



AUDITOR - G E N E R A L

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

### **1. AUDIT ASSIGNMENT**

The financial statements as set out on pages 8 to 23, 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). These financial statements, the maintenance of effective control measures and compliance with relevant laws and regulations 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 of 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 in accordance with the standards determined by the Institute of Municipal Treasurers and Accountants in its Code of Accounting Practice (1997) and Report on Published Annual Financial Statements (second edition – January 1996), which constitute an entity-specific basis of accounting.

## **4. QUALIFICATION**

### **4.1 Prior period qualifications**

The prior year's audit report contained a disclaimer of audit opinion. I was unable to obtain sufficient and appropriate audit evidence as to whether the matters previously reported had been adequately resolved and that the financial statements did not contain misstatements that materially affected the results of the municipality's operations and cash flows for the period under review.

### **4.2 Comparative information on the balance sheet, cash flow statement, notes to the financial statements and supporting annexures**

- a) The totals of prior year figures for capital employed (R131 929 863) and for employment of capital (R132 049 863) on the balance sheet differed by R120 000.
- b) Certain items of comparative information disclosed in the cash flow statement, notes to the financial statements and supporting annexures were the balances of the 2003-04 audited financial statements.

### **4.3 Water and sanitation service level agreement**

The municipality entered into a service level agreement with Vhembe District Municipality in respect of the provision of water and sanitation services. The following material financial contract stipulations were not adhered to:

- Cash received from consumers for water services was not paid to the district municipality;
- capital assets and officials of the municipality were not identified and transferred to the district municipality;
- expenses incurred in respect of water supply services were not calculated and claimed from the district municipality; and
- no debtor and creditor provisions were made in the municipality's books of account for the amount payable to/by the district municipality.

The financial impact could not be determined due to a dispute between the municipality and district municipality.

### **4.4 Material misstatement of financial statements**

- a) The retained income on the balance sheet (R22 119 479) was misstated by R7,1 million due to an incorrect entry included as an appropriation amount, which should have been allocated to the suspense accounts that were included in the balance as long-term debtors. This incorrect allocation negatively affected the net surplus balance.
- b) The trial balance reflected an uncleared amount of R9,99 million. I observed that R7,89 million was incorrectly disclosed as long-term debtors (suspense account) in the financial statements. The difference of R2,1 million could not be explained.

- c) No provision had been made in the financial statements for the councillors' arrear remuneration for the period March to June 2006, amounting to approximately R1,8 million.

#### **4.5 Statutory funds (note 1, page 14), R83 690 527 (annexure A, page 19)**

- a) There were insufficient concomitant assets to substantiate the existence of the statutory funds as at 30 June 2006.
- b) The insurance and bursary fund balances reflected debit balances of R30 000 and R538 716 respectively. Amounts spent in excess of available funds should be allocated as expenditure in the income statement.
- c) The balance of the net statutory funds per note 1 to the financial statements amounted to R83 690 526 while the balance of annexure A amounted to R81 519 135, resulting in a difference of R2 171 391. Annexure A reflected the incorrect balance.
- d) An amount of R2 827 932 contributed to the insurance fund according to the general ledger was not budgeted for and/or was not approved by council. Annexure A did not reflect this contribution.
- e) Contributions to statutory funds from the operating income (R718 109) could not be reconciled to the amounts allocated to the funds according to annexure A (R191 846), resulting in an unexplained difference of R526 263.
- f) No contribution from income was made to the capital development fund. Approval was not obtained in this regard.
- g) Interest received from the capital development fund and consolidated loans fund was incorrectly allocated to the statutory fund in annexure A as contributions - R3 010 756 and other income - R3 030 851 instead of as interest on investments.
- h) According to the approved budget an amount of R60 000 was to be contributed to the bursary fund. According to annexure A an amount of R65 846 was contributed to the bursary fund.
- i) Management did not have proper control over transactions allocated to the various statutory funds as the relevant ledger accounts were not reviewed and reconciled on a monthly basis.
- j) Contribution to funds per the trial balance amounted to R2 910 109 while the contribution per annexure D amounted to R2 718 108, resulting in a difference of R192 000.
- k) Accounting policies for all the statutory funds were not disclosed in the financial statements in accordance with the guidelines of the Institute of Municipal Officers (IMFO).

Due to the seriousness of the errors and weaknesses detected, I did not obtain sufficient appropriate audit evidence regarding the existence, accuracy and completeness of the statutory fund balance on the balance sheet.

