



## **REPORT OF THE AUDITOR-GENERAL ON THE FINANCIAL STATEMENTS OF THE METSIMAHOLO LOCAL MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2006**

### **1. AUDIT ASSIGNMENT**

The financial statements set out on page 53 to 96, for the year ended 30 June 2006, have been audited in terms of section 188 of the Constitution of the Republic of South-Africa, 1996, read with sections 4 and 20 of the Public Audit Act, 2004 (Act No. 25 of 2004) and in accordance with the requirements of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). These financial statements are the responsibility of the accounting officer. My responsibility is to express an opinion on these financial statements based on the audit.

### **2. SCOPE**

The audit was conducted in accordance with the International Standards on Auditing read with *General Notice 1512 of 2006*, issued in *Government Gazette* no. 29326 of 27 October 2006. 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
- evaluating the overall financial statement presentation.

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

### **3. BASIS OF ACCOUNTING**

The municipality is required to prepare financial statements on the basis of accounting determined by the National Treasury, as described in the addendum to this report.

### **4. QUALIFICATION**

The qualifications listed below resulted from the following severe control weaknesses:

- the Standards of Generally Accepted Municipal Accounting Practice (GAMAP) and Standards of Generally Accepted Accounting Practice (GAAP) were not correctly implemented;
- inadequate monitoring and reviewing;

- the absence of a proper training strategy and programme to equip staff to be prepared for the changes in the accounting standards in the local government sphere;
- failure to adhere to the financial accounting and internal control systems;
- failure to adhere to the financial accounting standards and policies.

#### 4.1 Receivables (debtors)

(a) Receivables were misstated in the financial statements due to GAMAP and GRAP not being correctly implemented. The following are examples:

- (i) *Revenue*: Paragraphs 10 to 13 as well as 55 and 56 of GAMAP 9: *Revenue*, require that the fair value of revenue received or receivable should be recognised and disclosed. The municipality, however, did not recognise and disclose the fair value of revenue received or receivable. Consequently, revenue and debtors, and interest received/receivable have been misstated by an unknown amount.
- (ii) The fair value of trade and other receivables was not initially recognised and disclosed as required by paragraph 43 of IAS 39 (AC 133) *Financial Instruments: Recognition and Measurement*. Trade and other receivables were also not subsequently measured at amortised cost using the effective interest method as required by paragraph 46(a) of IAS 39 (AC 133) *Financial Instruments: Recognition and Measurement*. Consequently, trade and other receivables, and the operating surplus for the year, are overstated by an unknown amount.
- (iii) The municipality made a general provision for doubtful receivables based on the actual recovery of debtors during the year under review. This was contrary to paragraphs 63 and 64 of IAS 39 (AC 133): *Financial Instruments: Recognition and Measurement*, which require that loans and receivables be impaired if there is objective evidence that an impairment loss had been incurred. The amount of the loss should be measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. An entity should also first assess whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant.
- (iv) *Provision for doubtful debts*: Provision for doubtful debts as disclosed in note 14 and the related expense accounts is understated by R19 969 658 (2005: R54 572 431).
- (v) *Risk management policies*: Inadequate disclosure was made of the risk management policies as well as accounting policies relating to financial instruments as required by IAS 32 (AC 125) *Financial Instruments: Presentation*. Furthermore, no disclosure was made of fair value information, which included the method of determining fair value and significant assumptions made, as is required by IAS 32 (AC 125) *Financial Instruments*.

- (vi) *Traffic fines*: The accounting policy regarding fines issued indicates that fines are recognised when payment is received. Paragraphs 39 to 41 of GAMAP 9 require that an estimate be made of the spot fines and summonses that will be received based on past experience of amounts collected. During the current year, the actual recognition of fines issued was limited to fines actually received. Income and debtors were therefore understated by an unknown amount.
- (b) Accounts receivable were understated by R9 252 499 at year-end due to the duplication of credit journals and the incorrect allocation of receipts to debtors. Control measures were not in place to ensure that journals were correctly posted and recorded.
- (c) The validity and existence of debtors totalling R9 203 407 could not be confirmed as no payments were received after year-end and no proof could be provided by the municipality to confirm their validity and existence.

#### **4.2 Accounts payable (creditors)**

- (a) Due to shortcomings within the financial accounting and internal control systems, supporting documentation for creditors of R4 435 520 could not be submitted. The validity and existence of these creditors could therefore not be confirmed.
- (b) Paragraph 143 of IAS 39 (AC 133) *Financial Instruments: Recognition and Measurement* requires that accounts payable be accounted for at fair value. However, this was not implemented by the municipality. Accounts payable were consequently overstated by an unknown amount.

#### **4.3 Assets**

- (a) The useful lives, residual values and impairment losses of assets classified as property, plant and equipment were not reviewed at financial year-end as required by paragraphs 40, 41, 54, 56 and 59 of GAMAP 17: *Property, Plant and Equipment*. The adjustments to property, plant and equipment, which could have resulted from the assessment of the useful lives, residual values and impairment losses, have not been calculated and the effect on the financial statements could not be determined.
- (b) In terms of paragraphs 15, 17 and 39 of GAMAP 17: *Property, plant and equipment*, each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item, should be depreciated separately. Evidence could not be obtained that the municipality had evaluated the fixed assets to determine whether a part of an item of property, plant and equipment was significant in relation to the total cost of the item.

