

REPORT OF THE AUDITOR-GENERAL TO THE MEMBERS OF THE COUNCIL ON THE FINANCIAL STATEMENTS OF CENTRAL DISTRICT MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2006

1. AUDIT ASSIGNMENT

The financial statements as set out on pages ... to ..., 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 section 126 of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). These financial statements are the responsibility of the Municipal Manager. 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.

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

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

3. BASIS OF ACCOUNTING

The municipality's policy is to prepare the financial statements on the entity specific basis of accounting as described in note 1 of the accounting policies to the financial statements.

4. QUALIFICATION

4.1 Opening balances

It was not possible to verify the accuracy of the opening balances because of the impact of prior year qualifications and limitation of scope, since issues raised during the previous years were not resolved.

4.2 Revenue

The municipality was unable to provide underlying documentation for transactions amounting to R48 101 838 in respect of other operating income.

A register for direct income was not maintained.

It was not possible to confirm if revenue was recorded in the correct period, because some receipts were not submitted.

4.3 Grants received

Various weaknesses were identified in respect of compliance with the Division of Revenue Act, 2005 (Act No. 1 of 2005) (DORA). The accuracy of grants received could not be confirmed, due to the following:

- 4.3.1 An indirect grant amounting to R11 961 044 in schedule 7 of DORA could not be confirmed with the records of the council.
- 4.3.2 An unreconciled difference of R2 515 000 existed between schedule 3 of DORA, in respect of equitable share and the amount per financial statements.
- 4.3.3 The amount recorded in the general ledger is R20 938 969 more than the Municipal Infrastructure Grant amounts confirmed as per bank statement.

4.4 Expenditure

- 4.4.1 Various vouchers could not be submitted to substantiate expenditure amounting to R26 333 967.
- 4.4.2 Documentation to support journal entries to the value of R133 840 000 could not be submitted.
- 4.4.3 Furthermore, payments amounting to R309 040 were made on copy invoices instead of the original documentation.

4.5 Accumulated Surplus

- 4.5.1 An account balance has been understated by an amount of R29 630 770 in respect of the opening balance not accounted for in the trial balance.
- 4.5.2 Transactions to the value of R39 156 745 were incorrectly recorded to the appropriation account.

4.6 Funds and Reserves

- 4.6.1 The municipality could not provide the underlying documentation for transactions amounting to R501 058, R109 408 985 and R57 84 225 in respect of interest on investments, other income and expenditure respectively.
- 4.6.2 Funds and Reserves exceeded cash by an amount of R19 million. Furthermore, included in funds and reserves, was a debit balance of R6 206 268.

4.7 Long-term liabilities

- 4.7.1 An unreconciled difference amounting to R613 335 existed between the balance per outstanding loan confirmation letter and the amount recorded in the general ledger.
- 4.7.2 An unreconciled difference amounting to R306 000 existed between the break down provided and the amount recorded in the general ledger.
- 4.7.3 An unreconciled difference amounting to R463 163 existed between the loan repayment amount per confirmation letter and the amount recorded in the general ledger.
- 4.7.4 A detailed break-down of R2 739 629 in respect of the short-term portion of long term liabilities could not be submitted.
- 4.7.5 I was not able to agree the closing balance per loan register to the general ledger as there is no opening and closing balances in the ledger.

4.8 Fixed assets

Fixed assets as disclosed in the financial statements with a balance of R7 659 537 could not be verified due to the following, which serve only as examples:

- 4.8.1 A material unexplained difference of R39 467 952 occurred between the balance of fixed assets per asset register and the financial statement.
- 4.8.2 The asset register was inaccurate.
- 4.8.3 Assets could not be individually identified by means of bar-coding.
- 4.8.4 No asset management system was in place to track assets and identify losses.
- 4.8.5 Descriptions of assets were insufficient and incomplete.
- 4.8.6 An asset count was not performed at year-end.

- 4.8.7 Some assets were recorded twice.
- 4.8.8 The asset register was not updated regularly.
- 4.8.9 Additions to the value of R3 385 907 could not be substantiated by appropriate vouchers.
- 4.8.10 Information to support capital redeemed and other capital receipts to the value of R46 873 891 could not be supplied for audit purposes.

4.9 Investments

The accuracy and completeness of the investments reflected in the financial statements could not be confirmed due to the following:

- 4.9.1 The investment balance is overstated by R5 300 849.
- 4.9.2 An investment, to the value of R10 878 092 was not included in the opening balance.
- 4.9.3 Interest received was understated by the amount of R241 534.
- 4.9.4 Break-down and supporting documentation to verify the split between the long-term portion of investments of R584 000 and the short-term portion of investments of R39 277 000 could not be provided

4.10 Debtors

The accuracy, validity and completeness of debtors amounting to R21 929 526 could not be confirmed due to the following:

- 4.10.1 An unexplained difference of R16 715 090 occurred between the amount disclosed in the financial statements and the detailed sub-ledger (age analysis).
- 4.10.2 Bank reconciliations adjustments included in the debtors balance amounting to R5 558 471 could not be substantiated with supporting documents.
- 4.10.3 Provision for bad debts had not been raised for the year. However, debtors exceeding 120 days and older amounted to R15 959 127, which represents 75% of the total outstanding debts. This is considered to be unrealistic and materially high. A policy in this regard did not exist.
- 4.10.4 Some of the debtors were recorded twice in the age analysis.
- 4.10.5 Movement in respect of debtors establishment levy to the value of R2 953 339 was not supported by documents.
- 4.10.6 The amount of R1 403 806, included in the debtors balance, was not adequately classified, reconciled and cleared and remained unchanged since the prior years.
- 4.10.7 Other debtors with no supporting documentation amounted to R171 078.
- 4.10.8 Uncertainty exists as to the recoverability and accuracy of the VAT debtor amounting to R10 237 987 as various discrepancies were identified in respect of VAT input claimed and output declared.
- 4.10.9 No reconciliation was done between the actual VAT receivable or payable

and amounts reflected in the general ledger.

4.11 Provisions

The accuracy, validity and completeness of provisions amounting to R2 571 376 could not be confirmed due to the following:

4.11.1 Negative audit fee provisions amounting R731 198 have been created.

4.11.2 The municipality was unable to provide underlying documentation for transactions amounting to R1 602 467 in respect of leave expenditure.

4.11.3 The basis and method used to calculate the provisions of R845 347 and R179 321 in respect of Development TLC and Reparation Fund respectively could not be provided.

4.12 Creditors

4.12.1 The municipality was unable to provide underlying documentation for transactions amounting to R7 977 600 in respect of creditors.

4.12.2 Moreover, creditors amounting to R526 431 were not accounted for in the financial statements.

4.13 Cash and bank

4.13.1 The accuracy and validity of cash and bank amounts disclosed in the financial statements could not be verified due to the following:

4.13.2 Documentation to support reconciling cheques amounting to R30 209 743 could not be submitted for audit purposes.

4.13.3 Cheques outstanding for six months and longer, to the value R2 787 219, were still in the bank reconciliation as uncashed, and had not yet been reversed.

4.13.4 An overdraft of R41 908 771 was incorrectly allocated as current assets, instead of current liabilities.

4.13.5 The general ledger was incomplete and did not have the figures for opening and closing balances were not included.

4.13.6 Authorisation by a senior official of journals passed to the value of R169 731 000 could not be obtained.

4.14 Contingent liability

4.14.1 Contingent liabilities to the value of R3 559 787 were not included in the financial statements.

4.14.2 Moreover, the amount of R509 000 was incorrectly disclosed in the financial statements as contingent liabilities instead of long-term debtors.

4.15 Commitments

Commitments amounting to R147 704 799 were not disclosed in the financial statements.

4.16 Salaries and Wages

4.16.1 A material unreconciled difference amounting to R1 266 240 existed between the payroll register/system balance and the amount disclosed as employees salaries, wages and allowances in the financial statements.

4.16.2 A material unreconciled difference amounting to R500 000 existed between the payroll register/system balance and the amount disclosed as councillors' salaries, wages and allowances in the financial statements.

4.16.3 Performance bonuses to the amount of R1 241 547 were paid to senior management in the absence of a performance management system. The basis for the payments could not be determined.

4.16.4 Furthermore, the municipality was unable to provide underlying documentation for transactions amounting to R1 941 595 in respect of overtime and leave payouts.

4.16.5 Various internal control weaknesses were identified in respect of salaries and wages for which the following serve as examples. The payroll report for December 2005 could not be submitted for audit purposes, while the payroll report for March 2006 was not signed by management as proof that salaries and wages were accurate and correct.

4.16.6 An amount of R2 903 377 in respect of taxes due to South African Revenue Services remained outstanding with regard to tax returns for seven months which had not been submitted to the Receiver of Revenue.

4.17 Leases

4.17.1 Occurrence, completeness, classification and measurement of leases amounting to R583 489 could not be confirmed since no lease contract could be submitted.

4.17.2 Furthermore, the municipality does not have an accounting policy on leases.

4.18 Accounting records

The council's records did not permit the application of alternative auditing procedures regarding any of the above-mentioned items. Consequently I did not obtain all the information and explanations I considered necessary to establish the validity, accuracy and completeness of the account balances.

The cause of the above short comings stem from the severe capacity constraints and the lack of competency and skills in the finance component of the municipality. Performance reviews are not done, physical control is lacking and segregation of duties is not applied in most instances. Furthermore, no standardised procedures exist, management information is lacking and no reconciliations or reviews of information/exceptions were done.

5. ADVERSE AUDIT OPINION

In my opinion, because of the significance of the matters discussed in the preceding paragraph and its effect on the financial statements, the financial statements do not present fairly, in all material respects, the financial portion of the Central District Municipality at 30 June 2006 and the results of its operations and cash flows for the year then ended, in accordance with the basis of accounting determined by National Treasury of South Africa, as described in note 1 of the accounting policies to the financial statements and in the manner required by section 55(1)(c) of the Municipal Finance Management Act (Act No. 56 of 2003).