#### **4.6 Reserves (note 2, page 14), R3 595 887 (annexure A, page 19)**

- a) There were insufficient concomitant assets to substantiate the existence of reserves as at 30 June 2006.
- b) The balance of most of the funds reflected no movement for a couple of years, raising questions as to the need of such funds, especially when taking into consideration that these funds should be supported by cash.
- c) Contributions made from the operating account to reserves amounted to R126 000 while only R120 000 was budgeted for, resulting in unauthorised expenditure of R6 000.
- d) Accounting policies for all the reserve funds were not disclosed in the financial statements in accordance with IMFO guidelines.

#### **4.7 Trust funds (note 3, page 14), R32 648 291 (annexure A, page 19)**

- a) There were insufficient concomitant assets to substantiate the existence of trust funds as at 30 June 2006.
- b) The balance of some of the funds reflected no movement for a couple of years, raising questions as to the need of such funds, especially when taking into consideration that these funds should be supported by cash.
- c) The individual balances of the trust funds in the general ledger were not reconciled during the year under review, nor were detailed audit working papers compiled and submitted for audit purposes.
- d) No separate control register was maintained during the year under review and reconciled to the relevant ledger accounts for each trust fund.
- e) The municipality incurred and funded expenses from the people's housing process (PHP) housing fund without taking the stipulations of the municipality's approved supply chain management policy into consideration. No tenders were obtained for expenses exceeding the limits where tenders should have been obtained.
- f) Capital expenditure amounting to R250 545, incurred in respect of computers and vehicles was funded by the financial management grant (FMG). This capital expenditure was not included in the business plan of the FMG.
- g) The municipality received a municipal infrastructure grant (MIG) grant of R3,8 million for the erection of a taxi rank at Elim but the project was terminated due to a land dispute. The money received had not been refunded to government, nor was written approval obtained to utilise the funds for other capital projects.
- h) Supporting documentation for expenses funded by the PHP housing project amounting to R799 703 could not be supplied for audit purposes.
- i) Supporting documentation for expenses funded by the drought relief fund amounting to R480 671 could not be supplied for audit purposes.

- j) Supporting documentation for expenses funded by the integrated national electrification program (INEP) fund amounting to R91 050 could not be supplied for audit purposes.
- k) Supporting documentation for expenses funded by the municipal systems infrastructure grant (MSIG) fund amounting to R18 699 could not be supplied for audit purposes.
- l) Supporting documentation for expenses funded by the MIG fund amounting to R519 500 could not be supplied for audit purposes.
- m) Supporting documentation for expenses funded by the FMG fund amounting to R757 782 could not be supplied for audit purposes.
- n) A difference of R18 664 between the trial balance and the amount disclosed in annexure A to the financial statements was observed regarding expenses funded by the MIG fund.
- o) A difference of R317 201 between the trial balance and the amount disclosed in annexure A to the financial statements was observed regarding expenses funded by the PHP fund.
- p) A difference of R317 201 between the trial balance and the amount disclosed in annexure A to the financial statements was observed regarding expenses funded by the PHP fund.
- q) A difference of R198 363 between the trial balance and the amount disclosed in annexure A to the financial statements was observed regarding expenses funded by the MSIG fund.
- r) Accounting policies for all the trust funds were not disclosed in the financial statements in accordance with IMFO guidelines.

Due to the seriousness of the errors and weaknesses detected, I am unable to express an opinion on the existence, accuracy, completeness and appropriate disclosure of the trust fund balance on the balance sheet.

#### **4.8 Retained income (note 17, page 17), R22 119 479**

- a) The retained income balance at 30 June 2006 was materially overstated due to the effect of the material errors detected and reported in paragraph 4.4 of this report as well as other errors highlighted in the report.
- b) The appropriation account contained transactions with a net debit balance of approximately R4,2 million which were in respect of current year transactions and should have been allocated to the relevant expense and revenue accounts.
- c) The detail of the balance of the appropriation transactions was not disclosed as required by IMFO in note 17 to the financial statements.

Due to the seriousness of the errors and weaknesses detected, I am unable to express an opinion on the existence, accuracy and completeness of the retained earnings balance in the balance sheet.

#### **4.9 Long-term liabilities (note 4, page 14), R10 472 380 (annexure B, page 20)**

- a) No external loan register was maintained and reconciled to the relevant general ledger accounts during the year under review.
- b) The total capital charges between annexure D (R15 632 086) and note 16 (R9 785 476) of the financial statements differed by R5 846 610. This was mainly due to the interest charges for external and internal loans not being disclosed in note 16.
- c) The opening balances of the consolidated loans fund in the internal loan register differed from the general ledger by R76 332.
- d) No redemption was calculated during the year under review for the Natis system and tennis club internal loans.
- e) No interest was charged during the year under review for the tennis club, resulting in a loss of potential interest revenue.
- f) The annual redemption on some of the loans was not sufficient to repay the loans over the approved loan terms.
- g) Loans to the value of R574 075 were taken up during the year under review and funded by the capital development fund without these loans being approved by the council as required by section 46(2) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA).
- h) Section 46(1) of the MFMA stipulates that long-term debt can only be incurred to fund capital expenditure. I identified that costs to repair roads were financed by means of internal loans.