#### **4.4 Investment property**

Investment properties were not accounted for at fair value as required by paragraph 75(d) of International Statement of Generally Accepted Accounting Practice (GAAP) for investment property (IAS 40), when using the cost model as the method of accounting. I was unable to verify or calculate estimates in this regard due to a lack of sufficient supporting documentation. The extent of the misstatement could consequently not be established.

#### **4.5 Long-term receivables (debtors)**

- (a) Long-term debtors were not initially accounted for at the fair value as required by paragraph 43 of IAS 39 (AC 133) *Financial Instruments: Recognition and Measurement*. Long-term debtors were also not subsequently measured at amortised cost using the effective interest rate method as required by paragraph 46(a) of IAS 39 (AC 133) *Financial Instruments: Recognition and Measurement*. Consequently, long-term debtors and operating surplus for the year could be misstated by an unknown amount.
- (b) According to paragraphs 63 and 64 of IAS 39 (AC 133) *Financial Instruments: Recognition and Measurement*, loans and receivables should be impaired if there is objective evidence that an impairment loss had been incurred. The amount of the loss should be measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. An entity should also first assess whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. The municipality made no provision for impairment of long-term debtors as required by IAS 39 (AC 133) *Financial instruments: Recognition and Measurement*. No estimate for the latter could be made due to a lack of supporting documentation. The extent of the misstatement could consequently not be determined.

#### **4.6 Inventory**

- (a) In terms of paragraph 6 of GAMAP 12: *Inventories*, water reserves that were held for resale via the network should be recognised as inventory. The water reserves, however, were not recognised as inventory during the year under review. It was not possible to estimate the water quantity at year-end and inventory was therefore understated by an unknown amount.
- (b) In terms of paragraphs 4, 5, 15 and 17 of GAMAP 12: *Inventories*, land held for sale should be accounted for as inventory at year-end. This should be recognised and measured in the accounting record. The municipality did not recognise the land held for sale as inventory and no estimates could be made in this regard due to a lack of supporting documentation. Inventory is therefore understated by an unknown amount.

#### **4.7 Expenditure**

Supporting documentation amounting to R1 318 299 could not be submitted for auditing purposes. This amount included the following:

- Payment of wages totalling R842 375
- Expenditure totalling R309 944
- Creditor payments and journals amounting to R165 980

I was therefore not able to conclude on the validity of expenditure listed above.

#### **4.8 Long-term liabilities**

Long-term liabilities amounting to R10 579 101 could be misstated by an unknown amount in the financial statements because fair value accounting (discounting) of long-term liabilities, as required by IAS 39 (AC 133) *Financial Instruments: Recognition and Measurement*, for the initial recognition of long-term liabilities was not applied.

The liabilities were also not measured at amortised cost using the effective interest method as required by paragraph 47 of IAS 39 (AC 133). No estimates could be made in this regard due to a lack of supporting documentation. Long-term liabilities were consequently misstated by an unknown amount.

#### **5. Unadjusted material audit differences**

Although the municipality was afforded an opportunity to address the issues outlined in paragraph 4 above, the municipality did not provide me with additional evidence or make the necessary adjustments to the financial statements to avoid the qualifications.

#### **6. DISCLAIMER OF AUDIT OPINION**

Because of the significance of the matters referred to in paragraph 4, I do not express an opinion on the financial statements.

#### **7. EMPHASIS OF MATTER**

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

##### **7.1 Matters affecting the financial statements**

- (a) Invoices/creditor statements to the amount of R233 245 were not accounted for in the current financial year. This resulted in an understatement of creditors by R233 245. This was mainly due to a lack of monitoring and reconciliations of individual account balances at year-end.
- (b) Due to incorrect calculations applied by management, the provision for leave was found to be overstated by R245 136 (2005: R 816 576). This matter was also reported in paragraph 3.12 of the previous audit report.
- (c) No provision was made for unmetered water and electricity consumption of consumers at year-end, which resulted in an understatement of revenue and receivables. This was mainly due to a lack of controls and procedures to ensure the completeness of revenue.

##### **7.2 Financial management and internal control**

Sections 63 to 65 of the MFMA outline the accounting officer's responsibilities towards asset and liability, revenue and expenditure management as well as the reasonable steps to be taken in this regard. Due to inadequate supervision over the application of internal controls and procedures, the

following audit findings were identified, which indicated a weak financial administration and internal control environment:

- Insufficient managerial control measures existed over fixed assets. Examples included incomplete recording of all asset-related transactions in the assets register, a lack of reconciling controls between the asset register and the general ledger on a regular basis, while log books were not kept for all vehicles used for official purposes.
- There was a total lack of control over cash and the complete accounting thereof at the traffic department and Abrahamsrust holiday resort. This substantially increased the risk of fraud and error related to cash receipts.
- Various shortcomings related to salary payments and deductions were identified which included lack of prior approval of overtime worked and inaccurate tax deductions made.
- Insufficient controls existed over monthly processing of creditors as an unidentified creditor control account amounting to R117 653 was identified at year-end.

