with sections 1 and 15 of the MFMA as the funds overspent had not been approved and in addition no appropriate adjustments to the budget was made.

The expenditure items in respect of which over spending occurred and the value of the overspending are:

Councillors' allowances	R 118 416
Administration	R 319 402
Public works	R 20 116
Water	R 4 113

Adjustment to financial statements

17. In respect of all of the above findings Management were provided the opportunity to adjust the annual financial statements but elected not to. In addition Management did not provide the auditors with management comments on issues raised and did not provide a management representation letter.

Adverse opinion

18. In my opinion, because of the significance of the matters described in the Basis for adverse opinion paragraphs, the financial statements of Baviaans 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 the entity specific basis of accounting as set out in accounting policy note 1 to the annual financial statements and in the manner required by the MFMA.

Emphasis of matter

I draw attention to the following matters:

Going concern

19. The Mayoral foreword set out on page 4 of the annual financial statements indicates a concern that the Baviaans Municipality will face serious financial problems if consumer debt is not controlled. At 30 June 2007 the Municipality's liabilities exceeded its assets by R 2, 1 million (2006: R 2,8 million). This, in combination with other factors as described below, may indicate that the Municipality is at risk to continue operating as a going concern:
- (a) At least 35% of funds were not financed by investments.
 - (b) Debtors, before taking into account the effect of the provision for bad debts, increased by R 1, 7 million from R 7, 1 million to R 8, 8 million. The average number of days outstanding was 514 days, which was considered to be high.
 - (c) The average repayment rate by consumers was 29%.
 - (d) Consumer deposits represented less than 2% of total outstanding consumer debtors.
 - (e) Accumulated deficit totalled R 2, 1 million before the effect of audit differences mentioned in this audit report.
 - (f) The continued reliance on funding in the form of subsidies and grants from Provincial and National Government.
 - (g) Average creditor days outstanding equalled 38 days. This was in contravention of section 65(2)(e) of the MFMA which requires that "*the accounting officer must take*

all reasonable steps to ensure that all money owing by the municipality be paid within 30 days of receiving the relevant invoice or statement, unless prescribed otherwise “.

Deficiencies in the annual financial statements

20. During our review of the annual financial statements various shortcomings were identified that indicate that the financial statements do not comply with the minimum disclosure requirements of IMFO. These, inter alia, includes:
- (a) Contingent liabilities at year end had not been disclosed.
 - (b) No details on capital commitments at year end.
 - (c) Classification of leases are not disclosed.
 - (d) Insufficient disclosure in note 16 to the annual financial statements on councillor remuneration paid.
 - (e) The disclosures in note 15 to the annual financial statements on assessment rates is incomplete
 - (f) The disclosures in note 10 to the annual financial statements on debtors are incomplete.
 - (g) The chief financial officer report in the annual financial statements is incomplete.
 - (h) Details disclosed in Appendix F to the annual financial statements is incomplete.

OTHER MATTERS

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

Non-compliance with applicable legislation

21. The following non compliance with legislation was in evidence during the audit:
- 22.1 Municipal Finance Management Act No.56 of 2003
- (a) No disclosure of details and amounts in respect of amounts owed by councillors in respect of services (MFMA Section 124(1)(b)).
 - (b) The Municipality did not charge interest in respect of outstanding accounts (MFMA Section 64(2) (g)).
 - (c) Non-implementation of accounting, management and information systems to achieve the desired effects as set out in the act with respect to asset and liability management (MFMA Section 63(2) (a)).
 - (d) Monthly reports in respect of the budget were not tabled (MFMA Section 71).

- (e) Disclosure relating to intergovernmental and other allocations and other compulsory disclosure have not been made in the financial statements.(MFMA Sections 123 and 125).

22.2 Municipal Property Rates Act, 2004 (Act No. 6 of 2004)

The Municipality has not conducted a general valuation since August 2000 which is contrary to section 30(2) of the act. .

22.3 Municipal Systems Act, 2000 (Act No. 32 of 2000)

- (a) The Municipality failed to ensure that the Municipal Manager had an annually revised performance contract. (MSA Section 57(1)(b))
- (b) Employment contracts have not been introduced for all financial staff. (MSA Section 57(1)(a))
- (c) The Municipality did not ensure that the Municipal Manager had an annually revised performance contract (MSA Section 57(2)(b)).

22.4 Division of Revenue Act, Act 2 of 2006 (DoRA)

The Municipality failed to prepare the required reconciliations and maintain the required payment schedules as determined by section 33(2) of the DoRA.

Internal control

23. 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 opinion					
Income	X		X		
Current Liabilities	X		X		X
Debtors	X		X		X
Investments			X		X
Bank and Cash			X		X
Fixed assets			X		X
Unauthorised expenditure	X				X
Adjustment to financial statement	X			X	
Emphasis of matter					
Going concern	X	X			

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
Deficiencies in the annual financial statements			X		
Other matters					
Non-compliance with applicable laws and regulations			X		X

23.1 Control environment

The Municipality did not establish and maintain an environment throughout the organisation that set a positive and supportive attitude toward internal control and conscientious management.

23.2 Risk assessment

The Municipality did not establish clear and consistent entity-wide objectives and supporting activity level objectives following a thorough process of identification of risks, both from internal and external sources which may affect the ability of the Municipality to meet these objectives. The Municipality has not performed an analysis of risks, nor has it developed an appropriate approach for risk management. This did not enable the Municipality to implement mechanisms to identify changes that may affect the Municipality's ability to achieve its missions, goals and objectives.

23.3 Control activities

The Municipality did not manage and implement appropriate policies, procedures, techniques and control mechanisms to ensure adherence to established directives, which would ensure that proper control activities have been developed for each of the Municipality's activities and that the activities were properly applied.

23.4 Monitoring

The Municipality did not manage to implement procedures to monitor internal control on an ongoing basis as part of the process of carrying out its regular activities. This should ensure that management are aware of their responsibility for internal control and control monitoring, and that separate evaluations of internal control are periodically performed and that deficiencies found are investigated.

OTHER REPORTING RESPONSIBILITIES

Reporting on performance information

24. I was engaged to audit the performance information.

Responsibility of the accounting officer for the performance information

25. 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 Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

Responsibility of the Auditor-General

26. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 646 of 2007*, issued in *Government Gazette No. 29919 of 25 May 2007* and section 45 of the MSA.

27. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

28. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Non-compliance with regulatory requirements

29. The following requirements of the MSA in respect of the Municipality's Integrated Development Plan (IDP) and performance measurement system have not been adhered to:

- (a) A financial plan which included budgeted projections for at least the following three years. (MSA Section 26 (h))
- (b) An indication of the financial resources that was available for capital project developments and operational expenditure.
- (c) The inclusion of a financial strategy which defined sound financial management and expenditure control and the identified means of increasing revenues and external funding for the municipality.
- (d) The budget should include all development priorities and measurable objectives that have been formulated to be specific and clear.
- (e) The performance management system should set appropriate key performance indicators as a yardstick for measuring performance, including the outcomes and impact in relation to the development priorities and objectives detailed in the IDP. (MSA Section 41(1) (a))

APPRECIATION

30. The assistance rendered by the staff of the Bavians 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

GLOSSARY OF TERMS

A

Adverse opinion – An adverse opinion is expressed when the effect of a disagreement with management regarding departures from the financial reporting framework is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements.