Due to the seriousness of the errors and weaknesses detected, I am unable to express an opinion on the existence, accuracy and completeness of the long-term liability balance on the balance sheet.

#### **4.10 Consumer deposits (note 12, page 16), R3 971 290**

- a) The balance of consumer deposits as disclosed in the balance sheet (R3 971 290) differed from the balance according to the debtor system (R4 720 340) by R749 050.
- b) Although the balance of the consumer deposits was disclosed in note 12 to the financial statements, bank guarantees held by the municipality in respect of consumer accounts were not disclosed in note 12 as required by IMFO standards.

Due to the seriousness of the errors and weaknesses detected, I am unable to express an opinion on the existence, accuracy, completeness and appropriate disclosure of the consumer deposit balance in the balance sheet.

**4.11 Fixed assets and external loans / internal advances (note 5, page 15), R61 042 906 (annexure B, page 20 and annexure C, page 21)**

- a) The total net additions to fixed assets funded by operating income according to annexure D amounted to R6 080 220 whilst the additions per the fixed asset register funded by contributions from income amounted to R6 054 683, resulting in a difference of R25 537.
- b) The total additions per annexure C funded by grants and subsidies amounted to R20 973 460 while note 3.2 of the acting chief financial officer's report disclosed this amount as R19 616 449, resulting in an unknown difference of R1 357 011. In addition, I could not be provided with supporting documentation for the amount of R20 973 460.
- c) The contribution to fixed assets from operating accounts per trial balance differed from the annexure D income statement by R1 004 068.
- d) According to annexure C to the financial statements the total movement for loans redeemed and advances amounted to R6 076 517 whilst the total redemption for internal and external loans per annexure B amounted to R9 785 476. Although I am aware that some loans were incurred to fund township development expenses and are part of the reason for the variances, I could not be supplied with detailed supporting documentation for the difference of R3 708 959.
- e) The movement during the year under review for loans redeemed and other capital receipts amounted to R18 277 172, including basically only the additions for the year. This did not agree to the asset additions and loan capital redemption which amounted to R19 091 573. This resulted in a difference of R814 401.
- f) The capital budget balances captured on the financial system did not agree to the capital budget that was approved by the National Treasury. The approved capital budget for 2005-06 amounted to R41 638 251 whilst the budgeted amount captured on the financial statements amounted to R49 924 923.
- g) The budgeted figure was not disclosed in note 5 to the financial statements as required by IMFO guidelines.

**4.12 Physical verification of fixed assets (note 5, page 15), R326 792 702**

The fixed asset register maintained in terms of section 54 of the Standard Financial By-Laws was insufficient to ensure proper physical control over assets:

- a) Due to the inadequate descriptions of the assets in the asset register it was not in all instances possible to physically verify the assets from the premises to the asset register and vice versa.
- b) In some instances asset items were grouped together in the asset register, making it basically impossible to verify such assets.
- c) The descriptions of the assets on the inventory sheets were in most instances inadequate, as no serial and/or model numbers were recorded.

- d) A Ford Mondeo registration number DWJ870N vehicle which was damaged beyond repair approximately two years ago was not removed from the asset register.
- e) Assets no longer in working order were not identified by management and removed from the asset register.
- f) Assets disposed of in previous years were not removed from the asset register.
- g) No detailed physical asset verification was conducted during the year under review, and the results were not reconciled to the asset register and relevant fixed asset ledger accounts, as had been the position for the previous two financial years.
- h) Capital expenditure with a net value of R63 550 was expensed as repairs and maintenance in the previous year. This correction was not effected in the asset register.
- i) Value-added tax (VAT) was not always treated correctly regarding fixed assets obtained. In some instances VAT was incorrectly claimed back from SARS, e.g. four vehicles bought for the traffic department.
- j) I could not perform a reconciliation between the title deeds of properties registered in the municipality's name and the properties captured on the asset register due to insufficient detail in the fixed asset register.
- k) In the previous year I mentioned that a capital contract register was not properly maintained. The situation had not improved as a detailed register was still not in place.