### **7.3 Supply chain management**

- (a) Purchases of goods and services amounting to R1 519 901 and R772 326 were identified, which were not accompanied by the necessary quotations and/or tenders/contracts as required by the supply chain management (SCM) policy. This was due to the SCM policy that was not properly implemented.
- (b) Land was sold to Heron Banks Development for an amount of R5,5 million. Neither tenders nor the basis on which the contract was awarded to the buyer could be obtained. This was in direct contravention of sections 14(5), 111 and 112 of the MFMA, which require the disposal of capital assets to be fair and transparent. This matter was also reported in paragraph 5.4.3 of the previous audit report. At the time of writing this report, a conclusive reply from the municipal manager was still outstanding. This was mainly due to the fact that the supply chain management was not adequately implemented.

### **7.4 Material losses, unauthorised, fruitless and wasteful expenditure and irregular expenditure**

#### **(a) Asset register**

Notwithstanding the fact that a total amount of R721 260 was paid to a vendor for compiling an asset register, a complete asset register had not been received by the municipality at the time of the audit. It was also determined that this amount consisted of monthly payments made to a related party of the CFO and that the CFO was also the chairperson of the bid committee. This expenditure could be regarded as fruitless and wasteful in terms of the definition in section 1(1) of the MFMA.

#### **(b) Photocopier machines**

A contract was signed by the municipal manager during February 2006 for the rental of photocopier machines, with monthly instalments of R316 514,

without proper tender procedures having been followed. As payments were made during February 2006 for both the old and the new photocopier machines and given that certain of these machines were not in use, the payment of R316 514 is regarded as fruitless and wasteful expenditure in terms of the definition in section 1(1) of the MFMA. With reference to a council meeting held on 22 February 2006, the council issued a notice to the municipal manager to clarify uncertainties regarding this acquisition whereby proper tender procedures were not followed. At the time of writing this report no evidence could be obtained that the municipal manager had responded to the council's request.

(c) **Motor loan to a director**

A director passed away during February 2006 while she was indebted to the municipality for a motor vehicle loan of R178 592. According to paragraph 7 of the loan agreement, the principal of the loan was payable upon termination of employment with the municipality. The procedures as stipulated in the contract had not been followed to recover the remaining balance and the recoverability of this amount appeared uncertain. Although the municipality did claim this amount against the estate of the deceased director, the matter was still unresolved at the time of writing this report. This was mainly due to a lack of implementation of debt collection policies and procedures.

(d) **Unauthorised expenditure**

Salaries and allowances paid to the municipal manager and directors did not agree with the salary scales approved by the council. Overpayments totalling R48 449 and an underpayment of R8 705 were identified during the financial year. The overspending of R48 449 is regarded as unauthorised expenditure in terms of the definition in section 1(1) of the MFMA. The municipality did not disclose this unauthorised expenditure as required by the MFMA.

## 7.5 **Going concern**

The financial statements have been prepared on the going-concern basis, which assumes that the municipality will be able to meet its liabilities in the ordinary course of business. Accordingly, these financial statements do not include any adjustments relating to the valuation of assets and the classification of liabilities that might be necessary if the council is unable to continue as a going concern. The following issues indicated that the risk existed that the council might not be able to continue as a going concern:

- (a) Debtors at year-end increased by approximately 5,5% to R174,8 million (2005: R165,7 million). The average time to recover outstanding consumer debtors decreased to 216 days (2005: 234), which was still regarded as unacceptably high. The increase in consumer debtors before the provision for bad debts amounted to R9,1 million, while the provision for bad debts increased by approximately R21 million to R82,3 million.
- (b) The income from water levies was only 72,9% of the total budget income for this account for the year. The levies totalled R55,9 million (2005: R52,5 million) for the year, while an amount of R76,8 million had been budgeted for this account. Subsequent to year-end (July to October 2006) it was noted that the income from water levies that were actually levied to consumers, decreased further to only 51% of the budgeted income.

- (c) The investments held by the municipality decreased by R19,3 million during the year to only R6,7 million (2005: R26 million) at year-end. Subsequent to year-end these investments decreased further and this impacted negatively on the council's ability to continue as a going concern in the near future.
- (d) Since year-end, the pressure on the cash flow of the municipality increased and at the time of writing this report the municipality was experiencing difficulty in paying creditors within the agreed terms.

## **7.6 Non-compliance with laws and regulations**

- (a) *Mayors' Trust and consolidated financial statements:* The financial statements for the Metsimaholo Mayors' Trust (municipal entity) and consolidated financial statements of this local municipality had not been submitted in respect of the 2004-05 and 2005-06 financial years. In the absence of these financial statements, compliance with various sections of the MFMA could not be confirmed. This matter had also been reported on in my previous audit report.
- (b) Various capital projects were identified on the integrated development plan (IDP) which were not included in the budget for the current year due to insufficient funding. In terms of section 17(3) of the MFMA, the budget and the IDP should be aligned. Procedures were not in place to ensure that these documents agreed and had the same objective.
- (c) Evidence could not be obtained that the municipality had issued any by-laws to give effect to the implementation and enforcement of its tariff policy as required by section 75 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).
- (d) In terms of schedules 1 and 2 of the MSA, councillors (paragraphs 5 and 7 of the code of conduct for councillors) and staff members (paragraph 5 of the code of conduct for municipal staff members) respectively are required to furnish the municipality with declarations of interest. Various instances were found where this was not done during the year under review.
- (e) According to section 15(5) of the Water Services Act, 1997 (Act No. 108 of 1997), the water services development plan should be included in the IDP. Proof could not be obtained that this was done as the water services development plan had not been finalised.