Audit evidence – All of the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Audit evidence includes the information contained in the accounting records underlying the financial statements and other information.

Audit matters of governance interest – Those matters that arise from the audit of financial statements and, in the opinion of the auditor, are both important and relevant to those charged with governance in overseeing the financial reporting and disclosure process. Audit matters of governance interest include only those matters that have come to the attention of the auditor as a result of the performance of the audit.

Audit of financial statements – The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.

C

Comprehensive basis of accounting – A comprehensive basis of accounting comprises a set of criteria used in preparing financial statements which applies to all material items and which has substantial support.

Control activities – Those policies and procedures that help ensure that management directives are carried out. Control activities are a component of internal control. (See Internal control)

Control environment – Includes the governance and management functions and the attitudes, awareness and actions of those charged with governance and management concerning the entity's internal control and its importance in the entity. The control environment is a component of internal control. (See Internal control)

D

Disclaimer of opinion – A disclaimer of opinion is expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence to form an opinion and accordingly is unable to express an opinion on the financial statements.

Documentation – The material (working papers) prepared by and for, or obtained and retained by the auditor in connection with the performance of the audit. Working papers may be in the form of data stored on paper, film, electronic media or other media.

E

Emphasis of matter paragraph(s) – An auditor's report may be modified by adding an emphasis of matter paragraph(s) to highlight a matter affecting the financial statements which is included in a note to the financial statements that more extensively discusses the matter. The addition of such an emphasis of matter paragraph(s) does not affect the auditor's opinion on whether the financial statements are fairly presented. The auditor may also modify the auditor's report by using an emphasis of matter paragraph(s) to report matters other than those affecting the financial statements, such as material inconsistency of other information included in the annual report.

G

Governance – Describes the role of persons entrusted with the supervision, control and direction of an entity. Those charged with governance ordinarily are accountable for ensuring that the entity achieves its objectives, financial reporting, and reporting to interested parties. Those charged with governance include management only when it performs such functions.

Information system relevant to financial reporting:

A component of internal control that includes the financial reporting system, and consists of the procedures and records established to initiate, record, process and report entity transactions (as well as events and conditions) and to maintain accountability for the related assets, liabilities and equity.

Internal control: The internal control system is the whole system of financial and other controls, including the organisational structure, methods, procedures and internal audit, established by those charged with governance, management and other personnel to:

- assist in conducting the business of the audited entity in a regular economic, efficient and effective manner
- ensure adherence to management policies
- ensure compliance with applicable laws and regulations
- safeguard assets and resources
- secure the accuracy and completeness of accounting records
- produce timely and reliable financial and management information

It provides framework for considering how different aspects of an entity's internal control may affect the audit. The auditor's primary consideration is whether, and how, a specific control prevents or detects and corrects material misstatements in classes of transactions, account balances, or disclosures, and their related assertions.

Internal control consists of the following components:

- (a) The *control environment*. The control environment includes the governance and management functions and the attitudes, awareness, and actions of those charged with governance and management concerning the entity's internal control and its importance in the entity. The control environment sets the tone of an organisation, influencing the control consciousness of its staff. It is the foundation for all other components of internal control, providing discipline and structure.

Elements of the control environment are:

- Communication and enforcement of integrity and ethical values through policy statements, codes of conduct and by example
- Commitment to competence
- The "tone at the top", i.e. management's philosophy and operating style
- Organisational structure
- Human resource policies and practices
- Assignment of authority and responsibility
- Participation by those charged with governance.

(b) *Risk assessment* process; Risk assessment is the process of identifying and analysing relevant risks from internal and external sources to the achievement of the entity's objectives, as identified in the strategic plan, and determining how the risks should be managed.

Risk assessment implies:

- risk identification
- risk evaluation
- assessment of the risk appetite of the organisation
- development of responses to the risk profile.

(c) The *information system*, including the related business processes, relevant to financial reporting, and communication: Relevant and reliable information, both financial and non-financial, and the communication of this information are essential to realising all internal control objectives. In order to help ensure the quality of information and reporting, carry out the internal control activities and responsibilities, and make monitoring more effective and efficient, the internal control system should be fully and clearly documented and should be available for examination.

(d) *Control activities* Control activities are the policies, procedures, techniques and mechanisms established to address/mitigate risks and to achieve the entity's objectives. They are an integral part of the entity's planning, implementing, reviewing and accountability for stewardship of government resources and achieving effective results.

Control activities include a range of detective and preventive control activities as diverse as, for example:

- authorisation and approval procedures
- segregation of duties
- access restrictions to and accountability for resources and records
- verifications
- reconciliations
- reviews by management of performance
- controls over information processing (application controls)
- general IT controls
- proper execution of transactions and events
- accurate and timely recording of transactions and events
- appropriate documentation of transactions and internal control
- reviews of operations and processes
- establishment and review of performance measures and indicators
- supervision
- human capital management

(e) *Monitoring of controls:* Internal control systems should be monitored to assess the quality of the systems' performance over time. Monitoring is accomplished through routine activities, separate evaluations, or a combination of both. It involves assessment by appropriate personnel of the design and operation of controls on a suitable timely basis and the taking of necessary actions. It includes regular management and supervisory comparisons, reconciliations and actions.

Ongoing monitoring

- Ongoing monitoring of internal control should be built into the normal, recurring operating activities of an entity. It includes regular management and supervisory activities, and other actions personnel take in performing their duties.
- Ongoing monitoring activities cover each of the internal control components and involve action against irregular, unethical, uneconomical, inefficient and ineffective internal control systems.

Separate evaluations.

- The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures.
- Separate evaluations may take the form of self-assessments as well as reviews by internal and external auditors of control design and the direct testing of internal control.

L

Limitation on scope – A limitation on the scope of the auditor's work may sometimes be imposed by the entity (for example, when the terms of the engagement specify that the auditor will not carry out an audit procedure that the auditor believes is necessary). A scope limitation may be imposed by circumstances (for example, when the timing of the auditor's appointment is such that the auditor is unable to observe the counting of physical inventories). It may also arise when, in the opinion of the auditor, the entity's accounting records are inadequate or when the auditor is unable to carry out an audit procedure believed desirable.

M

Management fraud – Fraud involving one or more members of management or those charged with governance.

Material inconsistency – Exists when other information contradicts information contained in the audited financial statements. A material inconsistency may raise doubt about the audit conclusions drawn from audit evidence previously obtained and, possibly, about the basis for the auditor's opinion on the financial statements.

Material misstatement of fact – Exists in other information when such information, not related to matters appearing in the audited financial statements, is incorrectly stated or presented.

Material weakness – A weakness in internal control that could have a material effect on the financial statements.

Materiality – Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather.

Misstatement – A misstatement of the financial statements that can arise from fraud or error (also see Fraud).

Modified auditor's report – An auditor's report is considered to be modified if either an emphasis of matter paragraph(s) is added to the report or if the opinion is other than unqualified.

N

Non-compliance – Refers to acts of omission or commission by the entity being audited, either intentional or unintentional, that are contrary to the prevailing laws or regulations.