Due to the seriousness of the errors and weaknesses detected, I am unable to express an opinion on the existence, accuracy, completeness and appropriate disclosure of the fixed asset balance in the balance sheet.

#### **4.13 Investments (note 6, page 15), R41 335 234**

- a) Interest accrued amounting to R293 377 on notice deposits was not provided for in the financial statements.
- b) I could not be supplied with updated external confirmations for the amount disclosed as a short-term investment amounting to R58 015.
- c) Interest earned amounting to R46 803 on a 32-day notice account was incorrectly allocated to the bank ledger account.
- d) Investments held on behalf of former employees amounting to R301 728 were not disclosed as investments and a liability in the financial statements.
- e) Management did not adhere to the stipulations of the MFMA regarding the reporting on investments to third parties.



Due to the seriousness of the errors and weaknesses detected, I am unable to express an opinion on the existence, accuracy and completeness of the investment balance in the balance sheet.

**4.14 Long-term debtors and short-term portion of long-term debtors (note 7, page 15), R7 959 878**

- a) I could not be supplied with supporting documentation substantiating the balance of the short-term portion of the long-term debtors amounting to R500 000.
- b) No reconciliation was performed between the balance of the long-term debtor sub-system and the relevant general ledger accounts. In addition, long-term debtors were disclosed in the general ledger in more than fifty individual accounts, resulting in difficulties to perform reconciliation.

Due to the reconciliation not being performed I detected that the balance of the housing debtors per the list of stand debtors (R2 051 144dt) was not reconciled to the general ledger account (R759 533cr) on a regular basis. This resulted in a difference of R2 810 677 at year-end.

- c) Disclosed under long-term debtors were suspense accounts with a net balance of R7 892 936 that were not cleared and were not substantiated by relevant supporting working papers. Affecting this suspense account was an incorrect allocation of R7,1 million that had already been reported on in note 4.4.
- d) The short-term portion of the long-term debtors was understated by R150 087.
- e) Included in the list of long-term debtors were various balances that were long overdue and/or showed no movement during the year under review. Management did not implement credit control procedures, nor did they provide for possible bad debts.
- f) A limitation was placed on my audit scope in that completed and signed loan agreements/contracts could not be supplied for certain housing, sale of stand and bursary loans.
- g) The interest charged to the short-term portion of the long-term debtor balances did not in all instances agree to the stipulations of the loan agreements/contracts.
- h) The balance of stand debtors included balances of transactions that were cancelled.
- i) The opening balance of stand sales in the general ledger (R2 102 307) differed from the prior year's audited closing balance (R2 199 776) by R97 468.
- j) The stand sale transaction amounting to R85 000 was duplicated in the municipality's books of account.
- k) Bank guarantees held by the municipality in respect of stand sale transactions to the value of R4 217 518 were not disclosed in note 7.

Due to the seriousness of the errors and weaknesses detected, I am unable to express an opinion on the existence, accuracy and completeness of the long-term debtors balance in the balance sheet.

#### **4.15 Debtors (note 9, page 15), R41 277 219**

##### **4.15.1 Trade debtors**

- a) Included in the list of trade and sundry debtors were credit balances amounting to R4 816 595 which were not disclosed under current liabilities. On closer inspection of these balances I detected revenue transactions for which invoices were never raised, resulting in an unknown understatement of revenue and long-term debtor balances in the financial statements.
- b) I could not rely on the accuracy of the trade debtor age analysis as days outstanding movements from one month to the next month did not agree.
- c) Several of the balances included in the trade and sundry debtor lists were long overdue and recoverability seemed unlikely. From my test sample, I detected balances in arrears amounting to R1,97 million. Refer to paragraph 6.1 of this report.
- d) The debtors balance in the notes to the financial statements was not disclosed according to IMFO requirements. Current disclosure was a one-line entry instead of differentiating between the various types of debtors such as trade, sundry, etc.
- e) The individual balances that appeared on the debtor system were not reconciled on monthly basis to ensure completeness and accuracy. Various instances were detected of individual trade debtors with credit balances or debtor accounts that showed no movement during the year under review. I could not be supplied with reasons for these deviations.
- f) A limitation was placed on my audit scope in that fully completed and signed trade service agreements/contracts could not be supplied for audit purposes for certain consumer and sundry debtors.
- g) Unallocated deposits with a net value of R1,6 million were carried on the bank reconciliation as reconciling items without these transactions being followed up and cleared. Some of these deposits could affect the balance of the trade debtors. Refer to paragraph 4.17 of this report.
- h) The balances of unknown deposits that appeared on bank statements were transferred to a separate ledger account called "amounts paid in advance". The balance of the ledger account amounted to R797 666 at year-end. This account was not followed up and cleared during the year under review. Some of these deposits could affect the balance of the trade debtors.
- i) Council approved an amount of R1 277 061 to be written off as bad debts. This represented balances included in the year-end debtor list. These balances were not removed from the debtor list nor was the amount to be written off disclosed in the debtor note 9.