## **8. Late finalisation of the audit report**

In terms of section 126(3)(b) of the MFMA I am required to submit my report to the accounting officer within three months of the receipt of the financial statements. In the interest of improving accountability and due to the process implemented by me to ensure consistency in the manner in which material audit findings are reported, I have delayed the finalisation of my report to the date reflected on the audit report.



## 9. APPRECIATION

We express our sincere appreciation to the council and the staff for their assistance during the audit.

S Cele

*for Auditor-General*

Bloemfontein

24 February 2007



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

**ADDENDUM TO THE REPORT OF THE AUDITOR-GENERAL ON THE  
FINANCIAL STATEMENTS OF THE METSIMAHOLO LOCAL MUNICIPALITY FOR  
THE YEAR ENDED 30 JUNE 2006**

**Basis of preparation**

The financial statements have been prepared in accordance with the Standards of Generally Recognised Accounting Practices (GRAP) and the Standards of Generally Accepted Municipal Accounting Practices (GAMAP) prescribed by the Minister of Finance in terms of:

- *General Notice 991 of 2005*, issued in *Government Gazette* no. 28095 of 7 December 2005; and
- *General Notice 992 of 2005*, issued in *Government Gazette* no. 28095 of 15 December 2005.

The standards comprise the following:

GRAP 1	Presentation of Financial Statements
GRAP 2	Cash Flow Statements
GRAP 3	Accounting Policies, Changes in Accounting Estimates and Errors
GAMAP 4	The Effects of Changes in Foreign Exchange Rates
GAMAP 6	Consolidated Financial Statements and Accounting for Controlled Entities
GAMAP 7	Accounting for Investments in Associates
GAMAP 8	Financial Reporting of Interests in Joint Ventures
GAMAP 9	Revenue
GAMAP 12	Inventories
GAMAP 17	Property, Plant and Equipment
GAMAP 19	Provisions, Contingent Liabilities and Contingent Asset

Accounting policies for material transactions, events or conditions not covered by the above GRAP and GAMAP Standards have been developed in accordance with paragraphs 7, 11 and 12 of GRAP 3. These accounting policies and the applicable disclosures have been based on the South African Statements of Generally Accepted Accounting Practices (GAAP) including any interpretations of such Statements issued by the Accounting Practices Board.



## **REPORT OF THE AUDITOR-GENERAL ON PERFORMANCE MEASUREMENT AT THE METSIMAHOLO LOCAL MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2006**

### **1. ASSIGNMENT**

The compilation, presentation and publishing of performance measurements as part of the annual reports of municipalities and the implementation, management and internal control of supporting systems, are the responsibility of the accounting officer.

As required by section 45(b) of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) my responsibility is to provide an assessment of the controls implemented by the accounting officer to develop and manage the municipality's performance management system, my role is not to assess or comment on the municipality's actual performance.

### **2. NATURE AND SCOPE**

I have performed the procedures agreed upon and described below regarding the performance measurement system of Metsimaholo Local Municipality. The assignment was undertaken in accordance with the International Standard on Related Services (ISRS 4400) applicable to agreed upon procedures engagements.

The procedures were performed solely to evaluate the controls implemented and managed by the accounting officer regarding the municipality's performance measurement system against the criteria set out in:

- chapter 6 of the Municipal Systems Act, 2000;
- the Local Government: Municipal Planning and Performance Management Regulations, 2001 (No. R. 796)

The procedures performed during our assignment were based on the high-level overview checklist completed by the accounting officer and included a review of the following aspects:

1. Development of an integrated development plan
2. Development of a performance management system
3. Development and implementation of key performance indicators
4. Setting of targets for key performance indicators
5. Actual service delivery process
6. Internal monitoring of performance measurements
7. Internal control of the performance management system
8. Performance measurement and reporting
9. Revision of strategies and objectives

### **3. FINDINGS**

I report my findings below:

#### **3.1 Integrated development plan**

The Municipality has developed and adopted an Integrated Development Plan for the year under review. We have reviewed the IDP and compared the plan and the processes followed with the relevant legislative requirements. No weaknesses were noted.

#### **3.2 Performance management system**

No audit work could be performed on sections 41, 46 and 81 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (**MSA**) as well as regulations 13 and 15 of The Local Government: Municipal Planning and Performance Management Regulations, 2001 (No. R.796) (**Regulations**), due to the fact that no supporting documentation could be provided by the accounting officer.

#### **3.3 Development and implementation of key performance indicators**

No audit work could be performed on section 42 of the MSA as well as Regulation 15(2), due to the fact that no supporting documentation could be provided by the accounting officer.

#### **3.4 Setting of targets for key performance indicators**

No audit work could be performed on sections 26 and 46 of the MSA as well as Regulations 11, 12 and 15, due to the fact that no supporting documentation could be provided by the accounting officer.

#### **3.5 Actual service delivery and internal monitoring**

No audit work could be performed on sections 25 and 35 of the MSA, due to the fact that no supporting documentation could be provided by the accounting officer.

