

REPORT OF THE AUDITOR-GENERAL TO THE MEMBERS OF THE COUNCIL ON THE FINANCIAL STATEMENTS OF MADIBENG LOCAL MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2005

1. AUDIT ASSIGNMENT

The financial statements as set out on pages to, for the year ended 30 June 2005, have been audited in terms of section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996), read with sections 4 and 20 of the Public Audit Act, 2004 (Act No. 25 of 2004). These financial statements, the maintenance of effective control measures and compliance with relevant laws and regulations are the responsibility of the municipal manager. My responsibility is to express an opinion on these financial statements, based on the audit.

2. NATURE AND SCOPE

The audit was conducted in accordance with Statements of South African Auditing Standards. Those standards require that I plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement.

An audit includes:

- examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements,
- assessing the accounting principles used and significant estimates made by management, and
- evaluating the overall financial statement presentation.

Furthermore, an audit includes an examination, on a test basis, of evidence supporting compliance in all material respects with the relevant laws and regulations which came to my attention and are applicable to financial matters.

The audit was completed in accordance with Auditor-General Directive No. 1 of 2005.

I believe that the audit provides a reasonable basis for my opinion.

3. QUALIFICATION

3.1 Opening balances

As reported in the prior year a disclaimer of audit opinion was issued. During the year under review no corrective measures were implemented by management on qualifications reported. Therefore, no reliance can be placed on the opening balances in

the financial statements and no inference should be drawn between the opening and closing balances.

3.2 Going concern

The following main factors raise doubt as to the council's ability to carry on as a going concern:

- funds amounting to R31,8 million are not represented by cash or investments;
- since June 2005 no VAT returns have been submitted or paid over to SARS;
- loans amounting to R256,5 million were not repaid in accordance with the conditions of the loans.

Furthermore, management did not make an assessment of the going concern assumption, therefore an incorrect disclosure basis was applied.

3.3 Statutory Funds

The Township Development Fund amounting to R26,4 million and the Endowment Fund amounting to R nil as disclosed in note 1 to the financial statements, could not be verified as the supporting documentation relating to the expenditure amounting to R16,0 million and other income amounting to R4,5 million could not be provided.

Furthermore, although funds and reserves should have been represented by cash and investments but reserves and statutory funds of R29 million were not represented by cash or investments.

I therefore did not obtain all the documentation and explanations necessary to verify the completeness, allocation, rights and existence of statutory funds amounting to R113,3 million as disclosed.

3.4 Reserves

Assistance to indigents reserve as disclosed in note 2 to the financial statements, could not be verified as the supporting documentation relating to expenditure amounting to R7,2 million could not be provided, and no authorisation could be presented for the contributions made to this reserve amounting to R6,2 million. Furthermore a negative reserve has been created.

I therefore did not obtain all the documentation and explanations necessary to verify the completeness, allocation, rights and existence of reserves amounting to (R0,44 million) as disclosed.

3.5 Retained earnings

No supporting documentation could be provided for the prior year adjustments amounting to R20 million as reflected in the financial statements.

I therefore did not obtain all the documentation and explanations necessary to verify the completeness, allocation, rights and existence of the accumulated deficit amounting to R117 million as disclosed.

3.6 Trust funds

The Grants Fund as disclosed in note 3 to the financial statements, could not be verified as the supporting documentation relating to the expenditure amounting to R14,4 million could not be provided.

I therefore did not obtain all the documentation and explanations necessary to verify the completeness, allocation, rights and existence of trust funds amounting to R2,8 million as disclosed.

3.7 Fixed assets

There was a limitation on the audit work that could be performed due to the following factors:

- the municipality did not perform a complete physical verification of fixed assets during the year under review.
- the fixed asset register does not have any reference numbers to facilitate the identification of fixed assets, therefore it was not possible to trace the assets from the asset register to the physical asset.
- There is an unresolved difference of R161,4 million between the net book value of fixed assets and the loans outstanding.
- No supporting schedules were provided for additions amounting to R14,4 million, which represent 54% of the vouchers selected.

I therefore did not obtain all the documentation and explanations necessary to verify the completeness, valuation, rights and existence of fixed assets amounting to R155 million as disclosed.

3.8 Consumer deposits

An unexplained difference of R1 million existed between the amount as disclosed in note 5 and the balance per the debtors consumer deposits listing.