O

Opinion – The auditor's report contains a clear written expression of opinion on the financial statements as a whole. An unqualified opinion is expressed when the auditor concludes that the financial statements give a true and fair view (or are presented fairly, in all material respects) in accordance with the applicable financial reporting framework (also see Modified auditor's report).

Other information/Other matters – Financial or non-financial information (other than the financial statements or the auditor's report thereon) included – either by law or custom – in the annual report.

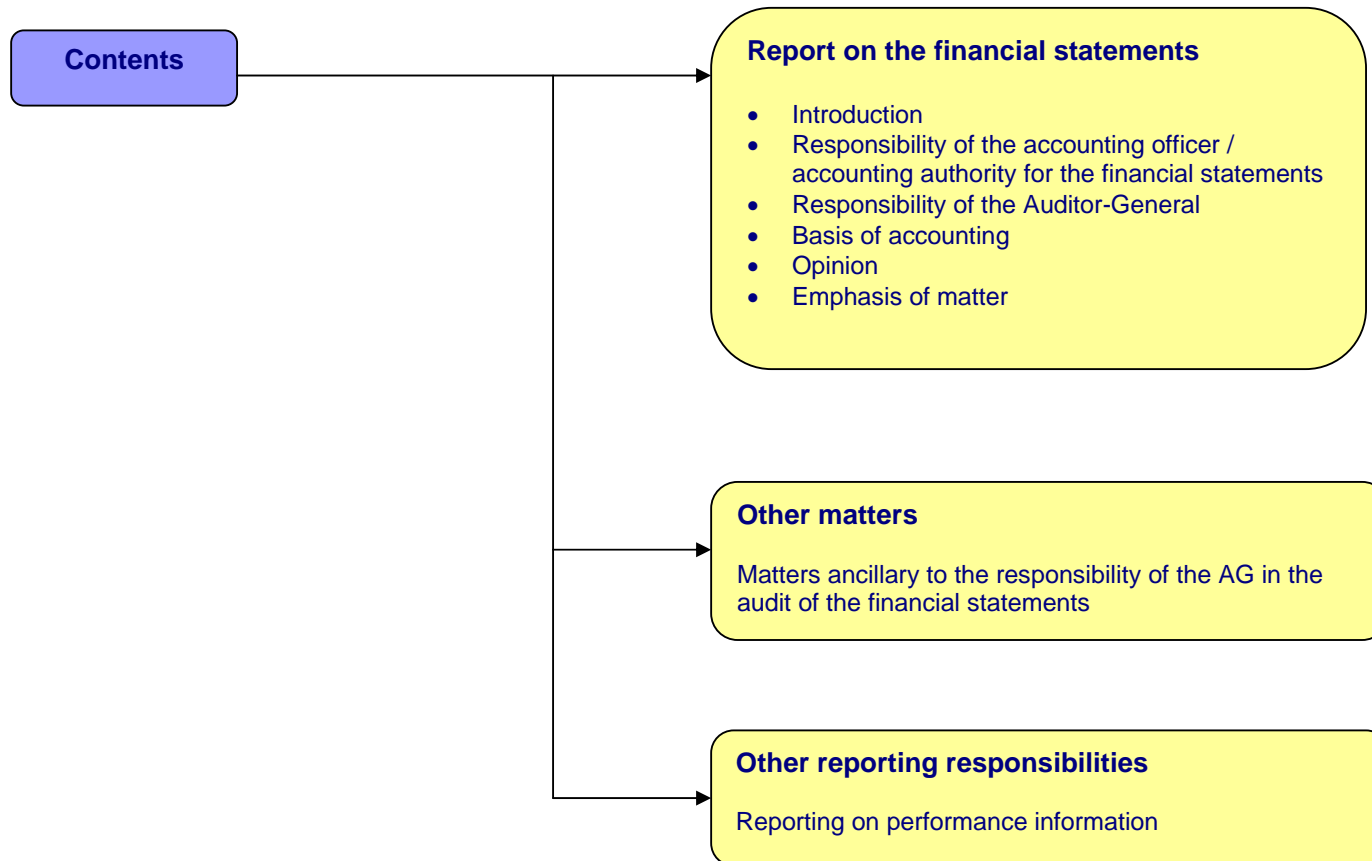
P

Planning – Involves establishing the overall audit strategy for the engagement and developing an audit plan, in order to reduce audit risk to an acceptably low level.

Q

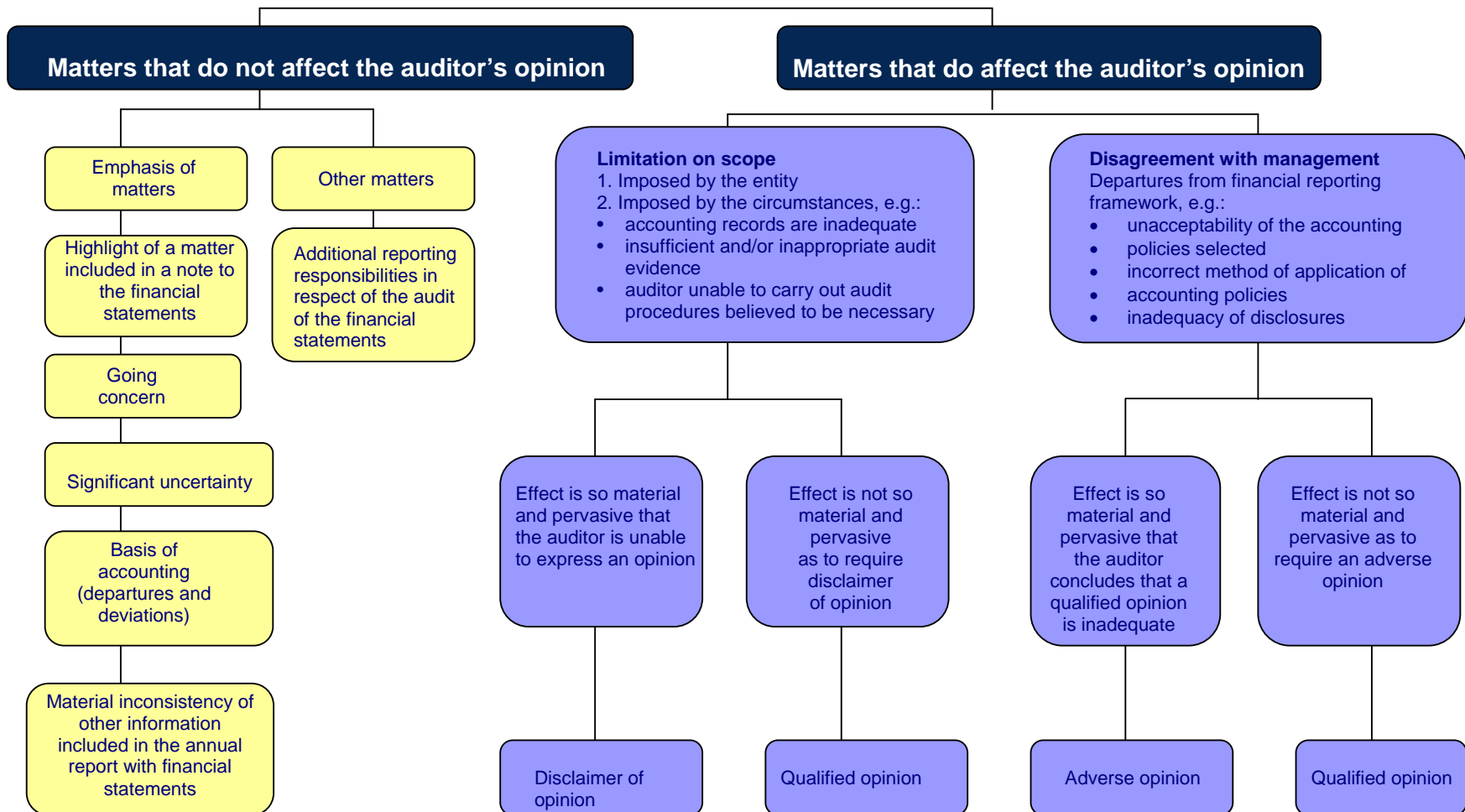
Qualified opinion – A qualified opinion is expressed when the auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with management regarding departures from financial reporting framework, or limitation on scope is not so material and pervasive as to require an adverse opinion or a disclaimer of opinion.

