

**REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL OF THE BAVIAANS MUNICIPALITY ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF BAVIAANS MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2008.**

**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 2008, 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 28.

**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) and the Division of Revenue Act, 2007 (Act No. 1 of 2007 (DoRA). 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 and General Notice 616 of 2008, issued in Government Gazette No. 31057 of 15 May 2008. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance on 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. 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 determined by the National Treasury, as set out in note 1 of the accounting policies.

#### **Basis for qualified opinion**

##### **Creditors**

9. Included in the Creditors balance of R1.9 million in the balance sheet, is an amount of R811 399 that relates to Trade Creditors (see Note 14 to the financial statements). The trade creditors balance in the financial statements of R811 399 does not agree to the trial balance where an amount of R0 is reflected. As this matter emanates from a prior year unexplained difference, the creditors balance and retained income balances may be overstated by this amount.

##### **Debtors**

10. Included in the debtors balance of R3.7 million in the balance sheet, is an amount of R1.1 million that relates to "Other debtors" (see Note 10 to the financial statements). The municipality did not claim value added tax on certain expenses to the amount of R456 992. This resulted in the balance for "Other debtors" being understated whilst the affected expenditure items being overstated by an amount of R456 992. Also affected is the retained income balance which will be understated.
11. The current provision for doubtful debts of R2 492 799 as disclosed in note 10 to the financial statements is estimated to be understated by R2.5 million. Management acknowledged the under provision during the audit and indicated that council approval was needed for the adjustment. The adjustment was not made and as a result the consumer debtor balance is therefore overstated and the provision for doubtful debt balance is understated by an estimated R2.5Million.

##### **Fixed assets**

12. Fixed Assets in the Balance sheet totalling R216 963 (2007: R337 435) was understated due to assets totalling R98 144 being incorrectly classified as repairs and maintenance expenses during the year. This resulted in an overstatement of repairs and maintenance expenditure for the year and an understatement of the Retained Income and the 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.

##### **Fruitless and Wasteful Expenditure**

13. The municipality has omitted disclosure of potential fruitless and wasteful expenditure of R83 064 , which was incurred during the financial year. The matter was pointed out during the audit to management who did not dispute the audit finding. Note 35 to the financial statements was not updated by management with the result that Section 125(2)(d) of the MFMA which requires disclosure of this matter in the annual financial statements, was not adhered to.

##### **Disclosure**

14. 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 no details on capital commitments at year end and classification of leases not disclosed. In addition, although management included notes 27 to

35 to the financial statements to deal with the compulsory disclosures as required by section 123 to 125 of the MFMA, these notes have no amounts nor detail to give effect to the MFMA requirements and are therefore understated.

The non-disclosure occurred due to inadequate controls in place over financial reporting to ensure the completeness of the financial statements.

### **Qualified Opinion**

15. In my opinion, except for the effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements of the Baviaans Municipality as at 30 June 2008 and its financial performance and cash flows for the year then ended have been prepared in all material respects in accordance with the basis of accounting as set out in note 1 of the accounting policies to the annual financial statements and in the manner required by the MFMA and DoRA.

### **OTHER MATTERS**

Without qualifying my audit opinion, I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

#### **Non-compliance with applicable legislation**

16. The following non-compliance with legislation was in evidence during the audit:

- 16.1 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.

- 16.2 Municipal Systems Act, 2000 (Act No. 32 of 2000)(MSA)

Performance contracts have not been introduced for all staff who reports direct to the Municipal manager as set out in section 57(1)(a) of the act.

- 16.3 MFMA

- (a) No disclosure as set out in section 124(1)(a) of the act of details and amounts in respect of amounts owed by councilors in respect of services.
- (b) Non-implementation of accounting, management and information systems to achieve the desired effects as set out in section 63(2)(a) of the act with respect to asset and liability management.
- (c) Disclosure relating to intergovernmental and other allocations and other compulsory disclosure have not been made in the financial statements as set out in sections 123 and 125 of the act. The more important ones being :
  - 123(1)(a) – any allocations received by the municipality.
  - 123(2)(b) – any allocations made by the municipality.
  - 123(3)(c) – how the allocations were spent.
  - 123(4)(d) – whether the municipality has complied with the conditions of the allocations received.
  - 125(2)(d) – any material losses and any material irregular or fruitless and wasteful expenditure.
- (d) The municipal entity does not comply with section 111 of MFMA as there is currently no supply chain management policy in place
- (e) Completeness of (trade creditors) payables to the amount of R22 639 could not be confirmed as there are indications that all payables were not recorded, resulting in the

understatement of Creditors and Expenditure and the overstatement of surplus for the year. This is in contravention with section 65(2)(b) of 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”