I therefore did not obtain all the documentation and explanations necessary to verify the completeness, valuation, rights and existence of consumer deposits amounting to R7,7 million as disclosed.

3.9 Long-term debtors

The recoverability of the long-term debtors for housing and stand loans disclosed as R15 004 452 in note 8 to the financial statements is doubtful. Several of these debtors' accounts were tested to ensure that repayments were made in accordance with the signed sale agreements. Eighty per cent of the accounts tested showed no repayments during the year under review, nor subsequent to year-end.

I therefore did not obtain all the documentation and explanations necessary to verify the completeness, valuation, rights and existence of long-term debtors amounting to R12 million as disclosed.

3.10 Inventory

No supporting documentation could be provided for the valuation of the inventory as disclosed in note 9 to the financial statements. I was also not able to verify the completeness of inventory as no delivery notes were available and orders made during the year could not be submitted for audit purposes.

I therefore did not obtain all the documentation and explanations necessary to verify the completeness, valuation, rights and existence of inventory amounting to R4 million as disclosed.

3.8 Debtors

There was a limitation of scope on the audit due to the following factors:

- An unexplained difference of R2,7 million existed between the debtors listing and the consumer debtors, as disclosed in note 10.
- Consumer debtors outstanding for a period of 90 days and longer as at 30 June 2005 amounted to R209,6 million although a bad debt provision of only R130,5 million was made. Based on past payment history, the provision is therefore understated by R79 million.
- No adequate supporting documentation including debtors' listings and debtors' reconciliations could be presented for the following balances classified as debtors:

- VAT suspense	R 12 617 774
- Grants fund debtors	R 58 970 343
- Consumer debtors ODI	R 96 145 040
- Debtors suspense accounts	R 96 969 460
- The current debtors were understated by R17,7 million due to receipts after year-end being included in the current accounting period.

- No VAT reconciliations could be submitted and no reliable accounting records were available to estimate the tax due to the council.

I therefore did not obtain all the documentation and explanations necessary to verify the completeness, valuation, rights and existence of debtors amounting to R266,8 million as disclosed.

3.9 Short-term portion of long-term debtors

No supporting documentation could be provided for the short-term portion of long-term debtors.

I therefore did not obtain all the documentation and explanations necessary to verify the completeness, valuation, rights and existence of the short-term portion of long-term debtors amounting to R3 million as disclosed.

3.10 Provision for leave pay

The leave pay provision amounting to R2 051 862 as disclosed in note 11 to the financial statements is understated by R4 583 740.

3.11 Creditors

No adequate supporting documentation including creditors' listings and creditors' reconciliations could be presented for the following classes of balances as disclosed in note 12:

• Rates charged in advance	R 2 773 082
• Trade creditors	R 8 448 712
• Suspense: unprocessed receipts	R 75 851 166
• Cash suspense bank deposits	R 98 173 207
• Cash suspense easipay	R 3 059 266

I therefore did not obtain all the documentation and explanations necessary to verify the completeness, valuation, obligation and existence of creditors amounting to R200,2 million as disclosed.

3.11 Bank overdraft

No supporting evidence could be provided for the long outstanding and unusual items amounting to R26,2 million included in the bank reconciliation of the bank overdraft, as disclosed in note 22.

I therefore did not obtain all the documentation and explanations necessary to verify the completeness, valuation, obligations and existence of bank overdraft amounting to R12 million as disclosed.

3.12 Revenue

There was a limitation on the audit work that could be performed due to the following factors:

- Completed bank reconciliation, cleared debtors suspense accounts, accurate debtors listings, valuation roll reconciliation and supporting documentation for journal entries were not available.
- No supporting documentation or monthly reconciliations could be provided for the prepaid electricity revenue of R9,5 million.
- The assessment rates amounting to R61 million are understated by R6 million. No reconciliation between the valuation roll and the monthly charges has been performed.
- A significant number of properties were not charged with rates, water, sewerage and refuse services.
- The interest charged amounting to R3,8 million appears to be understated by an amount of R4 million. Furthermore no supporting documentation could be provided regarding the movement in interest during July 2004 and September 2004.
- No explanation could be provided for the difference of R2,6 million between the Natis System and the general ledger, as no reconciliation has been performed. I was therefore unable to verify the license fee income amounting to R4 million
- Included in the revenue were transactions dating back to 1998 amounting to a net credit of R34 million. No explanations could be provided for these transactions.