- i) No proof could be obtained that management reconciled the balance of the trade and sundry debtor system on a monthly basis with the relevant ledger accounts.

Due to the seriousness of the errors and weaknesses detected, I am unable to express an opinion on the existence, accuracy and completeness of the debtors' balance in the balance sheet.

#### **4.15.2 Provision for doubtful debt**

- a) According to my calculations the current provision for doubtful debt amounting to R11 567 285 reflected in note 9 of the financial statements was understated by R42,2 million.
- b) Credit control procedures were not effectively implemented against holders of accounts that were in arrears. Refer to paragraph 6.1 of this report for detail.

Due to the seriousness of the errors and weaknesses detected, I am unable to express an opinion on the existence, accuracy and completeness of the provision for doubtful debt provided for in the financial statements.

#### **4.16 Inventory (note 8, page 15), R6 964 542**

- a) The inventory balance according to the general ledger (R6 958 613) differed from the total of the final financial statements (R6 964 542) by R5 929.
- b) Inventory items with an unknown value kept at Waterval store, a former R293 town now controlled by the municipality, were not included in the inventory balance at year-end. Furthermore there was no physical control over these store items as they were not controlled via the municipality's perpetual inventory system.
- c) Included in the inventory year-end balance was diesel stock at Dzunani, Vuwani, Sitale, Ravele and Waterval that could not be accounted for, resulting in a loss and overstatement of the inventory balance by R321 187.
- d) From a test sample I detected slow moving items or items that showed little or no movement since the previous year to the value of R786 449 that were included in the final inventory lists. No provision was made in the financial statements for slow moving items.
- e) The method used to value inventory at year-end was not correctly disclosed in the accounting policies in the financial statements in accordance with IMFO guidelines.
- f) Various differences were detected between the quantities in the inventory count sheets and the quantities in the year-end inventory sheets. From my test sample I detected differences amounting to R177 654.

As a result of the errors and material weaknesses identified in the inventory accounting process, inventory could be materially misstated, and I am therefore unable to express an opinion on the accuracy and completeness of the amount disclosed in the financial statements.

#### **4.17 Bank and cash (note 23, page 15), R1 409 440**

- a) The balance of bank and cash as disclosed in the financial statements (R1 409 440) differed from the bank ledger account (R1 432 360) by R22 920.
- b) There was an unreconciled difference of R725 693 between the cash book and bank statements. This difference was carried over from the previous year's audited financial statements.
- c) Outstanding cheques to the value of R1,4 million were reflected on the bank reconciliation although these cheques were older than six months and would no longer be honoured by any financial institution. Included in the list were cheques with credit balances amounting to R72 089 that did not contra to debit balances.
- d) Cancelled cheques amounting to R352 598 were included in the list of outstanding cheques.
- e) Cheques to the value of R332 962 appeared on the list of outstanding cheques, however, the supporting documentation for these cheques could not be supplied for audit purposes.
- f) A reconciling line item "Cheques on bank statement not in cashbook" amounting to R25 811 appeared on the bank reconciliation. This balance represented cheques that had not yet been captured in the municipality's financial system, resulting in an understatement of expenses.
- g) Direct expenses amounting to R730 021 were not cleared and captured to the correct accounts before year-end. This amount was carried as reconciling item on the year-end bank reconciliation.
- h) Two line items appeared on the bank reconciliation that were not reconciled and captured to the correct accounts before year-end. The items were "Deposits in cashbook not on bank statements" amounting to R13,1 million and "Deposits on bank statements not on cashbook" amounting to R11,5 million. Furthermore, the difference of R1,6 million was not resolved.
- i) Refer-to-drawer cheques amounting to R715 910 were carried as reconciling items on the bank reconciliation. Some of these individual transactions were long outstanding and should have been reversed to the relevant debtors' accounts.

As a result of the abovementioned I was unable to obtain sufficient appropriate audit evidence regarding the accuracy, existence and completeness of bank and cash balances reflected in the financial statements.

#### **4.18 Provisions (note 10, page 15), R1 709 289**

- a) No provision was made for the proportional bonus liability that existed as at 30 June 2006. The amount could not be determined.
- b) The balance of the leave reserve amounting to R1 709 289 was not updated to represent the actual liability that existed as at 30 June 2006. This balance had remained unchanged since the 2003 financial year.

