

REPORT OF THE AUDITOR-GENERAL TO THE COUNCIL ON THE FINANCIAL STATEMENTS OF MADIBENG LOCAL MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2006

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of Madibeng Municipality which comprise the statement of financial position as at 30 June 2006, statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx].

Accounting Officer's responsibility for the Financial Statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with Generally Recognised Accounting Practice and Generally Accepted Municipal Accounting Practice (GRAP/GAMAP) and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) and Auditor- General Audit circular 1 of 2005. This responsibility includes:
 - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error;
 - selecting and applying appropriate accounting policies; and
 - making accounting estimates that are reasonable in the circumstances.

Auditor General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with International Standards on Auditing, *General Notice* 1512 of 2006, issued in Government Gazette no. 29326 of 27 October 2006. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.
6. An audit also includes evaluating the:
 - appropriateness of accounting policies used

- reasonableness of accounting estimates made by management
 - overall presentation of the financial statements.
7. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis of accounting

8. The Madibeng Local Municipality's policy is to prepare financial statements on the basis of accounting determined by National Treasury, as set out in note 1 to the financial statements

Basis for Adverse Opinion

9. Opening balances

As reported in the prior year, a disclaimer of audit opinion was issued. During the year under review no corrective measures were implemented by management on qualifications reported. Therefore, no reliance could be placed on the opening balances in the financial statements and no inference should be drawn from the opening and closing balances.

10. Going concern

The following main factors raised doubt as to the Municipality's ability to operate as a going concern:

- Funds and reserves amounting to R48,4 million were not represented by cash or investments.
- No Value-added tax (VAT) returns were submitted or paid over to SARS for the year under review.
- Loans amounting to R289,8 million were not repaid in accordance with the loan conditions.
- Creditors were not paid within 30 days after receipt of invoice as required by Section 65(2)e of the MFMA.
- Conditional grants amounting to R2,8 million were not spent.

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

11. Funds and reserves

Funds and reserves amounting to R154 million disclosed in the financial statements could not be verified as supporting documentation could not be provided for expenditure amounting to R43 million and other income amounting to R13 million.

No authorisation could be obtained for the contributions made to the Assistance to Indigents Reserve amounting to R10,5 million.

I therefore did not obtain all the documentation and explanations necessary to verify the completeness, allocation, rights and existence of funds and reserves amounting to R154 million as disclosed.

12. Accumulated deficit

No supporting documentation could be provided for the prior year adjustments amounting to R6,7 million as disclosed in the financial statements.

I therefore did not obtain all the documentation and explanations necessary to verify the completeness, allocation, rights and existence of the accumulated deficit amounting to R163 million as disclosed.

13. Long term and short term liabilities

The Long term and short term liabilities could not be verified due to:

- Agreements for loans amounting to R289,8 million was not submitted for audit purposes.
- The Municipality did not have systems in place to identify and account for finance leases. This resulted in two known finance leases amounting to R2,1 million not included as long term liabilities as prescribed by International Accounting Standards 17 (IAS).
- Securities indicated on the Municipalities register does not agree with the loan confirmations received.

Therefore the completeness, rights and existence of long term liabilities amounting to R46,8 million and short term liabilities amounting to R300 million could not be verified.

14. Creditors

No supporting documentation including creditors listing and creditor reconciliations, could be presented for the following classes of balances, as disclosed in note 3:

- Trade creditors R 18,5 million
- Payments received in advance R 9,4 million
- Other creditors R 301,2 million

The leave provision was significantly overstated because the system was not updated with the leave taken.

I therefore did not obtain all the documentation and explanations necessary to verify the completeness, valuation, obligation and existence of creditors amounting to R342,6 million as disclosed.

15. Consumer deposits

No consumer debtors listing/register could be provided due to system problems. No reconciliation with the control account was performed.

I therefore did not obtain all the documentation and explanations necessary to verify the completeness, valuation, rights and existence of consumer deposits amounting to R7,4 million as disclosed.

16. Property Plant and equipment

The following factors limited the scope of the audit of fixed assets:

- The municipality did not perform a complete physical verification of fixed assets during the year under review.
- The fixed asset register did not have any reference numbers to facilitate the identification of fixed assets. It was therefore not possible to trace the assets from the asset register to the physical assets.
- No supporting documentation was provided for additions amounting to R12,8 million, which represent 17% of the vouchers selected.
- No listing of projects in progress could be obtained and no contract register existed.
- Contractors' payment certificates were not signed as proof of payment.
- The municipality did not have the systems in place to identify and account for finance leases. This resulted in two finance leases not having been capitalised as assets as prescribed by IAS 17.
- Expenditure was incurred on projects not budgeted for.

