



**MALUTI-A-PHOFUNG MUNICIPALITY**  
**MASEPALA wa MALUTI-A-PHOFUNG**

# Fax

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N MOKHESI

CHIEF FINANCIAL OFFICER

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2007-05-31

**REPORT OF THE AUDITOR-GENERAL TO MALUTI-A-PHOFUNG MUNICIPAL COUNCIL  
ON THE FINANCIAL STATEMENTS OF MALUTI-A-PHOFUNG LOCAL MUNICIPALITY  
FOR THE YEAR ENDED 30 JUNE 2005**

**1. AUDIT ASSIGNMENT**

The financial statements as set out on pages 5 to 25, for the year ended 30 June 2005, have been audited in terms of section 188 of the Constitution of the Republic of South Africa, 1996, 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 Statements of South African Auditing Standards which 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, as well as
- evaluating the overall financial statement presentation.

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

The audit was completed in accordance with Auditor-General directive no. 1 of 2005.

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

**3. QUALIFICATION**

**3.1 Fixed assets**

- (a) A complete updated asset register was not available. No internal control processes or frameworks were in place to ensure that expenditure capitalised in the ledger was also recorded on the asset register. Capital expenditure of R74,2 million (2004: R81,5m) could as a result not be verified owing to a lack of supporting documentation. A similar finding was also reported in paragraph 3.7(a) of my previous report.
- (b) As reported in paragraph 3.7(b) of my previous report, municipal assets valued at R415 million (2004: R341 million) could not be verified for completeness and accuracy. The municipality



could again not prove that it had verified the total assets under the control of the council. This matter has been reported on numerous occasions but to no satisfactory finalisation.

- (c) Management did not implement measures to accurately record any capital commitments and as a result, commitments of R5 million according to the financial statements could again not be verified against appropriate records. This matter was also reported in paragraph 3.7(e) in my previous report dated 7 October 2006.
- (d) With reference to paragraph 3.7(d) of my previous report, I could again not verify the existence, ownership or evaluation of assets totalling R75 million that were transferred from the former Qwa-Qwa government to the Maluti-A-Phofung Municipality. Since this matter had been reported during the 1994 financial year, it is disappointing to note that nothing noteworthy has been done to bring the matter to a close.

It is therefore not possible to express an opinion on fixed assets as disclosed in note 4 to the financial statements.

### 3.2 Creditors

Owing to a lack of management processes over creditors, an amount of R988 922 was not included as an outstanding amount at financial year-end. Creditors as disclosed in note 12 to the financial statements were therefore understated by the said amount. This matter was also reported in paragraph 3.12(a) in my previous report dated 7 October 2006.

### 3.3 Debtors

- (a) Consumer debtors amounting to R102 592 584 as disclosed in note 9 to the financial statements could not be verified as correct. According to a calculation made from the trial balance, debtors should be R104 161 752 and were thus understated by an amount of R1 569 168.
- (b) Sundry debtors (current and other) amounting to R51 775 089 as disclosed in note 9 to the financial statements could not be verified as correct. The balance included outstanding deposits and cash book/deposit suspense accounts which were not included in the bank reconciliation. Supporting documentation of the equitable shares allocations amounting to R7 615 692 could also not be obtained for audit purposes. Many accounts also showed no movement and the validity of these accounts is doubtful.
- (c) The debtors age analysis at year-end could not be obtained. According to the municipality this was mainly due to problems with the implementation of the Sebata computer system. A completeness test on the correctness of individual debtors accounts could therefore not be confirmed as correct.
- (d) A credit note amounting to R87 769 859 could not be verified. Debtors could be understated, as supporting documentation amounting to only R10 million of the said amount could be obtained for audit purposes. Supporting documentation for a journal amounting to R90 million could also not be obtained.
- (e) Receipts amounting to R19 073 725 for payments made during April 2005 were duplicated on the system. This was only corrected after year-end and although disclosed as a note to the



financial statements, the debtors figure was not adjusted, resulting in the understatement at year-end.

- (f) Reasons for credit balances on debtors amounting to R29 039 481 could not be obtained from the municipality.
- (g) A payment for water consumption was processed on 30 June 2005 for R50 million. Supporting documentation could not be obtained for this amount and it could therefore not be verified as correct.
- (h) The balance of the accounts receivable subledger could not be agreed to the balance of the general ledger at 30 June 2005. Only part of the debtors subledger requested could be submitted for auditing purposes, which placed a limitation on the scope of the audit, as the balance of the debtors subledger at 30 June 2005 could not be agreed to the general ledger. Explanations for a difference of R12 819 493 could not be submitted.
- (i) As reported in paragraph 3.10(b) of the report of the prior year, proof that an amount of R11,4 million was a *bona fide* claim owed by the Revenue Service could not be submitted, which included an amount of R550 000 allegedly owed on capital items and reported since the 2001-02 financial year by this office. As a result the validity of this amount could not be verified.
- (j) Measures introduced by management to identify and recover monies registered in the name of "the occupier" were not functioning properly because account balances of R136 612 (2004: R992 428) had been identified. This matter was also included in paragraph 3.10(g) of the previous report.

