

XREFS TO MR [WP P1.6] AND EX'S TO SUPPORT OPINION .

AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS OF BAVIAANS MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Baviaans Municipality, which comprise the statement of financial position as at 30 June 2010, the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory information, and the accounting officer's report, as set out on pages **xx to xx**.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and in the manner required by the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). This responsibility includes designing, implementing and maintaining internal 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; and making accounting estimates that are reasonable in the circumstances.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of South Africa, 1996 (Act No. 108 of 1996), section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on the financial statements based on the audit in accordance with International Standards on Auditing and *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was not able to obtain reasonable assurance to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Receivables and revenue

4. Sufficient appropriate audit evidence could not be provided for journals and transactions in respect of receivables and revenue to the value of R7,3 million. No alternative procedures could be performed to obtain reasonable assurance that these journals and transactions were valid, accurate and that the receivables and revenue as disclosed were complete. The limitation experienced was a result of a lack of proper record keeping. MR PAR 9 [ITEM1+2+9] - EX 103 +118+119+147
5. Consumer debtors at year-end are disclosed in note 12 to the amount of R5,1 million. The existence of debtors amounting to R623 645 could not be confirmed and as a result trade receivables were overstated by this amount. MR PAR 8 [ITEM6+7] - EX 217+118+119
6. In addition, the provision for debt impairment as disclosed in note 12 appears understated by R701 138. The provision for debt impairment was calculated by management using the 31 March 2010 debtor's age analysis instead of the debtor's age analysis as at 30 June 2010. MR PAR 8 [ITEM1] - EX 199

Trade payables and expenditure

7. Sufficient appropriate audit evidence could not be provided for journals and transactions in respect of creditors and expenditure to the value of R14,2 million. No alternative procedures could be performed to obtain reasonable assurance that these journals and transactions were valid, accurate and that the creditors and expenditure as disclosed were complete. The limitation experienced impacts, both operating and capital expenditure, and was a result of a lack of proper record keeping. MR PAR 9 [ITEM3+4+5+10+12]
8. Trade payables at year-end amounts to R6,5 million. This balance was overstated by R733 745 as a result of incorrect/invalid accruals. This overstatement also impacted on expenditure to the same amount. MR PAR 8 [ITEM5] - EX 178
9. Total operating expenditure for the year amounted to R35 million. Sufficient appropriate audit evidence could not be provided for the debt impairment expenditure included in this expenditure to the value of R497 382. No alternative procedures could be performed to obtain reasonable assurance that the journals and transactions were valid, accurate and complete. MR PAR 9 [LAST ITEM] - EX 199

Value added tax (VAT) receivable

10. The VAT receivable balance at year-end was disclosed at R1,5 million. The South African Revenue Services confirmed that, per their records, they did not owe the municipality this amount. In addition, a recalculation indicated that the amount of VAT receivable as disclosed on the statement of financial position is overstated by an amount of R 858 073. MR PAR 8 [ITEM4] - EX 72



Restatement of corresponding figures and correction of prior period of errors

Journal entries processed to correct the prior period errors (note 36) totalling R8,8 million and pertaining to the restatement of comparative figures (note 37) totalling R27,2 million did not contain sufficient supporting documentation. Consequently, I was unable to satisfy myself that these disclosures were fairly stated. MR PAR 9 [ITEM 7 &8] - EX 98

Statement of financial position

11. The following individual account balances were found to be misstated which, in aggregate, resulted in the material misstatement of the statement of financial position as a result of uncorrected errors totalling R1,7 million:

Statement of financial position account	Amount
Provisions	340 634
Fixed assets (PPE)	340 634
Receivables	306 603
Cash and bank	223 365
Conditional grants	191 867
Accumulated surplus	185 382
Investments	96 474
Accounts payable	92 049
Finance leases	4 176
Total	1 781 184

The misstatements arose primarily as a result of the provision on landfill site being overstated [EX174] as a result of the illegal operation of the sites, the existence of debtors (receivables) not confirmed [EX118 +119, cash and bank shortage between bank reconciliation and balance in trial balance, misallocation of interest [EX164] and expensed amounts which was due to be processed in the new financial year..

Statement of financial performance

12. The following individual account balances were found to be misstated which, in aggregate, resulted in uncorrected errors totalling R580 497:

Statement of financial performance – accounts	Amount
Revenue	417 163
Expenditure	158 883
Employee costs	4 451
Total	580 497



The misstatements arose primarily as a result of:

- repairs and maintenance expenditure that was incorrectly capitalised [EX 132];
- the existence of debtors not being confirmed which in turn affects the validity of revenue [EX118 +119];
- misallocation of interest[EX64]; and
- expensed amounts which were due subsequent to year-end.