- c) No provision had been made at year-end for councillors' back pay amounting to approximately R1,8 million.
- d) Payment in respect of leave encashment was not allocated to the leave reserve but was expensed in the operating expense accounts.

As a result of the errors and weaknesses mentioned above, the balance of provisions is materially misstated, and I am therefore unable to express an opinion on the accuracy and completeness of the amount disclosed in the financial statements.

#### **4.19 Creditors (note 11, page 16), R9 958 596**

- a) The creditor general ledger control account amounted to R5 656 and was included in the suspense account total at year-end that was not reconciled and cleared at year-end. Furthermore, the balance of the creditor sub-ledger amounted to R1 529 at year-end while the list of trade creditors as disclosed in the notes to the financial statements amounted to R8 373 930. No explanation could be obtained for these variances.
- b) Included in the year-end creditor balance was a line item "Amounts paid in advance" amounting to R797 666. This balance represented unknown deposits that appeared on the bank statements. This balance was not followed up and cleared during the year under review, nor could I be supplied with detailed information that substantiated this balance.
- c) The balance of value-added tax (VAT) amounting to R787 000 was included in the creditors balance at year-end. Various shortcomings were detected regarding VAT. This is separately dealt with in paragraph 4.20 of this report.
- d) Management did not follow up on subsequent payments to identify liabilities not provided for. I detected payments to the value of R12 760 made after year-end that were not provided for as creditors.

As a result of the errors and weaknesses mentioned above, the balance of creditors could be materially misstated, and I am therefore unable to express an opinion on the accuracy and completeness of the amount disclosed in the financial statements.

#### **4.20 Value-added tax (note 11, page 16), R787 000**

- a) I was not supplied with a detailed reconciliation that substantiated the amount disclosed in the notes to the financial statements amounting to R787 000 with regard to value-added tax (VAT).
- b) No reconciliations were performed between the VAT201 returns and the amounts disclosed in the VAT general ledger accounts. According to my calculations a difference of R1,2 million existed at year-end.
- c) Zero-rated and exempt supplies were not disclosed on the VAT returns.
- d) The copies of the VAT201 returns submitted to me for July and August 2005 differed materially from the original SARS returns. These differences were not followed up.

- e) VAT was incorrectly claimed on expenses that did not qualify to be claimed as input VAT, e.g. traffic vehicles bought during the financial period.
- f) The municipality changed its basis of VAT registration from the invoice to the cash basis. I could not obtain written approval from SARS for the change.
- g) VAT was not paid to SARS in respect of stand sales. From my test sample I detected VAT to the value of R498 040 that was not treated as input VAT. This resulted in the overstatement of stand sales and understatement of the VAT liability.
- h) The municipality, from time to time, utilised the consumer deposits as payment of accounts that were in arrears. Due to the fact that the municipality was claiming VAT on the cash basis, VAT should have been paid over on these deposits utilised as payment of accounts. This was not done during the year under review.
- i) The VAT set up on the Munsoft financial system for ledger accounts was either zero rated or 14%. No proportional rates were utilised.

As a result of the above-mentioned I could not obtain sufficient appropriate audit evidence regarding the completeness, accuracy and appropriate presentation of the VAT balance reflected in the financial statements.

#### **4.21 Payments and other sundry expenses**

- a) The amount paid to political office bearers during the year under review amounted to R7 952 986. However, only R7 047 347 was disclosed in the notes to the financial statements.
- b) According to invoices submitted for audit purposes the amount actually paid for telephone expenses during the year under review amounted to R1 310 920 whilst the amount disclosed in the ledger amounted to R1 258 231, resulting in an understatement of R52 689. The difference of R52 689 could not be explained.
- c) Supporting documents for expenses totalling R6,3m could not be supplied for audit purposes, placing a limitation on the audit scope.

As a result of the above-mentioned I could not obtain sufficient appropriate audit evidence regarding the completeness, existence, accuracy and appropriate presentation of these expense items.

#### **4.22 Payroll accounting cycle**

- a) Unemployment insurance fund expenses amounting to R550 394 were disclosed in the annexure D income statement as general expenses although it actually represented salary-related expenses.
- b) Various instances were detected where overtime payments of individual employees were more than 30% of officials' basic salaries, which contravened the Basic Conditions of Employment Act.