Report of the Auditor-General on the financial statements and performance information



Modification of the audit opinion

Modification of the audit opinion: This decision tree illustrates the circumstances. Under which the audit report would be modified



Communication in the audit process

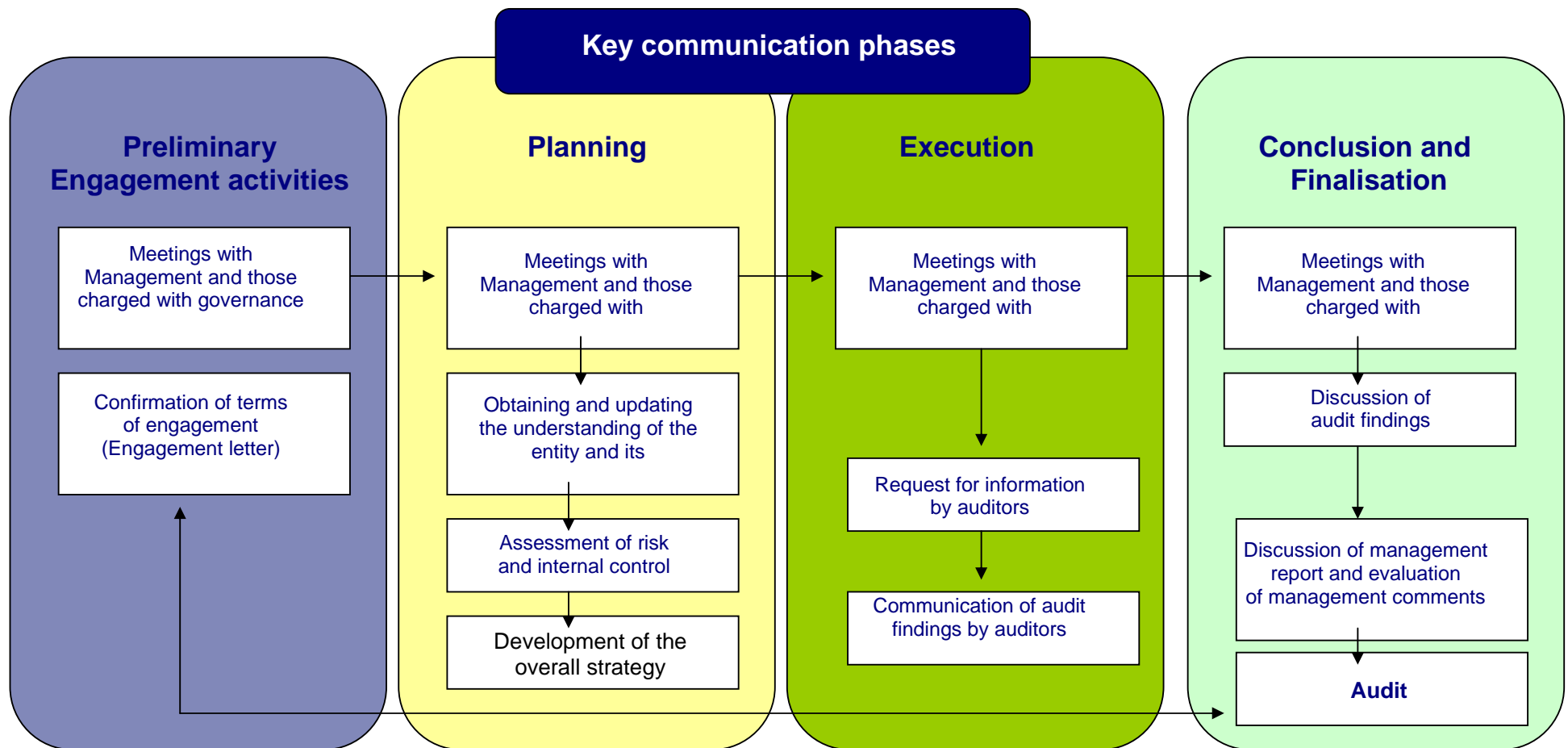
Those charged with governance

The persons (not necessarily a natural person) with responsibility of overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. This may include some executive members of management.

Key role players at an entity

Management

The persons who have executive responsibility for the conduct of the entity's operations.



The Accounting Officer
Baviaans Municipality
P.O. Box 15
Willowmore
6680

18 February 2008

Reference: 60044REG07/08
Enquiries: Naude Kotze

Dear Sir

AUDIT ENGAGEMENT LETTER

Introduction

1. The consolidated financial statements and performance information of Baviaans Municipality are subject to auditing by the Auditor-General (AG) in terms of section 188 of the Constitution of the Republic of South Africa, 1996 read with sections 4, 15 and 20 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA).

The purpose of this letter is to outline:

- the terms of the audit engagement and the nature, and limitations, of the annual audit
 - the respective responsibilities of the auditor and the accounting officer in the annual audit.
2. The terms of the audit engagement are set out below. Once these terms have been agreed, this letter will remain effective until a new audit engagement letter is issued. We would be grateful if you could confirm your agreement to the terms of this letter by signing and returning the enclosed copy, or contact us if the terms of our engagement are not in accordance with your understanding.

Objectives of the annual audit

3. The objectives of the annual audit are:
 - to express an independent opinion on the consolidated financial statements prepared in accordance with the applicable financial reporting framework and legislation
 - to report on other matters relevant to compliance with any applicable legislation relating to financial matters, financial management, other related matters and performance against predetermined objectives.

The auditing standards applied when conducting the annual audit

4. We will conduct our audit in accordance with the International Standards on Auditing read with *General Notice No. 544 of 2006*, issued in *Government Gazette No. 28954 of 2006*.

5. As set out in *General Notice No. 646 of 2007*, issued in *Government Gazette No. 29919 of 2007*, a phasing-in approach to the auditing of performance information has been adopted until such time as the environment promotes a state of readiness for audits to be conducted to provide reasonable assurance on the performance information in the form of an audit opinion or conclusion.