#### **3.6 Internal control**

No audit work could be performed on sections 45 and 81 of the MSA as well as Regulation 14, due to the fact that no supporting documentation could be provided by the accounting officer.

#### **3.7 Performance measurement and reporting**

No audit work could be performed on sections 41, 46 and 81 of the MSA as well as Regulations 7, 13 and 15, due to the fact that no supporting documentation could be provided by the accounting officer.

### 3.8.1 Revision of strategies and objectives

No audit work could be performed on sections 27, 32, 34, 41, 42 and 81 of the MSA as well as Regulations 3, 7, 13 and 15, due to the fact that no supporting documentation could be provided by the accounting officer.

## 4. STATEMENT

Because the above procedures do not constitute either an audit or a review made in accordance with International Standards on Auditing or International standards on Review Engagements, I do not express any assurance on the performance measurements as at 30 June 2006.

Had I performed additional procedures or had I performed an audit or review of the performance measurement in accordance with International Standards on Auditing or International standards on review engagements, other matters might have come to my attention that would have been reported to you.

This report relates only to the purpose set forth in the first paragraph of this report and does not extend to any financial statements of the Metsimaholo Local Municipality, taken as a whole.

## 5. APPRECIATION

The assistance rendered by the staff of the Metsimaholo Local Municipality during the assignment is sincerely appreciated.

Signed by M Klopper  
*for Auditor-General*

Bloemfontein  
15 December 2006



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

## ISSUES RAISED BY THE AUDITOR-GENERAL IN AUDIT REPORTS

In terms of section 131(1) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003), a municipality must address issues raised by the Auditor-General in an audit report. The management comments addressing the issues raised in the Report of the Auditor-General on the Financial Statements for the year ended 30 June 2006 (pages 31 to 39) are indicated below.

### 1 **AUDIT ASSIGNMENT**

The constitutional right of the Auditor General is noted and accepted.

### 2 **SCOPE**

The Scope of the audit is noted. As the financial statements was compiled and submitted in terms of the Municipal Finance Management Act no 56 of 2003, the statements were duly submitted on 31 August 2006. The statements did not comply to the guideline as the guideline was issued only after the submission date of the statements. The readiness of the Municipality to comply with the notice issued on 27 October 2006 was of concern and subsequently the statements were not redrafted. The resubmission of the statements should be considered as part of the 2006/07 financial year statements process by the Audit Committee, Accounting Officer and Oversight Committee. It is also noted with concern that the draft Audit report and final audit report qualifications is not aligned and the fundamental difference created delays in the submission of the Annual Report Component of the Auditor Generals report.

### 3 **BASIS OF ACCOUNTING**

The requirements of accounting standards as set by National Treasury are accepted. It is however of great concern that those standards are set retrospectively and it is further noted that lesser requirements are agreed for the 2006/07 financial year.

### 4 **QUALIFICATIONS**

#### General

The non management of changes was due to misinformation of the accounting staff and Chief Financial Officer of the applicable standards. It is of great concern that full compliance was requested in the 2005/06 financial year whereas the standards propose an implementation phase supported by Circular 36. The relevant standards received attention and the relevant standards will be complied to as far as possible. The redrafting of these statements will be considered by the Audit Committee, Accounting Officer and Oversight Committee.

#### 4.1 (A) **Receivables**

- (i) **Revenue:** The accounting system of the Municipality was not set up to provide the relevant incremental billing and account information. The problem extended to the previous financial year and available information was not sufficient to comply with the present value disclosure as required in GAMAP 9. The relevant information will be available for 2006/2007 financial year. The previous standard was complied with.
  - (ii) The effective interest rate was not applied to amortize the trade and other receivables and the initial recognition criteria of IAS 39 were not met. The relevant information will be available for 2006/07 financial year.
  - (iii) The impairment criteria of IAS 39 were not met. Provision for doubtful debt was made. The impairment and interest calculations required will be made for the 2006/2007 financial year.
  - (iv) The under provision is noted. The provision was improved dramatically and will be further addressed in 2006/07 and 2007/2008 financial years. The non write off of bad debts for 5 years and subsequent interest charges is of concern and will be addressed by the write off of bad debts in terms of the new Credit Control and Debt Collection Policy.
  - (v) Risk management policies : The risk policies will be developed and included in the 2006/07 financial year.
  - (vi) Traffic fines: The traffic fine income was undated in detail required to ensure compliance is available for the 2006/07 financial year.
- (B) **Account no 8756.** The bank used incorrectly the bank account number as the amount. This was picked up with the finalization of the bank reconciliation in August 2006 and account no. 8756 was debited with R5 200 000.62 on 12/09/2006. A further incorrect allocation of R46 177.26 was also corrected. R4 007 429 referred to 10 accounts where the incorrect levies as a result of incorrect readings, be corrected twice. All the corrections were done in 2006/07 financial year.
- (C) The debtors of R9 203 407 refer to Consumer debtors. The levies on the accounts were done in terms of Council Resolutions and promulgated tariffs. The collection of the outstanding debt is an ongoing process, and is being dealt with in terms of the Credit Policy.

#### 4.2 **Accounts Payable (Creditors)**

- (a) **VAT Provincial Projects : R673 454,82.** There is no documentation except the original payment certificates. This is the amount for bridged financing (VAT) for projects executed and financed by the Provincial Government. This was for VAT on mostly housing projects between 1999 and 2001. It is recommended that this amount be written off against the Accumulated Surplus Account.