**Internal control**

17. 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 that give rise to the inefficiencies in the system of internal control which led to the qualified opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
<b>Basis for opinion</b>					
Creditors	X		X		
Debtors			X	X	
Fixed assets			X		
Fruitless and wasteful expenditure	X		X		
Disclosure	X				
<p><u>Control environment</u>: establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.</p> <p><u>Risk assessment</u>: involves the identification and analysis by management of relevant financial reporting risks to achieve predetermined financial reporting objectives.</p> <p><u>Control activities</u>: policies, procedures and practices that ensure that management’s financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.</p> <p><u>Information and communication</u>: supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allows people to carry out their financial reporting duties.</p> <p><u>Monitoring</u>: covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within a process.</p>					

**Matters of governance**

18. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of certain key governance responsibilities, which we have assessed as follows:

<b>Matter of governance</b>	<b>Yes</b>	<b>No</b>
<b>Audit committee</b>		
▪ The Municipality had an audit committee in operation throughout the financial year.	√	
▪ The audit committee operates in accordance with approved written terms of reference.	√	
▪ The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.		√
<b>Internal audit</b>		
▪ The Municipality had an internal audit function in operation throughout the financial year.	√	
▪ The internal audit function operates in terms of an approved internal audit plan.	√	
▪ The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.		√
<b>Other matters of governance</b>		
▪ The annual financial statements were submitted for audit as per the legislated deadlines as set out in section 126 of the MFMA .	√	
▪ The financial statements submitted for audit were not subject to any material amendments resulting from the audit.		√
▪ No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.		√
▪ The prior year's external audit recommendations have been substantially implemented.		√
▪ There are documented policies and procedures and controls systems to ensure reliability of financial information reporting.		√
▪ There are documented policies and procedures and control systems to ensure compliance with applicable laws and regulations.		√
▪ The information systems were appropriate to facilitate the preparation of financial statements that are free from material misstatement.		√
▪ Delegations of responsibilities are in place.	√	
▪ Supply chain management policies and procedures were appropriately applied.		√
▪ There is a functioning performance management system.		√
<b>Implementation of Standards of Generally Recognised Accounting Practice (GRAP)</b>		
▪ The municipality submitted an implementation plan, detailing progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 30 October 2007.	√	
▪ The municipality substantially complied with the implementation plan it submitted to the National Treasury and the relevant provincial treasury before 30 October 2007, detailing its progress towards full compliance with GRAP.	√	
▪ The municipality submitted an implementation plan, detailing further progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 31 March 2008.		√

## **Unaudited supplementary schedules**

19. The supplementary information set out as Appendices to the financial statements does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

## **OTHER REPORTING RESPONSIBILITIES**

### **Reporting on performance information**

20. I have audited the performance information for the year end 30 June 2008.
21. There are not adequate policies and procedures to address the accurate compilation of the performance reports.
22. The internal auditors did not audit the performance measurements on a continuous basis, as required by section 45(a) of the MSA and did not submit quarterly reports on their audits to the municipal manager and the audit committee.

### **Responsibility of the accounting officer for the performance information**

23. 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 MSA.

### **Responsibility of the Auditor-General**

24. I conducted my engagement in accordance with section 13 of the PAA read with General Notice 616 of 2008, issued in Government Gazette No. 31057 of 15 May 2008 and section 45 of the MSA.
25. 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.
26. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings as reported below.

### **Audit findings (performance information)**

- 27 Non-compliance with regulatory requirements
  - 27.1 The municipality did not submit performance information as required in terms of General Notice 616 issued in May 2008 and section 46 of the MSA, as required by section 121(3)(c) of the MFMA. The municipality has not implemented a performance management system to report on institutional performance.
  - 27.2 The Municipal Planning and Performance Management Regulations, 2001 (GNR 796 of 24 August 2001) (hereafter referred to as the regulation) issued in terms of Chapter 6 of the MSA regulates the establishment and operation of the Performance Management System and related functions.
  - 27.3 The Baviaans Municipality did not have a properly functioning performance audit committee during the 2007/08 financial year. The existing audit committee was also not utilised as the performance audit committee, as allowed for in terms of regulation 14(2)(a) of the Municipal Planning and Management Regulations, 2001.

27.4 The internal audit processes and procedures did not include assessments of the extent to which the Baviaans Municipality's performance measurements were reliable in measuring performance of the municipality on key as well as general key performance indicators, as required in terms of section 45(a) of the MSA.

27.5 The internal auditors of the Baviaans Municipality did not audit the performance measurements on a continuous basis and did not submit quarterly reports on their audits to the municipal manager and the audit committee as provided for in terms of regulation 14(1)(c) of the Municipal Planning and Management Regulations, 2001.

#### **APPRECIATION**

28 The assistance rendered by the staff of the Baviaans Municipality during the audit is sincerely appreciated.

Port Elizabeth

30 November 2008



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