Planning and performing the audit

6. The auditing standards require us to plan and perform the audit so as to obtain all the information and explanations which we consider necessary in order to obtain reasonable assurance that the consolidated financial statements are free of material misstatements, whether caused by fraud or error.
7. Our audit involves performing procedures to obtain audit evidence about the information presented in the consolidated financial statements and performance information and compliance with any applicable legislation related to financial matters, financial management and other related matters. Audit procedures generally include:
 - determining whether all accounting policies are appropriate, in terms of the applicable financial reporting framework, and are applied consistently
 - determining whether financial management controls, relevant to the preparation of the financial statements, are working and can be relied on to produce complete and accurate data, including an assessment of the underlying root causes of any identified weaknesses in internal control
 - determining significant risks of material misstatement, whether due to fraud or error
 - evaluating the reasonableness of accounting estimates and judgements made by management
 - verifying samples of transactions and account balances
 - confirming year-end balances
 - performing analyses to identify anomalies in reported data
 - determining whether all financial statement disclosures are adequate
 - determining whether information supplied is relevant, reliable, comparable and understandable
 - evaluating the fair presentation of the financial statements
 - considering whether the financial statements, after adjustments, are consistent with the auditor's understanding of the entity and its environment
 - considering whether the financial statements, including disclosures in the notes, faithfully represent the underlying transactions and events in a manner that fairly presents the information in the context of the applicable financial reporting framework.
8. We do not examine every transaction, nor do we guarantee complete accuracy of the consolidated financial statements or performance information, or compliance with all applicable legislation. Because of the test nature and other inherent limitations of an audit, together with the inherent limitations of any information and internal control systems, there is an unavoidable risk that some, even material, misstatements might remain undiscovered.
9. We evaluate the overall adequacy of the presentation of information in the consolidated financial statements and the manner in which the performance information is reported. We also read other information accompanying the consolidated financial statements to identify whether there are material inconsistencies in the audited consolidated financial statements and the performance information.

Matters of waste and productivity

10. During the audit we also consider whether the municipality has obtained and applied its resources in an economical and efficient manner and whether public money has been wasted or used in an inefficient manner.

Materiality

11. Materiality is one of the main factors affecting our judgement on the areas to be tested and the timing, nature and extent of the tests and procedures we will perform during the audit. In planning and performing the annual audit, we aim to obtain reasonable assurance that the financial statements are free from material misstatements, whether caused by fraud or error. Material misstatements are differences in or omissions of amounts and disclosures that would affect a reader's overall understanding of the consolidated financial statements.
12. In evaluating whether a matter is material, both its amount (quantitative materiality) and its nature (qualitative materiality) will be considered. We may choose to revise our assessment of materiality at any time during the audit, before signing the audit report.

Reports arising from the annual audit

13. The reports arising from the annual audit are:
 - the audit report on the financial statements
 - the management report provided to the accounting officer.

The auditor's report

14. The audit report arising from the annual audit contains, inter alia:
 - (a) an opinion as to whether or not the consolidated financial statements, in all material respects, fairly present the financial position, results of operations and cash flows of Baviaans Municipality, in accordance with the applicable financial reporting framework and in the manner required by the MFMA.
 - (b) an elaboration on non-compliance with any applicable legislation relating to financial matters, financial management and other related matters
 - (c) root causes of matters reported which relate to the ineffectiveness or absence of appropriate internal controls
 - (d) material corrections to the financial statements submitted for audit
 - (e) matters of governance
 - (f) value-for-money matters
 - (g) a report on the audit of performance information (refer to paragraph 5 above).
15. The audit opinion provides readers with reasonable audit assurance on whether the consolidated financial statements are free of material misstatements and comply with the applicable financial reporting framework.
16. The audit opinion does not:
 - provide a guarantee of absolute accuracy in the consolidated financial statements
 - express a view on the adequacy of the municipality's information and internal control systems or the effectiveness and efficiency with which the accounting officer has conducted its affairs
 - guarantee the municipality's future viability.

Management report to the accounting office

17. Another important report arising from the annual audit is the management report. The management report is provided to the accounting officer and communicates any matters that came to our attention during the audit which, in our opinion, are relevant to the municipality. For example, we will report matters that came to our attention concerning:
- significant departures from the applicable financial reporting framework
 - inappropriate accounting practices and policies
 - uncorrected misstatements noted during the audit (current year and prior year), the reasons for, and the implications of the failure to correct, the misstatements and the potential effect on the audit report and future financial statements
 - non-identification, non-disclosure or inappropriateness of disclosures of related-party relationships or transactions
 - non-compliance with any applicable legislation relating to financial matters
 - any significant weaknesses in, or our observations on, the design, implementation or operating effectiveness of internal controls which are identified as the root cause of matters included in the audit report
 - significant difficulties encountered during the audit, including such matters as: delays in management providing information, an unnecessarily brief time in which to complete the audit, extensive unexpected effort to obtain sufficient appropriate audit evidence, unavailability of information and restrictions imposed on the audit by management
 - significant deficiencies in governance structures or processes and significant decisions or actions by senior management that lack appropriate authorisation
 - events or conditions that may cast significant doubt on the municipality's ability to continue as a going concern, including whether the going-concern assumption is appropriate in preparing the financial statements and the adequacy of disclosures in the financial statements
 - instances where fraud has been identified or suspected
 - other significant matters such as misstatements of fact or material inconsistencies in information accompanying the financial statements
 - matters concerning the reporting and management of performance against predetermined objectives.
18. The report will include the auditor's recommendation on how the matter reported should be addressed. Management will be requested to indicate agreement with the facts of the finding and comment on how the matter will be rectified and the anticipated date by which such action will have been completed. The accounting officer remains responsible for all comments submitted. We request that the accounting officer be available to provide the required responses within the agreed time frames.
19. The report will be issued at least at the conclusion of the audit or at such intervals during the audit as may be appropriate in the circumstances.

Other communication to those charged with governance

20. In addition to the audit report and the management report, it will be necessary to communicate on other matters with those charged with governance, which may include persons in the municipality's governance structure other than the accounting officer and management, such as the audit committee.
21. The form, timing and general content of this communication will depend on the circumstances and may include:
- agreement on the appropriate persons within the governance structure with whom to communicate

- the allocation/delegation of responsibilities between those charged with governance and management
 - gaining an understanding of the municipality and its environment
 - the municipality's objectives and strategies and the related risks that may result in misstatement of the financial statements
 - identifying appropriate sources of audit evidence
 - providing information about specific transactions or events
 - providing information on objectives and strategies and related risks
 - comment on the acceptability of significant accounting practices, including the selection of, and changes in, significant accounting policies and the application of new accounting pronouncements
 - cooperation with, or reliance on, internal audit
 - knowledge of any actual, suspected or alleged fraud
 - matters that may warrant particular attention during the audit and any areas where additional audit procedures might be requested to be undertaken
 - any significant communications with the regulators
 - other matters that may influence the audit and any responses to previous communications
 - any of the matters included in the management report.
22. Although most of this communication will be initiated by the auditor, communication from the accounting officer will also be required. Such two-way communication is important in developing an understanding of the matters related to the audit and a constructive working relationship. To this end we will require that those charged with governance make themselves available at times agreed with the auditors to provide information relevant to the audit.