Disclaimer of opinion

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

Emphasis of matters

14. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

15. As disclosed in notes 36 and 37 to the financial statements, the corresponding figures for 30 June 2009 have been restated as a result of errors discovered during the 2010 financial year and changes in the accounting policies as a result of the first-time implementation of GRAP.

Unauthorised, fruitless and wasteful and irregular expenditure

16. As disclosed in note 41 to the financial statements, unauthorised expenditure to the amount of R1 million was incurred.

17. As disclosed in note 42 to the financial statements, fruitless and wasteful expenditure to the amount of R276 368 was identified during the audit, as the municipality incurred penalties and interest amounting to R116 934 due to assessments raised by the South African Revenue Services in respect of PAYE, UIF and SDL. The municipality could not provide all the supporting documentation for expenditure in all instances, resulting in such expenditure to be deemed as fruitless and wasteful expenditure to the amount of R161 030. The municipality did not disclose any fruitless and wasteful expenditure in the financial statements submitted on 31 August 2010.

18. As disclosed in note 43 to the financial statements, irregular expenditure to the amount of R11,4 million was identified during the audit, as a supply chain management policy had not been adhered to in all instances. The municipality did not disclose any irregular expenditure in the financial statements submitted on 31 August 2010.

Material underspending of the capital budget (infrastructure)

19. As disclosed in note 4 to the annual financial statements, additions to infrastructure assets via the capital expenditure amounting to R8,3 million were incurred during the year. This actual capital expenditure represents an underspending of R19,6 million or 66% of the original capital budget which amounted to R24,9 million.

Additional matter

20. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited supplementary schedules

21. The supplementary annexures, set out on pages ... to ..., do not form part of the financial statements and are 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

22. As required by the PAA and in terms of *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*, I include below my findings on the report on predetermined objectives and compliance with key laws and regulations, namely The MFMA, Municipal Regulations (Regulations – GNR/GN), DoRA, Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA), the Municipal Structures Act, 1998 (Act No. 117 of 1998) and regulations and financial management (internal control).

Predetermined objectives

23. Material findings on the report on predetermined objectives, as set out on pages ... to ..., are reported below:

Non-compliance with regulatory and reporting requirement

Usefulness of information

24. The following criteria were used to assess the usefulness of the planned and reported performance:

- Consistency: Has the department/entity/municipality/municipal entity reported on its performance with regard to its objectives, indicators and targets in its approved strategic plan/corporate plan/annual performance plan/integrated development plan, that is, are the objectives, indicators and targets consistent between planning and reporting documents?
- Relevance: Is there a clear and logical link between the objectives, outcomes, outputs, indicators and performance targets?
- Measurability: Are objectives made measurable by means of indicators and targets? Are indicators well defined and verifiable, and are targets specific, measurable and time bound?

The following findings relate to the above criteria



- Development priorities with corresponding targets, as listed in the SDBIP for 2009-10, do not have specific budgeted amounts allocated to them, but merely a vote reference, and others have a nil budget.
- There is no split in the budget reference to the vote for a specific target.
- Also, no specific explanation could be given for the "annual target" percentage stated for each key performance indicator (KPI) on the SDBIP.
- A performance assessment was not performed for the first six months of the financial year, and the report was not submitted to the National Treasury by 25 January 2010.
- The targets tested are not specific, do not appear to be measurable, nor time bound. The following is a table representing this finding :

Target	Not specific	Not measurable	Not time bound
Reduction of the arrear accounts	x	x	-
No account complaints	x	x	x
Correct billing of rates	x	x	x
Correct accounts sent out	x	x	x
Increased levels of competency among youth	x	x	x
All residents must have access to all BAYC	x	x	x
Meetings reaching agreement with the Department of Education to open such a school in Willowmore	x	x	x

Reliability of reported performance information

25. The following criteria were used to assess the reliability of the planned and reported performance:

- **Validity:** Has the actual reported performance occurred and does it pertain to the entity, that is, can the reported performance information be traced back to the source data or documentation?
- **Accuracy:** Have the amounts, numbers and other data relating to reported actual performance been recorded and reported appropriately?
- **Completeness:** Have all actual results and events that should have been recorded been included in the reported performance information?

The following findings relate to the above criteria:

26. The performance management system does not disclose details of how accurate monitoring and review of performance against predetermined objectives should take place. This is further attributed to lack of specific budget/finance available for the development of priorities as per target and the lack of reporting on performance for the first six months of the year under review. This could further have an impact on the service delivery in the municipality of Bavians.