I therefore did not obtain all the documentation and explanations necessary to verify the completeness, occurrence, accuracy, classification of income amounting to R327 million as disclosed.

3.13 Expenditure

- Vouchers amounting to R116 million, could not be provided for audit. These vouchers represent an error rate of 56 per cent of the total expenditure.
- No supporting documentation could be provided for the difference of R20 million between the general ledger and the payroll.
- Salaries and wages amounting to R17 million have been allocated to general expenditure.
- Salaries and wages per the financial statements were R3,1 million more than the actual payroll.
- No reconciliation was performed between the payroll and the general ledger.
- No supporting documentation could be provided for the difference of R2 million between the interest paid as disclosed in the financial statements and the third party confirmations.

I therefore did not obtain all the documentation and explanations necessary to verify the completeness, occurrence, accuracy and classification of income amounting to R327 million as disclosed.

3.15 Disclosure

- Contrary to section 125(2)(a) of the Municipal Financial Management Act, 2003 (Act No 56 of 2003) (MFMA) the following expenditure has not been disclosed in the annual financial statements:
 - Audit fees
 - Taxes
 - Levies
 - Duties
 - Pension and medical aid contributions.
- Supporting documentation for the Appendix F statistical information has not been presented.
- The bank account details were not disclosed according to section 125(2)(a) of the MFMA.
- Several statement items do not correspond with the respective notes, for example, the balance sheet incorrectly refers to note 23 instead of note 22, in respect of cash on hand and bank and bank overdraft.

The root cause for most of the above problems relates to the significant capacity problems experienced throughout the year. The high vacancy rate of the finance directorate was mainly due to the shortage of skills and staff with the required experience. This has had a negative effect on the municipality's ability to comply with their internal procedures, policies and record keeping, as highlighted above.

4. DISCLAIMER OF AUDIT OPINION

Because of the significance of the matters referred to in paragraph 3, I do not express an opinion on the financial statements.

5. EMPHASIS OF MATTER

Without further qualifying the audit opinion expressed above, attention is drawn to the following matters:

5.1 Financial indicators

- During the year under review the water services had a trading loss of R19,8 million compared with a budget income of R10,5 million.

- The accumulated deficit grew from R91,6 million to R117 million.
- R8 million was spent on councillors remunerations.

5.2 Non-compliance with laws and regulations

The following are examples of the laws and regulations that the council did not comply with:

5.2.1 Non-compliance with the MFMA:

- Contrary to section 71 the municipality did not submit the required reports.
- Contrary to sections 64(1) and (2) the municipality has not implemented proper revenue management systems.
- Contrary to section 64(3), no reports were submitted to the National Treasury regarding amounts owing by organs of state for periods longer than 30 days.
- The municipality website was not regularly updated and the required documents had not been placed in terms of section 75(2).
- Contrary to section 126 the financial statements were only submitted on 14 August 2006. Final adjustments were resubmitted on 8 October 2006.
- Contrary to section 165 the internal audit unit reported to a divisional head instead of directly to the audit committee.
- Contrary to section 67(1) no dismissal letters were being filed on the personnel files.

5.2.2 Non-compliance with other acts:

- Senior managers and the municipal manager did not have annual performance agreements as required in terms of section 57(1)(b) of the Municipal Systems Act, 2000 (Act No 32 of 2000) as amended.
- Contrary to the National Energy Regulator Act, 2004 (Act 40 of 2004) the tariff increases for the 2004/2005 financial year were not approved by the National Energy Regulator of South Africa.
- No evidence could be obtained to ensure that section 2(1) of Preferential Procurement Policy Framework Act, 2000 (Act No 5 of 2000) relating to the preference point system was implemented for the awarding of tenders.
- Contrary to schedule 7 of the Income Tax Act, 1962 (Act No. 58 of 1962) as amended, fringe benefits for housing were not included on individual IRP5s.

6. APPRECIATION

The assistance rendered by the staff of Madibeng Local Municipality during the audit is sincerely appreciated.

Pieter Maritz CA (SA) *for* Auditor-General

Rustenburg

21 October 2006



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