Our independence

23. It is essential that we remain independent of the municipality. This involves being, and appearing to be, free of any interest that, whatever its actual effect, might be deemed incompatible with integrity, objectivity and independence. In this regard we have a code of conduct as prescribed by section (3)(b) of the PAA, which governs our professional conduct.
24. To protect our independence, specific limitations are placed on us in accepting engagements with the municipality other than the annual audit. We may accept certain types of other engagements, subject to the requirements of the auditing standards and section 5(1)(a) of the PAA.
25. Any such other engagements will be the subject of a separate written arrangement between the municipality and us.

Responsibilities of management and those charged with governance

General responsibilities

26. We remind you that the responsibility for the preparation of consolidated financial statements that fairly present the financial position, financial performance and cash flows of the municipality in accordance with the applicable financial reporting framework is that of management, with the oversight of the accounting officer. Our audit report will explain that management is responsible for the fair presentation of the financial statements in accordance with the applicable financial reporting framework and this responsibility includes:
- designing, implementing and maintaining internal controls relevant to the preparation of financial statements that are free from misstatement, whether due to fraud or error
 - selecting and applying appropriate accounting policies
 - making accounting estimates that are appropriate in the circumstances.

27. In addition, the accounting officer is responsible for ensuring, through oversight of management, that the municipality establishes and maintains internal control to provide reasonable assurance with regard to the effectiveness and efficiency of operations and compliance with applicable legislation. The systems of financial and risk management and internal control should provide reasonable assurance that adopted policies and prescribed procedures are adhered to for the prevention and detection of errors and irregularities, including fraud and illegal acts. They should also provide for the regular monitoring of performance against objectives, and ensure that waste is minimised and business is conducted with due regard to probity.

Specific responsibilities

28. The accounting officer has specific responsibilities relating to the preparation of the consolidated financial statements and performance information and in respect of financial management and accountability matters. These specific responsibilities are set out in the attachment to this letter. We assume that the accounting officer is familiar with those responsibilities and, where necessary, has obtained advice on them.

Representation letter

29. As part of our normal audit procedures, we will request written confirmation of representations that we received during the course of our audit.

General matters

Statutory reporting deadlines

30. In order to meet the statutory reporting deadlines we are dependent on receiving your municipality financial statements and performance information within two months after the end of the financial year, that is, by 31 August 2008 and the consolidated financial statements by 31 August 2008. These statements and information must:
- comply with all applicable legislation
 - comply **in full** with the prescribed applicable financial reporting framework
 - be supported by proper information systems and complete evidential information.
31. To assist us with our audit, we will request sight of all documents or statements, including the draft annual report that is to be issued with the consolidated financial statements, by no later than 10 August 2008.
32. We will complete the annual audit and submit the audit report to the accounting officer within three months of receipt of the consolidated financial statements and performance information, unless that is not practicable because of the condition of the financial statements and performance information or for some other reason beyond our control. In these circumstances a suitable date/timetable, to be agreed to by all parties, will be determined.
33. All supporting information for the financial statements should be available during the course of the audit and should not be withheld until the last day of submission.
34. In order for us to meet the timelines as set out in the MFMA, any agreed audit adjustments and all outstanding additional documentation related to the audit queries raised must be completed/received **by no later than 30 October 2008**. Anything received after this date will not be taken into consideration for purposes of finalising the audit. Should the nature of the audit evidence received by 30 October 2008 result in an extension of the reporting date, this will result in a modified audit opinion. The audit timetable, reflecting key timelines, will be discussed with you.

Working papers

35. The working papers we produce in carrying out the audit are our property. Working papers are confidential documents of the Auditor-General.

Access to documents and information

36. We look forward to full cooperation from your staff and we trust that they will make available to us all requested records, documentation and other information in connection with our audit as contemplated by section 15 of the PAA.

Contracted auditors

37. It is possible that your audit will be conducted by an independent audit firm contracted by us. These auditors will conduct the audit under our supervision and on the same terms and conditions as set out in this letter. The Auditor-General remains responsible for the audit and the audit report.

Fees

38. Our fees are based on the time spent on your affairs by our managers and staff plus out-of-pocket expenses. Time may be spent on the audit at your premises or our premises as necessary. Individual hourly rates vary according to the experience and skills required and the responsibility involved. Our fees will be billed at monthly intervals during the course of the audit and settlement is due within 30 days of presentation of our invoices.

Liaison

39. The content of this letter and the accompanying document will be used by the Auditor-General as the basis for a relationship survey after completion of the audit process.
40. If you have any questions about the annual audit generally, or have any concerns about the quality of service you receive, you should contact Mr Naude Kotze at (041) 367 - 2823 as soon as possible.

Staff accommodation and resources

41. Section 19 of the Public Audit Act, 2004 requires you to render reasonable assistance to the Auditor-General or the authorised auditors performing this audit. You are further required to accede free of charge to all reasonable requests of the Auditor-General or authorised auditors to facilitate the expeditious completion of the audit, including the provision of suitable office accommodation and parking on your premises, logistical support and access to office equipment. Please ensure that the authorised auditors are made aware of any security and administrative arrangements with which they should comply.

Acknowledgement of the terms of the engagement

42. Please acknowledge receipt of this letter and confirm the terms of the audit engagement by signing the enclosed copy of the letter in the space provided and returning it to Mr Naude Kotze (audit manager).
43. If you require any further information, or wish to discuss the terms of the audit engagement further before replying, please do not hesitate to contact me.

ANNEXURE TO THE AUDIT ENGAGEMENT LETTER

RESPONSIBILITIES OF THE ACCOUNTING OFFICER/CHAIRPERSON OF THE ACCOUNTING AUTHORITY AND THE AUDITOR IN RESPECT OF THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION

Responsibilities of the accounting officer	Responsibilities of the auditor
<p>The accounting office is required by the MFMA to prepare financial statements that comply with the applicable financial reporting framework.</p> <p>The accounting officer is also required to prepare performance information. These financial statements and performance information must fairly present the financial position of the municipality's operations and cash flows and service performance achievements.</p> <p>The accounting officer must also ensure that any accompanying information in the annual report is consistent with that reported in the audited financial statements and performance information.</p> <p>The accounting officer required by the MFMA to prepare the financial statements and furnish them for auditing within two months of balance date, that is, by 31 August 2008. It is normal practice for the accounting officer/chairperson of the accounting authority to set their own timetable in order to comply with statutory reporting deadlines.</p>	<p>Our responsibilities are to conduct an annual audit and to form an opinion on whether the municipality's financial statements comply with the applicable financial reporting framework.</p> <p>We form an opinion on whether these financial statements fairly present the municipality's financial position and the results of the municipality's operations and cash flows.</p> <p>We report on material shortcomings in the process, systems and procedures of reporting against predetermined objectives that may come to the attention of the auditor during the audit and that may impact on the public interest. This reporting will be contained in the "other reporting responsibilities" section of the audit report.</p> <p>We will also review other accompanying information to the financial statements and performance information to identify whether there are material inconsistencies with the audited financial statements and performance information.</p> <p>As part of our audit, we will ask the accounting officer/chairperson of the accounting authority for written confirmation concerning representations made to us in connection with the financial statements and performance information. In particular, we will seek confirmation that:</p> <ul style="list-style-type: none"> • the adoption of the going-concern assumption is appropriate • all applicable legislative, regulatory and contractual requirements have been complied with • all material transactions have been included in the financial statements • uncorrected misstatements noted during the audit are immaterial to the financial