The above resulted from an inadequate management framework to ensure proper control and verification of debtors. Because of the above-mentioned deficiencies it is not possible to express an opinion on debtors of R89 846 277 as disclosed in note 9 to the financial statements.

#### 3.4 Completeness of income and expenditure

- (a) According to the general ledger, the total income and expenditure amounted to R331 309 451 and R307 807 265 respectively but, according to appendix D to the financial statements, income and expenditure for the 2004-05 financial year amounted to R326 954 959 and R300 580 564 respectively. The difference could not be substantiated satisfactorily owing to weaknesses in the reconciliation of ledger accounts.
- (b) Due to inadequate control measures, the correctness and completeness of service charges could not in all instances be verified. Examples of deficiencies found include the following:
  - Refuse charges on the new computer system were reduced, not levied at all, or levied at the wrong tariff.
  - The number of sewerage points was incorrectly captured on the new system, resulting in the underlevying of sewerage charges.
  - Not all consumers were charged for water consumption.



- (c) A numerical list of all receipts issued could not be obtained and adequate management controls had not been implemented in this regard. A completeness test on income could therefore not be executed and the possibility that not all receipts had been recorded on the system could therefore not be excluded. Sequence tests also revealed that receipt numbers were duplicated in other instances and receipt numbers were missing.

It is therefore not possible to express an opinion on income and expenditure as disclosed in the financial statements. This matter was also reported in paragraph 3.1.8 (a) of the previous report.

### 3.5 Value-added tax (VAT)

- (a) Due to inadequate management policies VAT 201 returns for the period February to June 2005 were not submitted timeously to the South African Revenue Service in order to calculate the VAT tax liability. According to a summary received, the net amount refundable was R3 492 824(CR). The trial balance however reflected an amount of R8 033 097(DR).
- (b) It would also seem that the VAT payable of R1 088 487 has not been correctly disclosed in note 15 to the financial statements. This matter was also included in paragraph 3.2 of the previous report dated 7 October 2005.
- (c) Inadequate management processes also resulted in VAT not declared, VAT not always claimed and tax invoices not always attached. In one instance, VAT amounting to R1 070 647 was not claimed.

### 3.6 Long-term debtors

The balance of long-term debtors of R996 214 as disclosed in note 9 to the financial statements at 30 June 2005 could not be verified as correct. Due to inadequate management controls confirmation thereof could not be obtained from the municipality or from the working papers submitted with the financial statements.

### 3.7 Bank and cash

- (a) As a result of inadequate management processes, balances included in the bank account could not be verified as correct, as substantiating evidence thereof could not be provided by the officials of the municipality.
- (b) The deposit suspense account reflected a negative balance of R6 438 624 but the details thereof could also not be submitted for audit purposes.

Bank and cash of R26 370 and the bank overdraft of R2 837 055 as disclosed in the financial statements at 30 June 2005 could therefore not be verified as correct.

### 3.8 Personnel

- (a) Salary control and salary advance accounts reflected closing balances of R520 549 and R1 083 026 respectively, but since management controls were not in place to ensure that these accounts were cleared timeously, it appears that expenditure is understated by the said amounts.
- (b) Due to a lack of proper policies and procedures, a number of employee files and study bursary documentation could not be submitted for audit purposes, which placed a limitation on the scope of the audit.
- (c) Salaries and allowances also increased by 14% to R77,9 million but due to a lack of proper control measures, evidence of increases could not in all instances be submitted for audit purposes.

### 3.9 Inventory

Adequate supporting documentation could not be obtained for a journal effecting adjustments of R438 089 to the stock account as a result of inadequate management policies and procedures. Various differences were also revealed during an audit test. The balance of stock of R2 414 485 as disclosed in note 8 to the financial statements at 30 June 2005 could therefore not be verified as correct.