I therefore did not obtain all the documentation and explanations necessary to verify the completeness, valuation, rights and existence of fixed assets amounting to R156 million as disclosed.

17. Investments

It was not possible to verify investments due to the following:

- Monthly investment reconciliations were not prepared;
- The investments made and sold were not done according to the investment policy, for example:
 - Minutes could not be submitted as proof that the council approved the investments; and
 - Quotations were not obtained before each investment was made.
- Amounts per confirmations received, the investment register and the financial statements could not be reconciled.
- Withdrawals recorded in the investment register could not be traced to the bank statements.
- Ceded investments disclosed and ceded investments per confirmations and investment register did not agree.

I therefore could not verify the completeness, valuation, rights and existence of investments amounting to R70,2 million as disclosed.

18. Long-term receivables

The recoverability of the long-term debtors for housing and stand loans disclosed as R14,4 million in note 8 to the financial statements is doubtful. All of the debtors accounts tested showed no repayments during the year under review, nor subsequent to year-end.

I therefore did not obtain all the documentation and explanations necessary to verify the completeness, valuation, rights and existence of long-term debtors amounting to R11,5 million as disclosed.

19. Inventory

Inventory disclosed could not be verified due to the following:

- Stock counted at year-end and stock recorded did not agree.
- No transaction listing/supporting documentation for selected stock items from the system could be submitted to verify the valuation.
- Stock requisitions could not be traced to the system.
- Monthly stock reconciliations were not performed.

I was therefore not able to verify the completeness, valuation and existence of inventory amounting to R 3,5 million.

20. Consumer debtors

There was a scope limitation due to the following factors:

- A difference of R33,2 million existed between the debtors' listing provided and the consumer debtors disclosed.
- Inaccurate provision for bad debts. Consumer debtors outstanding for 90 days and longer, as at 30 June 2006, amounted to R188,7 million although a bad debt provision of only R161 million was made. Based on past payment history, the provision was therefore understated by R27,7 million.
- 76% of the sample selection from the debtors listing could not be traced to the debtors system.
- Large and unusual transactions and journals could not be explained.
- The statement made in note 31 to the financial statements indicated that councillors' arrear accounts could not be provided due to system shortcomings.

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

21. Other debtors

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

- No adequate supporting documentation including a debtors listing and debtor reconciliations could be presented for the following balances classified as other debtors:

- Grants fund debtors	R 84,4 million
- Consumer debtors ODI	R 121,3 million
- Debtors suspense accounts	R 202,5 million
- The recoverability of the grant debtors could not be verified.
- Council approval to write off R 3,6 million was not obtained.
- No agreement could be obtained between ODI Water and the Municipality.

I therefore did not obtain all the documentation and explanations necessary to verify the completeness, valuation, rights and existence of debtors amounting to R289,8 million as disclosed.

22. Value-added tax receivable

No VAT reconciliations could be submitted and no reliable accounting records were available to estimate the tax due to or payable by the municipality.

Contrary to the Value-added Tax Act, 1991 (Act No.89, 1991) VAT returns were not submitted to SARS as required.

I therefore did not obtain all the documentation and explanations necessary to verify the completeness, valuation, rights and existence of VAT receivable amounting to R16,1 million as disclosed.

23. Short-term receivables

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

I therefore did not obtain all the documentation and explanations necessary to verify the completeness, valuation, rights and existence of the short-term portion of long-term debtors amounting to R2,9 million as disclosed.

24. Bank balances and cash

Bank balances and cash could not be verified due to the following factors:

- The reconciling items listing received did not agree with reconciling amounts on the bank reconciliation.
- The cashbook balance per bank reconciliation did not agree with the cashbook balance per the financial statements.
- The cashbook balance per financial statements did not agree with the cashbook per trial balance.
- There was no register or listing of returned cheques.
- There was no register that listed unidentified direct deposits to the municipal bank account to ensure the timely follow-up of these direct deposits.
- No monthly bank reconciliations were performed.
- No supporting documentation for cash suspense accounts could be submitted.

I did not obtain all the documentation and explanations necessary to verify the completeness, valuation, obligations and existence of bank balances and cash amounting to R12,4 million as disclosed.