	<p>statements.</p> <p>Any representation made does not in any way reduce our responsibility to perform appropriate audit procedures and make enquiries.</p>
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Responsibilities in respect of the information systems

Responsibilities of the accounting officer	Responsibilities of the auditor
<p>The accounting officer is responsible for maintaining records that:</p> <ul style="list-style-type: none"> • correctly record and explain the transactions of the municipality • enable the municipality to monitor the resources, activities and entities under its control • enable the financial position of the municipality to be determined with reasonable accuracy at any time • enable the accounting officer to prepare financial statements and performance information that comply with the MFMA and other applicable legislation and allow the financial statements and performance information to be readily and properly audited. 	<p>We will examine whether the municipality kept proper accounting records.</p> <p>We will perform sufficient tests to obtain reasonable audit assurance as to whether the underlying records are reliable and adequate as a basis for the preparation of the financial statements and performance information.</p> <p>Where, in our opinion, the records are not sufficiently reliable or accurate to enable the preparation of the financial statements and performance information and we are unable to obtain the evidence we require by other means, we will need to consider the impact on our audit report.</p>

Responsibilities in respect of information and internal control systems

Responsibilities of the accounting officer	Responsibilities of the auditor
<p>The accounting officer is responsible for establishing and maintaining information and internal control systems, supported by written policies and procedures, designed to provide reasonable assurance as to the integrity and reliability of financial and non-financial reporting.</p>	<p>The annual audit is not designed to identify all significant weaknesses in the municipality's information and internal control systems. We review the accounting and internal control systems only to the extent required to enable us to express an opinion on the financial statements and report on performance information.</p> <p>We will report to the accounting officer separately any weaknesses in the municipality's information and internal control systems, provided that the weaknesses come to our notice and we consider that they may be of relevance to the municipality. Any report will provide constructive recommendations to assist</p>

	you and your management team in addressing any weaknesses in the municipality's information and internal control systems.
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Responsibilities in respect of the prevention and detection of fraud and error

Responsibilities of the accounting officer	Responsibilities of the auditor
<p>The accounting officer is responsible for the prevention and detection of fraud and error through the application of internal control systems (appropriate to the size of the municipality) supported by written policies and procedures.</p> <p>In the event of identified, suspected or alleged fraud, the accounting officer has to deal with the matter as set out in the MFMA. The auditor should be informed immediately of any identified, suspected or alleged fraud.</p>	<p>We will design our audit to obtain reasonable, but not absolute, assurance of detecting fraud or error that would have a material effect on the financial statements and performance information.</p> <p>Although we will review the accounting and internal control systems only to the extent required for us to express an opinion on the financial statements and report on performance information, we will:</p> <ul style="list-style-type: none"> • assess the effectiveness of internal control systems and procedures by which fraud and error are prevented and detected within the municipality. • report to the accounting officer weaknesses in internal control systems and procedures related to monitoring the prevention and detection of fraud and error, provided that the weaknesses came to our notice and we consider that they could be of relevance to the municipality. <p>As part of our audit, we will ask the accounting officer for written confirmation that the municipality has disclosed to us all known instances of fraud or suspected fraud affecting it.</p> <p>If we become aware of the possible existence of fraud – whether through the application of audit procedures, advice from the municipality's management or any other means – it is our responsibility to communicate this to the accounting officer with the expectation that action will be taken in compliance with the municipality's fraud prevention policy.</p>

Responsibilities in respect of compliance with laws and regulations

Responsibilities of the accounting officer	Responsibilities of the auditor
<p>The accounting officer is responsible for ensuring that systems, policies and procedures (appropriate to the size of the municipality) are in operation which will ensure that all applicable legislative, regulatory and contractual requirements that apply to the activities and functions of the municipality are complied with. Such systems, policies and procedures should be documented.</p>	<p>We will assess during the course of the audit whether the municipality has systems, policies and procedures in operation (to the extent that such systems, policies and procedures are appropriate – given the size of the municipality) to ensure compliance with those legislative, regulatory and contractual requirements that we consider to be material.</p> <p>The way in which instances of non-compliance that come to our attention are reported will depend on their significance. All significant instances of non-compliance will be reported to the accounting officer and included in the audit report.</p> <p>We will also report to the accounting officer weaknesses that we observe in internal control systems, policies and procedures relating to monitoring compliance with laws, regulations and contractual requirements, where relevant.</p>

Responsibilities to establish and maintain appropriate standards of conduct and personal integrity

Responsibilities of the accounting officer	Responsibilities of the auditor
<p>The accounting officer should at all times take all practicable steps to ensure that its members and employees maintain high standards of conduct and personal integrity. The municipality’s expected standards of conduct and personal integrity should preferably be documented in a code of conduct and, where applicable, be supported by policies and procedures.</p>	<p>During the audit we will consider whether the accounting officer maintains high standards of conduct and personal integrity. Specifically, we will remain alert to significant instances where members and employees of the municipality may not have acted in accordance with the standards of conduct and personal integrity that are expected of them.</p>

Responsibilities in regard to conflict of interest and related parties

Responsibilities of the accounting officer	Responsibilities of the auditor
<p>The accounting officer should have policies and procedures in operation to ensure that its</p>	<p>In order to help determine whether members have carried out their duties free from bias, we</p>

members carry out their duties free from bias. In particular, the accounting officer must comply with the requirements of the MFMA and DoRA.

The accounting officer should maintain a full and complete record of related parties and their interests. It is the responsibility of the accounting officer to record and disclose related-party transactions in the financial statements – in accordance with generally recognised accounting practice.

will review information provided by the accounting officer that identifies related parties and will be alert to other material related-party transactions. For related-party transactions that come to our attention, we will check that the accounting officer has complied with any statutory requirements relating to conflicts of interest and whether these transactions have been properly recorded and disclosed in the financial statements.

Baviaans Municipality

Proposed audit schedule
2007/08

No.	Event	Original	Comments/ Re-scheduled
1	Initial meeting with those charged with governance	11 March 2008	Audit committee meeting
2	Complete overall audit strategy	30 April	
3	Complete detailed planning	May 08	
4	Attend audit committee	11 March 2008	As per Audit Committee schedules
5	Perform pre audit	May to June	
6	Attend physical asset and inventory counts	30-Jun-08	
7	Send confirmation letters	July 08	
8	Commence with audit	May 2008	Systems descriptions, finalise detail planning per component
		May – June 2008	Perform interim audit work recurring type transactions (Revenue and Expenditure cycles)
		End June 2008	Perform year end balances verification procedures
		August to September 2008	Perform final execution phase of audit
		October 2008	Conclude and reporting
9	Audit steering committee		As per Audit Committee meeting schedule
10	Communication with those charged with governance	June 2008	
11	Receive financial statements from auditee for audit	29 August 2008	
12	Acknowledge receipt of AFS and undertake high level review	8 September 2008	
13	Receive performance information for audit	30 September 2008	To verify and agree date with Management