**Loan Cost Building Society Zamdela : R3 732 065.** Council resolved at their meeting of 2 April 2007, Item 40 that the amount will be written off.

**Government Grant Oranjeville : R30 000.** This was taken over from Oranjeville with the amalgamation in 2001. There is no supporting documentation available. It is recommended that the amount be written off to accumulated surplus seen in the light that it is impossible for the Council to owe the Provincial Government R30 000 as a Grant.

- (b) The detail required for the calculations was not available for the 2005/06 Financial year. This matter will be addressed for the 2006/07 Financial year.

#### 4.3 **Assets**

- (a) **Asset register**

The Asset register was previously compiled by several companies. The most important fact is that the compliance requirements of an itemized asset register by 1 July 2007 was complied with by the municipality in May 2005. The compliance will be improved to GAMAP and IAS Standards through funding by the District Council in 30 June 2007. The physical asset count will be performed and communicated by the external service provider. The unbundling of PPE as well as impairment and investment property guidelines will need to be addressed in 2007/08.

The valuation roll (50%) and REDS (finalised) processes will finalise a major component of the GRAP requirements.

- (b) These matters will only be complied with in 2007/08 financial year. The information was not available to ensure compliance with GAMAP 17. An external supplier was appointed to assist the municipality to comply with the standards.

#### 4.4 **Investment Properties**

These matters will only be complied with in 2007/08 Financial year. The information was not available to ensure compliance with GAMAP 17. An external supplier was appointed to assist the municipality to comply with the standards.

#### 4.5 **Long term receivables (debtors)**

As the financial statements was compiled and submitted in terms of the Municipal Finance Management Act no 56 of 2003, the statements were duly submitted on 31 August 2006. The statements did not comply with the guideline as the guideline was issued only after the submission date of the statements. The readiness of the Municipality to comply with the notice issued on 27 October 2006 was of concern and subsequently the statements were not redrafted. The resubmission of the statements should be considered as part of the 2006/07 financial year statements process by the Audit Committee, Accounting Officer and Oversight Committee.



#### 4.6 **Inventory**

As the financial statements was compiled and submitted in terms of the Municipal Finance Management Act no 56 of 2003, the statements were duly submitted on 31 August 2006. The statements did not comply with the guideline as the guideline was issued only after the submission date of the statements. The readiness of the Municipality to comply with the notice issued on 27 October 2006 was of concern and subsequently the statements were not redrafted. The resubmission of the statements should be considered as part of the 2006/07 financial year statements process by the Audit Committee, Accounting Officer and Oversight Committee.

#### 4.7 **Expenditure**

##### **Payment of Wages : R842 375.**

Expenditure totalling R309 944 - this is also in respect of salary payments.

- Problems were experienced when Auditors (internal and external) and staff from SARS audited the documentation and did not return it to the office where it is kept normally. In future a person will have to sign for the payment vouchers/documents before it leave the office.

Creditor payments amounting to R165 980.

The following information was given by the auditors:

<b>Description</b>	<b>Reference</b>	<b>Amount R</b>
Dir21014: Second Front Axel Of Cat	1026683	127 165.00
Dir20446: Repair Diff CLB919FS	1026682	38 815.14

They were requested to submit cheque numbers, order numbers or fleet numbers in order to track the payment (Audit Query no 7 8/11/2006) but no feedback was received from the auditors.

#### 4.8 **Long term Liabilities**

As the financial statements was compiled and submitted in terms of the Municipal Finance Management Act no 56 of 2003, the statements were duly submitted on 31 August 2006. The statements did not comply to the guideline as the guideline was issued only after the submission date of the statements. The readiness of the Municipality to comply with the notice issued on 27 October 2006 was of concern and subsequently the statements were not redrafted. The resubmission of the statements should be considered as part of the 2006/07 financial year statements process by the Audit Committee, Accounting Officer and Oversight Committee.

5 **Unadjusted material audit differences**

The information was not available to comply with the new requirements. The resubmission of the Statements should be assessed with information available for the compilation of the 2006/07 Financial Statements. The adjustments on them are made on an informal basis.

6 **Disclaimer of Audit Opinion**

The significant matters as expressed are of great concern and will receive the required attention to ensure compliance as far as possible. A detailed audit compliance plan was drafted and is attached. The plan will ensure full compliance from 1 July 2008.

7 **Emphasis of the matter**

7.1 **Matters affecting the financial statements**

- (a) **Combined Systems:** The amount of R79 916.33 will be written back in 2006/07 financial year.
- (b) **PWC** Provision was made for the fees amount only, and did not include the disbursements and VAT.

No provision was made in 2006/07 and 2007/08 Operating budget for contributions towards Provision for leave. However it is not certain if the Auditors also took into account the 6 days special leave of the staff.

A policy will be drafted to correct the contribution for leave and the effect will be adjusted in terms of IAS 39.

- (c) **Noted.** This matter will be investigated and as far as possible controls will be implemented to ensure revenue is recognized correctly and completely.