### 3.10 Water and electricity providers

- (a) In terms of agreements between the council and water suppliers, audited financial statements should be submitted to the council within three months after their financial year-end. Due to inadequate management procedures, the municipality could not prove that statements had been received and that payments to these suppliers had been received and evaluated. The possible financial effect this may have on the financial statements of the municipality could not be determined.
- (b) Payments amounting to R12 million were made to an electricity supplier for which the account information could not be verified, as it was not detailed to identify the quantities and the description of different services rendered. Differences in tariffs which could not be explained were also revealed. It could also not be verified what methods were used by the municipality to check the payment details before it was approved for payment. Adequate management controls were not implemented to ensure that adequate supporting documentation existed before it was approved for payment.

Similar matters were also included in paragraph 3.6 of the previous audit report.



### 3.11 Assessment rates income

Management processes to reconcile the valuation rolls to the financial statements were not in place and owing to an assessment rate reconciliation not being submitted for audit purposes, assessment rate income amounting to R66 514 847 could not be reconciled and verified as correct. A difference of R1 259 874 existed between the rates levied and the amounts disclosed in the trial balance. This matter was also included in paragraph 3.9 (a) of the audit report of the previous financial year.

### 3.12 Grants

Due to a lack of management reconciliations, a difference of R6.7 million between grants received and the amount included in the income statement could not be explained.

### 3.13 Payment vouchers not submitted

Payment vouchers totalling R2 644 990 requested for audit purposes could not be obtained. This resulted in a limitation on the scope of the audit, as adequate management controls were not implemented to ensure that documentation was available. Similar deficiencies were reported in paragraph 3.4 of the previous report.

### 3.14 Provision for irrecoverable debts

According to a calculation based on the recoverable percentage, the provision as disclosed in note 9 to the financial statements was overstated by approximately R12 million (2004: R4.7 million). This matter was also reported in paragraph 3.10(e) of the previous report.

## 4. AUDIT OPINION

Because of the significance of the matters referred to in paragraph 3, I do not express an opinion on the financial statements of the Maluti-A-Phofung Local Municipal Council as at 30 June 2005.

## 5. EMPHASIS OF MATTER

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

## 5.1 Weaknesses in internal control

### (a) *General control weaknesses*

Various weaknesses with respect to the internal control systems were identified and reported to management.

These internal control weaknesses are hampering the effective management of the municipality and management should take drastic steps to correct the inefficiencies. The internal control weaknesses are also indicative of the matters reported in paragraph 3 of this report.

### (b) *Information and technological services (IT)*

An overview of the computer system indicated various general control and other control environment deficiencies, as proper policies and procedures were not always implemented. These included the existence and monitoring of policies like IT strategy, security, a business continuity and disaster recovery plan, access to computer hardware and software, data protection and physical security.

### (c) *Appropriation account*

Journals processed on the financial system were not in all cases authorised due to inadequate management policies and procedures. Transactions amounting to R1 314 925 are therefore not regarded as being properly authorised.

## 5.2 Procurement process: Irregular expenditure

- (a) A contractor was appointed for the renovation of the offices to an amount of R125 217 but it could not be confirmed that the proper tender process, as prescribed by the procurement policy, was followed. Furthermore, instructions were then given to the contractor for additional work without the approval of the tender committee or the council. The additional expenditure of R1 070 251 is therefore regarded as not properly authorised. Management controls were not implemented to ensure that proper approval had been obtained before the expenditure was incurred. This matter was also included in paragraph 5.2.3 of the audit report of the previous year.
- (b) Due to inadequate management controls, a signed contract for the insurance could not be submitted for audit purposes. The contract did not indicate the monthly premiums and/or the annual increase in the tariffs. The resolution from the mayoral committee meeting stated that the appointment was on the same conditions and rates for the period initially prescribed in the resolution, but the monthly payments increased considerably over a three-year period. The minutes of the tender committee meeting stated that the supplier's contract be extended for the period of a year. Proper tender procedures were therefore not followed as amounts over R50 000 require the municipality to invite tenders. It was also noted that the monthly insurance payments increased from R312 841 in 2003 to R654 460 in June 2004, to R711 211 in April 2005 and R2 009 243 in June 2005. According to explanations provided the increase could be attributed to an advance payment of premiums. In my view payments in advance could be viewed as being irregular since payments were made for services not rendered yet.