#### **4.23 Revenue**

- a) No reconciliations were performed by management on a monthly basis between the results of the billing system and the relevant general ledger accounts. For the year under review, I detected a net difference of R1,6 between the billing system (R110 112 677) and the general ledger accounts (R111 698 051).
- b) I obtained information regarding broken meters for which consumption was not accurately measured; the list supplied to me contained information for in excess of a hundred and fifty broken meters. This resulted in a loss of revenue as the broken meters were not repaired timeously.
- c) In addition to the above, I obtained information regarding meters not found in the meter reading books, which resulted in a potential loss of revenue. The list supplied to me contained information on more than a hundred unknown meters.
- d) No statistical information for the year under review regarding services provided per category was maintained and supplied by management for audit purposes, making it impossible to audit the completeness of electricity, water, sanitation and refuse revenue.
- e) The total of the monthly trade debtor interest billing reports (R8 808 724) differed from the balance in the general ledger (R8 886 165) by R77 441.

As a result of the errors and weaknesses mentioned above, the balance of revenue could be materially misstated, and I am therefore unable to express an opinion on the accuracy and completeness of the amounts disclosed in the financial statements.

#### **4.24 Financial statement disclosure errors / deviations**

During the review of the financial statements, the following deviations or errors from standard disclosure requirements were noted:

- a) Statistical information (annexure F)

Annexure F statistical information was not compiled and submitted together with the financial statements as stipulated by IMFO. This placed a limitation on the scope of the audit as I could not audit the statistical information.

- b) General statistics – assessment rates (note 13, page 16)

IMFO guidelines require municipalities to disclose general statistics differentiating between the valuation of rateable and non-rateable properties as well as between residential and commercial properties, valuation of residential and commercial properties and assessment rates.

The following weaknesses were detected:

- i) General statistics did not differentiate between rateable and non-rateable properties.

- ii) General statistics did not disclose the residential and commercial properties.
- iii) Valuations of residential and commercial properties were not disclosed;
- iv) The number of both residential and commercial properties as well as applicable rates was not disclosed. (Assessment rates: cents in the rand).

c) Foreword

No foreword by the mayor/municipal manager was compiled and submitted as part of the financial statements.

d) Chief financial manager's report

- Point 2.2 - The housing services 2005 expenditure column differed from the annexure E information by R10 869 and the 2005 surplus column differed by R13 484. The note did not add up, resulting in a difference of R14 744.
- Point 2.3 – The income and expenditure in the 2005 column differed from the annexure E information by R1 214 334 and R9 583 003 respectively.
- Point 3.1 – Total capital expenditure was disclosed as R18 460 033 instead of R11 800 380.
- Note 4 – The 2005 column should add up to R12 375 455 instead of R349 595.
- Note 5 – The 2005 column totals did not agree to the balance sheet. In the 2006 column the total of the bank amounted to R1 420 899 but was disclosed as R1 409 440 in the balance sheet. The cash on hand amounting to R11 460 was not disclosed in the note.
- Movements in the funds and reserves balances were not discussed in detail in the CFO's report.

e) Accounting policies

- The detail regarding the external loans was outdated as no local registered stock or annuity loans existed in the municipality's portfolio.
- The capital development fund disclosure was not detailed enough, nor was it in accordance with the stipulations of IMFO.
- Insurance fund policy stipulated that the fund's purpose was to finance any possible small insurance claims and excess payments. The fund was not utilised during the year under review as no small claims or excess payments were allocated to the fund.
- The income recognition policy did not comply with IMFO requirements as it did not address areas without meters and indigent consumers.
- The policy on the surplus for the year mentioned a deficit instead of a surplus of R9 994 244.

f) Balance sheet

- The reserve total in the 2005 column differed from the notes by R120 000.
- The trust fund total in the 2005 column differed from the appendix by R3 030 192.



g) Cash flow statement

- Various casting and cross-casting errors appeared on the cash flow statement.
- The total for cash generated by operations per the cash flow differed from the notes by R9 542 402.
- The investment income in the 2005 column differed from note 16 by R752 401.
- The increase in working capital in the 2005 column differed from note 19 by R4 874 630.
- Mention is made on the cash flow statement of note 27, however, no note 27 existed.

h) Notes to the financial statements

- Various casting and cross-casting errors existed on the notes.
- Notes 14 to 19. The balances disclosed in the 2005 column did not agree to the closing balances of the 2005 financial statements. These balances were the closing balances of the 2004 financial year.
- Finance transactions – note 16. Interest earned as well as capital charges did not agree to annexure D information.

i) Annexure A

- Amounts were disclosed in cents. The closing balances in the 2006 column were not rounded.
- Various casting and cross-casting errors were detected.