25. Revenue

There was a limitation on the audit work performed on revenue due to the following factors:

- Rates and services charges as per the monthly billing run and the financials statements differed by R13,1 million.
- Cleared debtor suspense accounts, accurate debtor listings, valuation roll reconciliation and supporting documentation for journal entries were not submitted.
- Property transfers were not done within three months of transfers.
- No supporting documentation or monthly reconciliations could be provided for the prepaid electricity revenue.
- Supporting documentation for assessment rates amounting to R62 million was not available.
- No reconciliation between the valuation roll and the monthly charges had been performed.
- Not all debtors were charged interest or were charged for incorrect periods.
- No explanation could be provided for the difference of R2,4 million between the Natis System and the general ledger for license fee income amounting to R4 million.
- Contrary to the National Energy Regulator Act, 2004 (Act No. 40 of 2004) the tariff increases for the 2004/2005 and 2005/2006 financial years were not approved by the National Energy Regulator of South Africa.

I therefore did not obtain all the documentation and explanations necessary to verify the completeness, occurrence, accuracy, classification of income amounting to R369,6 million as disclosed.

26. Expenditure

There was a limitation on the audit work performed on expenditure due to the following factors:

General expenditure

- 86% of vouchers selected could not be provided for audit.
- Bid documentation amounting to R10 million was not submitted for audit purposes.
- Debit orders amounting to R1,8 million were deducted from the municipality's bank accounts. The purpose and related services of the debit orders could not be explained.
- Expenditure incurred for the year under review amounting to R1,8 million was not recorded in the general ledger.
- Supporting documentation for journals passed was not submitted.
- Total expenditure spent was not within the approved budget.

Salaries and wages

- A difference of R1,2 million between the financial statements and the actual payroll occurred. No reconciliation was performed between the payroll and the general ledger.
- Salaries and wages were not always paid in accordance with approved SALGA salary scales.

I therefore did not obtain all the documentation and explanations necessary to verify the completeness, occurrence, accuracy and classification of expenditure amounting to R382,3 million as disclosed.

27. Irregular expenditure

Irregular expenditure could not be verified due to the following:

- The amount disclosed did not reconcile with amounts reported in forensic reports.
- Various instances occurred where the municipality did not comply with the supply chain management policy in terms of its expenditure.

The completeness, valuation and accuracy of the irregular expenditure in Note 30, to the value of R7,6 million disclosed in the financial statements could not be verified.

28. Contingent liability

Contingent liabilities could not be verified due to the following:

- The list provided by the legal department did not agree with the amount disclosed.
- No confirmations were received from the municipality's' attorneys.
- There was no documented process to identify and disclose contingent liabilities.

The completeness, existence, valuation and accuracy of the contingent liabilities information disclosed in Note 33, to the value of R4,0 million in the financial statements could not be verified.

29. Contingent assets

The inflow of economic benefits or service potential is not probable for the contingent assets. (Note 34)

Therefore the contingent assets should not have been disclosed and the related fruitless, wasteful and irregular expenditure should also not have been disclosed as recoverable.

30. Fruitless and wasteful expenditure

During the year under review the distribution losses for water services and electrical services were 56% and 27% compared to acceptable loss percentage of 10%. This resulted in fruitless and wasteful expenditure of approximately R31 million that was not disclosed.

Fruitless and wasteful expenditure amounting to R1,4 million spent on water restrictors no longer used was also not disclosed.

Therefore the completeness and accuracy of the fruitless and wasteful expenditure disclosed could not be confirmed.

31. Disclosure

Appropriate and adequate disclosure was not achieved. The following are examples of non-compliance with Generally Recognised Accounting Practice/ Generally Accepted Municipal Accounting Practice (GRAP/GAMAP):

- Although disclosed as such the fixed assets, funds and reserves and inventory did not comply with GAMAP/GRAP standards and no disclosure was made as to what standards were complied with. The impact of this non-compliance was not disclosed and could also not be determined. Due to the materiality of fixed assets, inventory and funds, the non-compliance with GAMAP/GRAP standards for the year under review is seen as pervasive.
- Discrepancies occurred in the accounting policies
- Financial information included in the Chief Financial Officer's Report did not correspond with information disclosed in the financial statements.
- Non-compliance with the following International Accounting Standards (ISA) occurred:
 - IAS 40 Investment property was not disclosed
 - IAS 36 No check for impairment of assets
 - IAS 39 Financial assets and liabilities were not disclosed at fair value, the financing element was not recognised and no risk exposure disclosed.
 - IAS 24 No disclosure of related parties.
 - IAS 20 Recognition of grants only to the extent that conditions are met (Provincial Health Subsidy) If not met amount must be disclosed as unspent conditional grant (liability)
 - IAS 19 Inadequate disclosure of retirement benefits information.
- Obligations in respect of restoring/rehabilitating landfill/dumping sites had not been accounted for or disclosed in terms of GAMAP 19.