7.2 **Financial management and internal control**

- \* The difference between the asset register and general ledger was due to a system problem. This amounted to R233 000 for the financial year. This problem was identified and corrected. The 2005/06 financial year was the first time the asset register and financial statements were linked. All known asset transactions were included except financial leases. The financial leases only need to be capitalized in 2008 as per new National Treasury Guidelines due to the availability of information problems. The vehicle log books controls have been updated and improved.

- \* The controls over Abrahamsrust resort was handed to the Financial Services department in April 2007. The controls will be improved and completeness of income ensured. Several other challenges will be communicated to the relevant stakeholders and the situation improved in the resort.

- \* The approval of leave, overtime and deductions was improved. The system calculations for tax deductions was improved and brought in line with Auditor General Guidelines.

- \* Insufficient controls were previously responsible for large creditors not being accounted for. Information will be requested from outside departments to ensure completeness and accuracy of creditors' provisions.
- \* The balance of R117 653.48 was determined from the Trial balances of Oranjeville and Deneysville with the amalgamation in 2001. No information is available and it is recommended that the Accumulated Surplus Fund be credited with the amount.

### 7.3 **Supply Chain Management**

- (a) Goods and services procurement was improved in 2006/07. The establishment of all relevant supply chain management committees and including a supply chain section. The supply chain section and internal audit section will be capacitated to ensure all transactions are compliant to the legislation.

The amount of R1 519 901 are as follows:

0001027309

Scotsman Ice Machine: Requested by Admin and approved by CFO and MM.

Cheque 152347

Marekeng Solutions: A detailed request was submitted by Electricity Department with a recommendation of a Supplier. This was approved by CFO and MM for payment. - Sole Supplier R215 850.

Cheque 149359

Stenhoy SA Ltd: Requested by Mechanical Workshop CFO. The only supplier that could repair the lift on top of the truck.

Cheque 148999

Q-Data: Contract R61 314.03. Q-Data was appointed in 2004/05 to upgrade the physical computer room. They also performed additional work required/identified due to the warranty of the equipment and physical room being compromised. For the alarm system utilized they are the only authorised service and install agents.

Cheque 149337

Jacobsco: Memo with quotations and purchase request were approved by CFO and MM (Intel Comp). R79 498.80.

Cheque 149337 and 148672 Jacobsco

The Council signed a Master Systems Plan (MSP) and engaged SITA to assist Council in the 2004/05 Financial year. They then in terms of the MSP advised the Council on the purchase of computer equipment through their SMS as well as tender 183 and 256 processes. They also provided us with (Proline – Jacobsco) as the only Supplier in the Vaal Triangle with SITA accreditation. The process followed was advised to be in line with Municipal Finance Management Act Section 110 2(c) and the contract specify quotations for tender verification process as well as allowing Council to perform the verification only periodically. Only

quotations for single PC's are specified in the SITA Process.

C H Marthinissen

Payment was an emergency repair for a breakdown at a substation and the supplier. R133 423.32.

Yale Kaporo

Is the supplier manufacturer of the product and the repairs also seen as a specialised sole supplier. R7 478.40.

Q-Data

The Company performed work in terms of an old but still valid tender (1998/99) No additional quotes required. R109 845.81.

Prompvest

Mrs Moens was appointed by the Portfolio Finance Committee before the implementation of the Municipal Finance Management Act. The contract is hair based and was drafted in terms of the Local Government Transitional Act. R55 600.

Jacobscro

Appointed in terms of SITA. They are also utilized for emergency supply of non stock items by the IT Division. The two cheques 152984 and 153696 were items so purchased. The cash flow did not allow for stock keeping of these items. R12 999.99.

Zenfer

A subsequent service level agreement was also drafted. The other quotations were also obtained from companies that did not make presentations to the portfolio. R141 019.44.

KIO Pac

Specialist company appointed to perform emergency work on account printers and other. The previous company was disqualified due to attempted fraud. R29 872.49.

Road mix

Sole Supplier. R93 312.65.

Deosiza

R4 250. - Performance of Soweto String Quartet in Theatre.

Supervac Service

R10 276.92 - Cleaning of Sewer.

SizaMekaar Construction CC

R52 213 - Contract - Main Street, Deneysville - Tender.

The R772 326 amount is as follows:

- (i) The payments made to RoadMac Surfacing are based on the fact that this supplier is the manufacturer and sole suppliers of this product available. R377 079.25

- (ii) CK Industries is a specialized sole supplier of services to the Council. They are the license holder for Hymax telephones. R394 246.50.

#### 7.4 **Material losses, unauthorised, fruitless and wasteful expenditure and irregular expenditure**

##### (a) Asset Register

Prior to the appointment of the vendor mentioned in the report approximately R450 000 was paid to Messrs BAUD for completion of our Municipal Asset Register. The Office of the Auditor General pronounced the expenditure to be fruitless. With the appointment of the vendor in terms of the Local Government Transitional Act Guidelines from 2004 it was essential to appoint a person with adequate skills and experience to ensure the previous mistakes are not repeated. The requirements to inspect the weak and contract of the vendor was not required as part of the audit but was audited during 2004/05. The supporting documents proved up to the part of completion of the audit was sufficient to show that the municipality complied with standards before 27 October 2006. The details of the appointment and results of the appointment were to be discussed on Friday 25 November 2006 at 12h00. The meeting could not continue due to the Consultant/Vendor being delayed by the instantly death of a municipal official on the access road. The accident also lead to the Chief Financial Officer not being available for the meeting as the person was reporting to the Chief Financial Officer. The information that the person was a distant relative to the Chief Financial Officer was disclosed by himself to the Municipal Manager and Auditor General representatives from June 2004 before the effective date of appointment. No further engagements could be secured to provide information to the Office of the Auditor General.