Compliance with laws and regulations

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

27. The municipality did not comply with section 122(1) of the MFMA since the financial statements submitted for audit on 31 August 2010 contained material misstatements of which some were corrected by management.
28. The municipality did not take all reasonable steps to ensure that unauthorised, fruitless and wasteful and irregular expenditure was prevented as required by section 62(1)(d) of the MFMA.

Municipal officials did not always adhere to their statutory responsibilities

29. Creditors were not settled within 30 days as required by section 65(2)(e) of the act. The CFO solely administers all bank accounts and has been doing so for the two previous financial years, which is contrary to healthy financial practices as required by section 63(2)(c) of the MFMA.
30. An adequate and complete register of assets was not maintained by the municipality as required by section 63(2)(c) of the act. Duplications, assets not found in register and vice versa, as well as items not properly described in the register, were some of the shortcomings discovered.

Municipal Supply Chain Management Regulations: GNR 868 of 30 May 2005 (MSCMR)

31. A number of tenders had discrepancies relating to the bid specifications as prescribed in terms of paragraph 11 of the Municipal Supply Chain Management Regulations: GNR 868 of 30 May 2005:
 - There was no evidence in the supporting documentation that the accounting officer approved the specifications of the bid prior to its publication.
 - The supporting documentation did not contain evidence that the winning bidder's municipal rates and taxes were not in arrears for more than three months
 - There was no documentation stating that the tender's bidders or directors were known to have committed a corrupt or fraudulent act in competing for the contract.
 - There was no documentation stating that any of the directors were known to have abused the institution's SCM system or had committed fraud or other improper conduct in relation to such system.
 - Construction contracts were not advertised on CIDB website within 21 working days.
 - The invitation to tender did not stipulate what preference points system was going to be used for evaluation.

- The municipality did not implement an anonymous whistle-blowing facility as part of its fraud prevention strategy during the year under review.
- The accounting officer did not review the SCM policy on an annual basis
- A suppliers' data list was not updated regularly.

Environmental Conservation Act, 1998 (Act No. ?? of 1998)

32. The municipality operated its landfill sites without the permit issued by the minister, as required by section 20 of the act.

INTERNAL CONTROL

33. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the MFMA, but not for the purpose of expressing an opinion on the effectiveness of internal control.
34. The matters reported below are limited to the significant deficiencies regarding the basis for disclaimer of opinion paragraph, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

- **Leadership**

Whilst at an operational level, each directorate may have demonstrated effectiveness in terms of leadership, there is a concern that the respective directors would not be providing the necessary support to the finance department which would enable this department to provide meaningful and accurate financial information timeously, specifically in light of the onerous requirements of the new reporting framework.

Effective oversight over the compliance with laws and regulations, in all instances, was not evident in view of the repetitive external audit findings from the prior year audit.

Management did not ensure that incidents of abnormal expenditures (irregular, fruitless and wasteful and unauthorised) were promptly reported to the relevant external role players in terms of the MFMA.

As such the accounting officer did not exercise effective oversight of reporting against predetermined objectives, compliance with laws and regulations and internal control.

- **Financial and performance management**

The financial and performance management control objective relates mainly to the preparation of quality financial statements and performance reports which are supported by appropriate record keeping and information systems.

Manual and automated controls, although designed, were not, in all instances, adequately implemented to ensure that all transactions that occurred were authorised and completely and accurately processed. Documented procedures were not in place in respect of the capturing of transactions, resolving incorrect processing, overrides and bypasses of the system and non-standard journal entries.

The controls implemented by management over the financial systems and the procedures used for disclosure notes were not adequate. Amendments were required to the disclosure notes related to irregular as well as fruitless expenditure and commitments.

With the implementation of the new reporting framework, the municipality has attempted but not succeeded in delivering financial information in line with the framework. This resulted in the following account balances being materially misstated:

- Property, plant and equipment and investment property
- Trade and other receivables from non-exchange transactions
- Consumer debtors
- Creditors
- Provisions

- **Governance**

The governance control objective relates mainly to the involvement of the audit committee and internal audit in the identification and management of risk (including information technology) and fraud prevention.

One specific area that is cause for concern is that, notwithstanding the use of consultants, the financial statements originally submitted for audit contained material misstatements which had to be amended. In addition, the corrections made/proposed by the consultant pertaining to the correction of the prior period error and comparative disclosures were not adequately reviewed and corroborated by management.

OTHER REPORTS

Investigations

35. An investigation into possible irregularities of prepaid electricity collected by a vendor but not paid over, is currently in progress and is done by an external audit firm appointed by the council.

Port Elizabeth

31 March 2011





AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