32. Fraud

Section 112(1)(m) of the MFMA states that the municipality should implement a prescribed framework for supply chain management that aims at combating fraud and corruption.

Fraud and corruption occurred freely due to a weak corporate governance and internal control environment, of which the following serve as examples only:

- A weak accounting system that did not account for all transactions.
- Access to the system was not controlled and unauthorised changes went undetected.
- Inadequate segregation of duties.
- No system was implemented to prevent, detect and report suspected fraud and corruption activities to the audit committee.
- No fraud prevention policy was approved and implemented.

It was not possible to quantify the impact of fraud and corruption on the financial statements due to the nature of fraud, the fact that several instances occurred where supporting documentation was not available for verification as well as ongoing fraud investigations. This constituted a significant uncertainty.

The following non-compliance in relation to fraud was as a result of the above:

- Contrary to sections 6 and 7 of the MFMA, the accounting officer and the council did not report incidents of fraud.
- Contrary to section 67(b) no substantiating proof could be submitted that the accounting officer was satisfied that the organisation implemented effective,

- efficient and transparent financial management and internal control systems to guard against fraud, theft and financial mismanagement.
- The accounting officer did not adhere to the following sections of the MFMA: Sections 32(1), 62(1), 65(2), 81, 95, 99(2), 173(1) – (3), 78(1). Several forensic investigations for the year under review indicated that the mentioned sections of the MFMA were not complied with.

The root cause for the above problems relates to:

- The significant capacity problems experienced throughout the year. The high vacancy rate of the finance directorate was mainly due to the shortage of skills and staff with the required experience and investigations into management resulting in the resignation and the dismissal of several senior managers. This also resulted in limited segregation of duties with no other compensating controls in place.
- Material information system problems. (Incorrect cut-off and allocation, unlimited access, no exception reporting.)

This has had a negative effect on the municipality's' ability to comply with its internal procedures, policies and record keeping, as highlighted above.

Adverse Opinion

33. In my opinion because of the significance of the matters discussed in the Basis for Adverse Opinion preceding paragraphs 9 to 32 these financial statements do not present fairly and have not been prepared, in all material respects, in accordance with the basis of accounting described in note 1, in all material respects, the financial position of Madibeng Local Municipality as at 30 June 2006 and of its financial performance and its cash flows for the year then ended in accordance with Generally Accepted Municipal Accounting Practice and Generally Recognised Accounting Practice and in the manner required by the Municipal Finance Management Act.

OTHER MATTERS

I draw attention to the following matters which are ancillary to my responsibilities on the audit of the financial statements.

34. Material non-compliance with applicable legislation

Non-compliance with the MFMA

- Contrary to section 126 the financial statements were only submitted on 28 February 2007.
- Contrary to sections 64(1) and (2) the municipality has not implemented proper revenue management systems.
- Contrary to section 71 the municipality did not submit the required reports to National Treasury.
- Contrary to section 64(3), no reports were submitted to the National Treasury regarding amounts owing by organs of state for periods longer than 30 days.

- The municipality website was not regularly updated and the required documents had not been placed in terms of section 75(2).
- Contrary to section 165 the internal audit unit did not report directly to the audit committee instead it reported to a divisional head.
- No proof could be submitted that all the required documents as per section 17 of the MFMA accompanied the budget when it was tabled.
- Other sections of MFMA not complied with: Sections 11(4), 52(d), 54(1)(2), 63(2)(a), 66, 72(1), 127(2), 131(1).
- Non-submission of bank account details to National Treasury and the Auditor-General.
- Unauthorised, irregular, fruitless and wasteful expenditure not reported as per section 32(4).

Non-compliance with other acts

- Non-compliance with staff establishment requirements as per section 66 of the Municipal Systems Act, 2000 (Act No 32 of 2000) as amended.
- Non-compliance with the tariff policy as prescribed by section 74 of the Municipal Systems Act.
- Non-compliance with the Supply Chain Management Regulations 6 and 14.
- Council meetings did not always have a quorum, which is contrary to the Municipal Structures Act.
- Non-compliance with sections 21 and 27 of the Division of Revenue Act, 2005 (Act No. 1 of 2005) (DORA).

APPRECIATION

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



P Maritz *for* Auditor-General

Rustenburg

30 May 2007



AUDITOR-GENERAL