##### (b) Photocopy machines

The photocopy machines have been procured in terms of the Supply Chain procedures of the Council. The delegated authority of the Municipal Manager stems from the Municipal Finance Management Act no 56 of 2003 being more than R10 million. The procurement was performed in line with a standing Council resolution and in line with Section 112(2)(b) of the Municipal Finance Management Act being procured by another organ of State. The expenditure was budgeted for and responded to the notice served to Council. The issue was not taken up with the Municipal Manager during the Audit.

##### (c) Motor loan to a Director

The motor loan was governed by the contract of the Director and specific motor vehicle loan. The outstanding amount was claimed from the estate as per contract and commercial and estate laws applicable. All amounts owed directly to the late Director were paid into the loan. After the event all existing motor vehicle loans was secured by Council owned. Life Insurance on the life of all loan holders.

- (d) The amounts paid to directors and the Municipal Manager was subject to

restructuring of packages and retrospective back pay. All payment corrections was made and recovered if applicable after detail reconciliation of payments made. The overpayments were due to Council contributions being increased by the medical aid fund without adjustment of the salaries of directors as an oversight.

#### 7.5 **Going concern**

Noted.

- (a) A detail Debt Collection and Credit Control Policy was approved by Council. The growth of debtors is mainly due to the interest charged on the arrear accounts. Several additional actions were implemented during 2006/07 to improve the collection. The write off of debtors will be done in June 2007.
- (b) The water levies are being investigated and detailed Demand Management and Loss Control Management process and project was implemented. The project will address the loss in billing over a period of 3 years. The Council lost approximately R30 million from 2005 on the water account.
- (c) Noted
- (d) Noted

#### 7.6 **Non-compliance with laws and regulations**

- (a) The Mayoral Trust accounts have been compiled with the assistance of the Chief Financial Officer. These statements will have to be approved by the board of trustees and then be consolidated with the Municipal Statements.
- (b) Noted. This will be addressed in the 2006/07 IDP and Budget.
- (c) Noted. This will be addressed in the 2006/07 Budget process.
- (d) Noted. This matter will be addressed in 2006/07.
- (e) Noted. The WSDP will be compiled with assistance of DWAF for the 2007/08 Financial year.

#### 8 **Late finalisation of the audit report**

The late finalisation is noted. Due to the material changes in the report of the Auditor General some of the matters raised needed to the investigated and caused a delay in tabling the Component of the Annual report.

## **Report of the Audit Committee**

The Audit Committee is pleased to present the report for the financial year ended 30 June 2006 as recommended by the Municipal Finance Management Act No.56 of 2003.

### **1. Audit Committee Members and Attendance**

The Audit Committee consists of the members listed hereunder and meets at least four times a year or more when the need arise. During the current year meetings were held on four occasions in terms of section 166 (4) b of the MFMA and the approved Audit Committee charter. Meetings were held on the following dates: 23 August 2005, 24 November 2005, 8 March 2006 and 16 May 2006.

#### **Name of the Members**

Prof. E.P Ababio (Chairperson)

R. Najjaar

P. Lessing

T. Melato

P.E. Mahonko

M. Tlou

R. Taye

### **2. Audit Committee Responsibility**

The Audit Committee reports that it has complied with its roles and responsibilities as outlined by section 166 of the MFMA and the approved charter. The Audit Committee also reports that it has adopted appropriate formal terms of reference as contained in the Audit Committee charter approved by the Municipal Council and has regulated its affairs in compliance with the charter and has discharged its responsibilities as contained therein.

### **3. Internal Control**

The system of internal control is partially effective as the various reports of the Internal Audit, the Audit report on the annual financial statements and the management letter of the Auditor General have reported certain significant and housekeeping matters of non compliance and control nature. However, nothing significant has come to the attention of the Audit Committee to indicate that any material breakdown in the functioning of internal controls, procedures and systems has occurred during the period under review.

### **4. Internal Auditing**

The Internal Auditing provides a supportive role to management and the Audit Committee to achieve their objectives by assisting in the management of risk within the Municipality.

The Internal Audit department is responsible for objective evaluation of the of the Council's system of internal control at a detailed level and to bring any significant business risks and exposures to the attention of management and the committee through the provision of comprehensive internal audit reports.

### **5. Risk Management**

The municipality has developed a risk management strategy. The Audit Committee has recommended that the strategy be approved by the Council as it will be the foundation for a continuous risk assessment process and for managing and monitoring of risks on an ongoing basis.

### **6. Evaluation of Financial Statements**

The Audit Committee has:

- Reviewed the financial statements prior its submission to the Auditors General.
- Reviewed and discussed the Auditor General Management letter and the Audit report with the Management and the Internal Audit.



The Audit Committee concurs and accepts the conclusion of the Auditor General on the annual financial statements and is of the opinion that the audited financial statements be accepted and read together with the report of the Auditor General.

**PROF E P ABABIO**  
**CHAIRPERSON**