
4.7 The Audit General's Report

Final Draft Report

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 THE BAVIAANS MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2009.

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 2009, the income statement and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages 51 to 100.

The accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation of these financial statements in accordance with the entity-specific basis of accounting as set out in accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with the Public Audit Act, 2004 (PAA), my responsibility is to express an opinion on these financial statements based on the 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.

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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. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
 6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis for qualified opinion

Appropriations

7. Appropriations for the year as disclosed in note 19 to the financial statements amounted to R5.5 million. Included in this amount are adjustments to the net amount of R4.2 million of which the supporting documentation could not be provided for audit purposes.
8. Included in the R4.2 million above is an amount of R2.6 million disclosed as VAT adjustments in the appropriation account which relate to a correction for current and prior year VAT errors.
9. The adjustment of R6.7 million disclosed in note 19 relates to the clearing of a salary control account and not to debtors as currently indicated.
10. Adequate supporting documentation was not available to substantiate these journal entries and I was unable to confirm by alternative means whether the journals were valid and processed at the correct amounts. These entries were also not reviewed by a person more independent of the preparer of the journals.

Short-term investments

11. Short-term investments' amounting to R16.5 million as disclosed in note 11 to the financial statements is understated by R1.8 million when compared to the amounts reflected in the bank statements. The difference relates to interest being capitalised and consequently revenue in the income statement is also understated by this amount.
12. The error identified is as a result of lack of ongoing monitoring and supervision to enable an assessment of the effectiveness of internal control over financial reporting.

Qualified opinion

13. 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 2009 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.

Other matters

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

Non-compliance with applicable legislation

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

14. A general valuation which included additions and improvements to property was performed during the year; however, the assessment rates were not calculated based on the new valuations. These new valuations will only be implemented from 1 July 2009, which is contrary to section 30(2) of the act.

Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA)

15. Confirmation that the MEC for Local Government was informed of unauthorised and fruitless and wasteful expenditure as required by section 32(4) of the MFMA could not be provided for audit purposes.
16. The control over bad debts written off and the recordkeeping as well as the reconciliation to the amounts approved by Council, was not as required by Section 64(2) (e) (ii) and (f) of the MFMA.
17. The above non-compliance was the result of actions not taken to address risks to the achievement of financial reporting objectives and an absence of effective monitoring.

Governance framework

18. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and other key governance requirements addressed below.

Internal control deficiencies

19. 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.

Par. no.	Basis for qualified opinion	CE	RA	CA	IC	M
7	Appropriation account	5		3		
11	Investments	5				1

Legend	
CE = Control environment	
The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.	1
Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.	2
Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.	3
Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting.	4
The accounting officer does not exercise oversight responsibility over financial reporting and internal control.	5
Management's philosophy and operating style do not promote effective control over financial reporting.	6
The entity does not have individuals competent in financial reporting and related matters.	7
RA = Risk assessment	
Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting.	1
The entity does not identify risks to the achievement of financial reporting objectives.	2
The entity does not analyse the likelihood and impact of the risks identified.	3
The entity does not determine a risk strategy/action plan to manage identified risks.	4
The potential for material misstatement due to fraud is not considered.	5

CA = Control activities	
There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.	1
General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.	2
Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.	3
Actions are not taken to address risks to the achievement of financial reporting objectives.	4
Control activities are not selected and developed to mitigate risks over financial reporting.	5
Policies and procedures related to financial reporting are not established and communicated.	6
Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system.	7
IC = Information and communication	
Pertinent information is not identified and captured in a form and time frame to support financial reporting.	1
Information required to implement internal control is not available to personnel to enable internal control responsibilities.	2
Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel.	3
M = Monitoring	
Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting.	1
Neither reviews by internal audit or the audit committee nor self-assessments are evident.	2
Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken.	3

Other key governance requirements

20. 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 I have assessed as follows:

Clear trail of supporting documentation that is easily available and provided in a timely manner			
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.	✓	
Quality of financial statements and related management information			
2.	The financial statements were not subject to any material amendments resulting from the audit.		✓
3.	The annual report was submitted for consideration prior to the tabling of the auditor's report.	✓	
Timeliness of financial statements and management information			
4.	The annual financial statements were submitted for auditing as per the legislated deadlines section 126 of the MFMA.	✓	
Availability of key officials during audit			
5.	Key officials were available throughout the audit process.	✓	
Development of and compliance with risk management, effective internal control and governance practices			
6.	Audit committee		
	<ul style="list-style-type: none"> The municipality had an audit committee in operation throughout the financial year. 	✓	
	<ul style="list-style-type: none"> The audit committee operates in accordance with approved, written terms of reference. 	✓	
	<ul style="list-style-type: none"> The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA. 	✓	
7.	Internal audit		
	<ul style="list-style-type: none"> The municipality had an internal audit function in operation throughout the financial year. 	✓	
	<ul style="list-style-type: none"> The internal audit function operates in terms of an approved internal audit plan. 	✓	
	<ul style="list-style-type: none"> The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA. 	✓	
8.	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.		✓
9.	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.		✓

10.	The information systems were appropriate to facilitate the preparation of the financial statements.		✓
11.	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 62(c) (i)/95(c) (i) of the MFMA.		✓
12.	Delegations of responsibility are in place, as set out in section 79 of the MFMA.	✓	
Follow-up of audit findings			
13.	The prior year audit findings have been substantially addressed.		✓
14.	Oversight resolutions have been substantially implemented.	✓	
Issues relating to the reporting of performance information			
15.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.	✓	
16.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.	✓	
17.	A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the municipality against its mandate, predetermined objectives, outputs, indicators and section 68 of the MFMA.	✓	
18.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.	✓	

21. The finance section does not have adequate skills and resources, which resulted in material amendments to the financial statements after submission for auditing.
22. Due to the size of the municipality there are not sufficient employees available to ensure that there is adequate segregation of duties.
23. The audit committee has not fulfilled all its responsibilities as it did not review the financial statements prior to submission for auditing.

Unaudited supplementary schedules

24. 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.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

25. I have reviewed the performance information for the year ended 30 June 2009 as set out on pages 21 to 24

The accounting officer's responsibility for the performance information

26. 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).

The Auditor-General's responsibility

27. 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.
28. 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.
29. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Audit findings (performance information)

Non-compliance with legislation

30. The municipality did not develop and implement mechanisms, systems and processes to detect and correct measures where under-performance has been identified, as required in terms of section 41(1) (d) of the MSA.

Internal auditing of performance information

31. The internal auditors of the Municipality did not audit the performance measurements and did not submit quarterly reports on their audits to the municipal manager and audit committee, as required by regulation 14(1) (c) of Local Government: Municipal Planning and Performance Management Regulations, 2001 (published under GN R796 in GG22605 of 24 August 2001). As such the audit committee did not review the information as required by regulation 14(2) read with section 166 of the MFMA.

Content of annual performance report

32. Comparative prior year performance information and measures taken to improve performance were not disclosed in the annual performance report, as required by section 46(1) of the MSA.

APPRECIATION

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

Port Elizabeth

30 November 2009



**AUDITOR - GENERAL
SOUTH AFRICA**

Auditing to build public confidence

Response by Baviaans Municipality to above report is set out in Annexure A