6. EMPHASIS OF MATTER

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

6.1 Long-term debtors

Various discrepancies were noted in respect of long-term debtors outstanding at year end. The following serve as examples:

- a) Capital repayments were incorrectly recorded in the general ledger.
- b) A register for long-term debtors could not be submitted for audit.
- c) An amount of R168 020 in respect of loans to employees remained outstanding with regard to employees who had resigned.

6.2 Weaknesses in internal control

The following control weaknesses of a general nature were identified during the audit:

- 6.2.1 A formal risk assessment had not been done and a Risk Management Strategy had not been implemented.
- 6.2.2 Formalised written policies to guide the financial accounting processes had not been developed and implemented.
- 6.2.3 Regular reconciliations were not performed.
- 6.2.4 Segregation of duties was compromised.
- 6.2.5 Inadequate safe keeping of records and documentation existed.
- 6.2.6 Reconciliations were not adequately performed.
- 6.2.7 Inadequate supervision existed over junior staff.
- 6.2.8 Various project contracts were not signed by the municipal manager.

6.3 Internal audit and the audit committee

Various shortcomings with regard to internal audit and the audit committee were identified. The following only serve as examples:

- 6.3.1 The annual internal audit plan 2005/06 was in draft format and not all the audits as per annual plan were performed for example debtors, cash management, budget control and stock management.
- 6.3.2 No target dates were set in the internal audit plan for audits to be conducted.
- 6.3.3 There was no indication in the minutes of the audit committee that the internal audit charter and internal audit plan were approved by the audit committee.
- 6.3.4 The internal audit charter did not indicate that the audit committee should agree with the appointment or dismissal of the Head of Internal Audit.
- 6.3.5 Internal audit reports were in draft format with management comments outstanding.
- 6.3.6 The following roles and responsibilities of the audit committee were not described in the audit committee charter:
 - 6.3.6.1 Review the fraud prevention plan implemented to prevent and detect fraud. Discuss any communication from management regarding their processes for identifying and responding to the risks of fraud in the entity.
 - 6.3.6.2 Communicate to the external auditor, any fraud, suspected fraud or fraud investigation currently being conducted.
 - 6.3.6.3 Discuss any concerns about the nature, extent and frequency of management's assessment of the accounting and control systems in place to prevent and detect fraud, with the external auditor.

- 6.3.6.4 Notify the council / board when the accounting officer has been implicated in fraud, corruption or gross negligence.
- 6.3.6.5 Submit minutes of the audit committee to the council / board.
- 6.3.6.6 Review the nature of any significant adjustments to the financial statements proposed by management and/or the internal or external auditors.
- 6.3.6.7 Review the reasons for major fluctuations in the financial results (current year compared with prior years).
- 6.3.7 The audit committee did not meet regularly as only two meetings were held during the financial year and as per charter a minimum of four meeting should be held in the financial year.
- 6.3.8 No evaluation of the effectiveness of the audit committee was done by the council as prescribed by the King Code.
- 6.3.9 Control and management of inventory were not adequate, as records pertaining to inventory movement and reconciliations were not kept for the financial year.
- 6.3.10 Variances occurred between stock lists and physical stock, which were subsequently corrected.

6.4 Non-compliance with laws, regulations, policies and procedures

Various aspects of non-compliance with laws, regulations, policies and procedures were identified. The following only serve as examples.

- 6.4.1 The municipality did not fully comply with the requirements of section 25 of the MFMA.
- 6.4.2 Evidence could not be obtained to indicate that quarterly equitable share reports and monthly duties on receiving reports were submitted in terms of sections 5 and 16 of DORA.
- 6.4.3 Creditors were not paid within 30 days as required by the MFMA.
- 6.4.4 Payments to the value of R2 893 000 did not comply with the policies and procedures, as three quotations were not attached to the payment.
- 6.4.5 Non-compliance with section 95 of the Municipal Systems Act
- 6.4.6 No evidence was obtained from management of implemented policies and procedures regarding the identification and disclosure of related party interest.
- 6.4.7 No information or documentation was obtained regarding any related party transactions or disclosure from council of any involvement in related party transactions.
- 6.4.8 According to Section 12(5) of the Regional Service Council Act, 1985 (Act no. 109 of 1985), one twentieth per cent of the total proceeds should be paid to the SETA. However no such payment was done to SETA.
- 6.4.9 Overtime paid to employees exceeds the 30% of basic pay which is in contradiction of policies and procedures.

6.5 Information systems

Various information system policies and plans had not been developed and approved. This included an information technology security policy, user account management procedures, a disaster recovery plan and a master system plan addressing the long and short-term objectives of the information technology environment.

6.6 Budget Process

Working papers to support the budget could not be submitted for audit purposes. Furthermore instances of non-compliance with MFMA in respect of the budget process were also noted.

6.7 Post- Balance Sheet Events

The municipal manager and chief financial officer were suspended after year-end.

6.8 Late submission of 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 reports to no later than 08 December 2006 where the financial statement in question were received by 31 August 2006.

7. APPRECIATION

The assistance rendered by the staff of Central District Municipality during the audit is sincerely appreciated.



DL Zondo *for* Auditor General

Pretoria

8 December 2006



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