No.	Event	Original	Comments/ Re-scheduled
14	Issue draft management letter	8 October 2008	
15	Audit steering committee		
16	Receive final management comments approved by MM	22 October 2008	
17	Issue final management letter	31 October 2008	
18	Audit file reviewed by SM	27 October 2008	
19	Prepare audit report	22 October 2007	
20	Final pre-issuance review	28 October 2008	
21	Amend and correct audit file	31 October 2008	
22	Submit file to BE for review	n/a	
23	Receive annual report for review	To be clarified with management - to submit draft by 30 Oct	
24	Finalise audit report	3 November 2008	
25	Submit audit report to Auditee	November 2008	
26	Complete and tidy audit file	November 2008	

ANNEXURE F

Baviaans Municipality

Audit: 2007/08

Budget:

Hours 838
 Estimated fee* R361 565

Senior Manager Christo van Dyk
Manager/ Controller Naude Kotze
Contracted in firm Ramathe

AUDIT PHASE	TIMING	HOURS
Strategic Planning	March to April	42
System descriptions	May to June	84
Follow up: Prior year	May to June	41
Detailed planning for interim audit (certain components only)	May to June	42
Interim detailed testing: Test of controls	May to June	67
Year end procedures for 30 June	June	41
Detailed planning: post year end procedures	August	126
Detailed testing of balance sheet items	August to September	84
High level review of financial statements	September	42
Detailed verification /substantive testing	September	126
Reporting phase	October	126
Finalisation	November	17
	TOTAL	838

*** Note**

The audit budget and fee is estimations figures and subject to change after assessment of risk level after planning is completed and charge out tariffs rates and scope of work that may change.

ANNEXURE G

Baviaans Municipality

Audit 2007/08

Risk identification

Note: Audit Risk identified are based on prior year knowledge (based on audit report findings) and subject to change and to be reconsidered after completion of the planning phase for the audit

Most of the risk identified is as a result of inadequate internal control mechanisms in place, relating to:

- Control environment
- Risk management
- Activity controls
- Information systems and communication
- Monitoring

<u>Component</u>	<u>Risk identified</u>	<u>Likelihood</u>	<u>Impact</u>	<u>Significant: Y/N</u>
Revenue	Scope limitations – supporting documentation may not be presented for audit purposes.	HIGH	HIGH	Y
Trust Funds	Housing funds may be incorrectly classified as vehicle registration fee.	HIGH	HIGH	Y
Creditors	Expenditure may not be accounted for at year-end, resulting in the understatement of Creditors and Expenditure and the overstatement of surplus/ (deficit) for the period.	HIGH	HIGH	Y
Creditors	Interest may be incurred because creditors are not paid timely resulting in fruitless and wasteful expenditure.	HIGH	HIGH	Y
Creditors	There is a risk that receipts may be recorded as a creditor and not recorded as revenue resulting in incorrect classification.	HIGH	HIGH	Y
Creditors	There may be creditors that are included in the financial statement for which there is no obligation to pay these creditors.	HIGH	HIGH	Y

Creditors	There is a risk that creditors and expenditure may be recorded in the incorrect financial year.	HIGH	HIGH	Y
Creditors	Creditors may be incorrect classified as a provision.	HIGH	HIGH	Y
Debtors	No collection policy may result in debtors been incorrectly valued because of the inappropriate provision for bad debts.	HIGH	HIGH	Y
VAT	Interest and penalties may be imposed by SARS because of non-submission of VAT 201 returns. Interest and penalties would then be classified as fruitless and wasteful expenditure.	HIGH	HIGH	Y
Investments	Investments may not all be recorded or carried at appropriately value.	HIGH	HIGH	Y
Bank and cash	There is a risk that bank records do not agree to the accounting records, because of the ineffective controls in place.	HIGH	HIGH	Y
PPE	There may be a risk that PPE may be incomplete because of the incorrect classification of repairs and maintenance.	HIGH	HIGH	Y
Budget	There is a risk of unauthorised expenditure where expenditure incurred exceeds the expenditure budgeted for.	HIGH	HIGH	Y
General	Management may not co-operate with the auditors because errors are not corrected, no prior year management letter was signed nor management comments received for audit findings.	HIGH	HIGH	Y
Going Concern	The municipality may not be a going concern because of its involvement position as well as poor working capital and cash management.	HIGH	HIGH	Y
Annual Financial Statement	Annual Financial Statement may not be prepared in terms of the applicable accounting framework.	HIGH	HIGH	Y
Compliance	There is a risk that the municipality my not comply with the applicable	HIGH	HIGH	Y

<p>Compliance</p>	<p>laws and regulations. Example:</p> <ul style="list-style-type: none"> • MFMA • DoRA • MSA • MPRA <p>Effective internal controls are not in place as required in terms of section 62(1)(c)(i) of the MFMA that states the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control.</p>	<p>HIGH</p>	<p>HIGH</p>	<p>Y</p>
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Extract: Section 166 of MFMA (Act No. 56 of 2003)

166. Audit committees.—

(1) Each municipality and each municipal entity must have an audit committee, subject to subsection (6).

(2) An audit committee is an independent advisory body which must—

(a) advise the municipal council, the political office-bearers, the accounting officer and the management staff of the municipality, or the board of directors, the accounting officer and the management staff of the municipal entity, on matters relating to—

- (i) internal financial control and internal audits;
- (ii) risk management;
- (iii) accounting policies;
- (iv) the adequacy, reliability and accuracy of financial reporting and information;
- (v) performance management;
- (vi) effective governance;
- (vii) compliance with this Act, the annual Division of Revenue Act and any other applicable legislation;
- (viii) performance evaluation; and
- (ix) any other issues referred to it by the municipality or municipal entity;

(b) review the annual financial statements to provide the council of the municipality or, in the case of a municipal entity, the council of the parent municipality and the board of directors of the entity, with an authoritative and credible view of the financial position of the municipality or municipal entity, its efficiency and effectiveness and its overall level of compliance with this Act, the annual Division of Revenue Act and any other applicable legislation;

(c) respond to the council on any issues raised by the Auditor-General in the audit report;

(d) carry out such investigations into the financial affairs of the municipality or municipal entity as the council of the municipality, or in the case of a municipal entity, the council of the parent municipality or the board of directors of the entity, may request; and

(e) perform such other functions as may be prescribed.

(3) In performing its functions, an audit committee—

(a) has access to the financial records and other relevant information of the municipality or municipal entity; and

(b) must liaise with—

- (i) the internal audit unit of the municipality; and
- (ii) the person designated by the Auditor-General to audit the financial statements of the municipality or municipal entity.

(4) An audit committee must—

- (a) consist of at least three persons with appropriate experience, of whom the majority may not be in the employ of the municipality or municipal entity, as the case may be; and
- (b) meet as often as is required to perform its functions, but at least four times a year.

(5) The members of an audit committee must be appointed by the council of the municipality or, in the case of a municipal entity, by the council of the parent municipality. One of the members who is not in the employ of the municipality or municipal entity, must be appointed as the chairperson of the committee. No councillor may be a member of an audit committee.

- (6) A single audit committee may be established for—
- (a) a district municipality and the local municipalities within that district municipality; and
 - (b) a municipality and municipal entities under its sole control.