j) Annexure B

- Various casting and cross-casting errors were detected.
- The opening balance of the consolidated loan fund differed from the balances of the 2005 financial statements by R76 331.
- In point 3.2 of the CFO's report mention is made that capital expenditure funded by the consolidated loan fund during 2005 amounted to R6 536 898, however, according to annexure B of the 2005 financial statements the internal loans taken up amounted to R3 745 704.

k) Annexure C

- Various casting and cross-casting errors were detected.
- The total expenditure in the 2006 column added up to R26 245 207 while the additions per the financial funding sources added up to R27 028 143. The difference of R782 936 did not reconcile to the internal loans taken up to fund asset additions amounting to R574 075.
- The opening balance of the fixed assets differed from the total of the 2005 financial statements by R21.
- The total loans redeemed per annexure C amounted to R6 076 517 while the total redemption amount per annexure B amounted to R9 875 476. I could not be provided with a detailed working paper that substantiated the difference.

#### **4.25 Limitation on audit scope**

Various documents requested for audit purposes were not submitted for audit purposes, placing a limitation on the scope of the audit.

##### **a) Housing guarantees**

Disclosed under investments was an amount of R58 015 (2003: R55 125) regarding housing guarantees. I could not be supplied with updated supporting documentation that substantiated the balance nor the movements for the year.

##### **b) Journals**

I could not be supplied with the supporting documentation for a number of journals processed.

#### **5. ADVERSE AUDIT OPINION**

In my opinion, because of the significance of the matters discussed in the preceding paragraph and their effect on the financial statements, the financial statements do not present fairly, in all material respects, the financial position of Makhado Municipality at 30 June 2006 in accordance with the basis of accounting described in paragraph 3 and in the manner required by the MFMA.

#### **6. EMPHASIS OF MATTER**

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

##### **6.1 Credit control**

The Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) section 96(a) stipulates that a municipality must collect all money that is due and payable to it, subject to the act and any other applicable legislation.

Although a credit control policy was approved by the council, it was not strictly enforced and effectively implemented by management. This resulted in the balance of current debtors increasing by approximately R14,6 million in 2006, representing an increase of 29,3% since 2005.

##### **6.2 Cash flow / Going concern**

Taking into account that all fund balances should be supported by cash, an overall cash shortfall of approximately R79,9 million rand existed as at the end of June 2006.

The cash flow position of the municipality at 30 June 2006 had improved since the previous year, however, most of the investment balances served as security for unspent trust funds and the municipality was therefore dependent on the equitable share allocations to trade as going concern in the near future.

### **6.3 Creditor reconciliations**

Monthly creditor reconciliations were not prepared for all trade creditor payments.

### **6.4 Approval of overtime**

Various instances were detected where officials were paid overtime without approved overtime application documentation.

### **6.5 Approval and capturing of leave forms**

Various instances were detected where leave forms were approved after leave had already been taken or where leave taken was not captured on the payroll system.

### **6.6 Legal and regulatory environment**

The current procedures in place to ensure adherence to relevant laws and regulations were found to be inadequate. A clear indication of this was the non-implementation of effective internal audit and performance measurement committees at the municipality. No proof could be submitted that indicated that the Legal Department followed up and ensured adherence to all laws and regulations relevant to the municipality.

### **6.7 Internal control environment**

The internal control environment of the municipality was evaluated during the audit planning phase and found to be insufficient. Effective and proper management review was virtually non-existent and the errors mentioned in this report are an indication of the weakness.

### **6.8 Revenue and other sundry income**

- a) Instances were detected where consumers were charged higher tariffs than those approved by the council.
- b) Reconnection charges were in some instances charged to consumer accounts without services actually being terminated.
- c) All the properties situated within the municipal jurisdiction of Makhado were not re-valued in the last four years as required by the Property Rates Act, 2003 (Act No. 56 of 2003).

### **6.9 Payments and sundry expense**

- a) Various instances of incorrect allocations of expenses in the general ledger were detected, *inter alia* as referred to in paragraph 4.10 of this report.
- b) As mentioned in paragraph 4.19 of this report, payments were in some instances instituted without all the relevant supporting documentation being attached. This was a clear indication that the management review process was not properly performed.

## **6.10 Human resources**

- b) Performance contracts were not in all instances finalised and signed within one month after the beginning of the financial year as required by the MFMA.
- c) Appointment letters could not be supplied for all officials.
- d) Excessive overtime was worked by some officials.

## **6.11 Information systems security and disaster recovery plans**

The municipality did not have information systems security and disaster recovery plans in place.

## **7. APPRECIATION**

The assistance rendered by the personnel of the municipality during the audit is appreciated.

N A Dzuguda  
*For: Auditor-General*

Polokwane

30 November 2006