- (c) Due to inadequate management procedures, documentation relating to the tenders invited, the appointment letters, correspondence relating to site meetings, etc. could not in all instances be obtained for audit purposes. This resulted in a limitation on the scope of the audit and it could therefore not be verified if proper tender procedures were followed, if tenders were invited at all and whether the requirements of the procurement policy were adhered to.
- (d) Adherence to paragraph 8.2(iv) of the procurement policy on the advertising of tenders could not be properly verified, as the information could not be submitted when requested for audit purposes.
- (e) The tender committee resolved that a contractor be appointed who was not recommended by the consultants, as the contractor had the most experience to successfully complete the project. The preference point system as prescribed by the preference procurement policy was thus not followed.
- (f) In a mayoral committee meeting it was resolved that a contractor be appointed for electricity works as they were the only 100% equity-driven company of all the tenders received. It was however noted from the tender adjudication report that the contractor was third in the ranking with the third highest points and it would therefore seem that the preference point system as prescribed by the preference procurement policy was not used to determine the most suitable tender for the contract.
- (g) At a mayoral committee meeting it was resolved that a contractor be appointed as they were at that time also involved in another similar project of the municipality and obtained the highest points from the tender adjudication report. In this report concerns regarding the contractor were stated regarding the incorrect pricing of the tenderer for the 22 kv breakers and other equipment that might result in a cash flow problem for the contractor. After adjustments had been made to the incorrect prices in the tender document, the price increased and was then not the lowest amount tendered. Procurement points were not adjusted after the adjusted tender amount of the tenderer. It was recommended by the consultants that another tender be appointed.

Various deficiencies in the procurement process were also reported in paragraph 3.4 of the previous report.

### 5.3 Non-compliance with laws and regulations

#### (a) *Internal audit function*

Owing to certain non-compliance with standards of the Institute of Internal Auditors, no reliance was placed on the work of the internal audit section of the municipality. This matter was also reported in paragraph 5.2.3(b) of the previous report.

#### (b) *Unauthorised expenditure*

Actual operating expenditure for the financial year exceeded the approved budget by R19 539 569, resulting in unauthorised expenditure in terms of section 1 of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). Adequate management controls were not implemented to ensure that the budget was properly controlled.



According to the approval the capital budget amounted to only R73 394 544, while R80 822 544 was disclosed in the financial statements. It would therefore appear as if the capital budget was exceeded by R846 499 at 30 June 2005, causing unauthorised expenditure.

(c) ***Performance contracts: Senior managers of the municipality***

The performance agreements of the senior managers for 2004-05 could not be obtained and the municipality did not adhere to section 57(1)(b) of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA). It was also noted that performance bonuses were paid to the senior managers of the municipality for the 2004-05 financial year although a valid performance agreement did not exist. This matter was also reported in paragraph 5.2.3(d) of the previous report.

Council approval for the evaluation of the performance contracts as required by section 57(4)(b) of the MSA could also not be submitted for audit purposes. It could therefore also not be established on what basis these performance evaluations were done.

(d) ***Reporting to the Treasury***

Owing to financial and internal control systems not being properly developed, the budget schedules as required by section 71(1) of the MFMA were not submitted to Treasury. In terms of this requirement, a monthly budget statement has to be submitted not later than 10 working days after the end of each month to the municipal manager and to the Treasury.

(e) ***Salaries, wages and allowances***

Procedures were not implemented to ensure compliance with section 66 of the MFMA, which stipulates that the accounting officer of a municipality must report to the council on all expenditure incurred by the municipality on staff salaries, wages, allowances and benefits. These reports were not submitted to council as required.

(f) ***Overtime***

Overtime paid exceeded the prescribed limits as determined in section 10(1) of the Basic Conditions of Employment Act, 1997 (Act No. 75 of 1997). According to this act an employer must not allow an employee to work more than three hours overtime a day and more than ten hours a week and payment must be restricted to not more than 30% of the employee's salary. The limit was exceeded by considerable margins and it would therefore seem that the municipality did not exercise adequate control over overtime in the absence of a policy on overtime. Approval of overtime prior to the working and payment thereof could not be obtained and therefore overtime is not regarded as properly authorised. This matter was also reported in paragraph 5.2.1(e) of the previous report.



**(g) Financial statements****(i) Submission of financial statements**

The financial statements should have been submitted within three months after year-end on 30 September 2005 in terms of section 126(1) of the MFMA. The financial statements were submitted on 3 October 2005 and resubmitted on 11 October 2005. On 9 December 2005 a letter was received that the financial statements were withdrawn, which letter was subsequently withdrawn on 17 May 2006. Deviations from prescribed disclosure requirements were also noted. Adequate management controls were not implemented to ensure that the financial statements correctly disclosed and were submitted in good time. This non-compliance was also included in paragraph 5.2.3 (c) of the audit report of the previous year dated 7 October 2006. Due to capacity problems, the audit report could not be finalised as this office was at that point busy with the completion of other statutory audits.

**(ii) Debtors**

The debtors' days outstanding are regarded as extremely high, which had a negative influence on the cash flow and could also have a negative effect on service delivery of the council. This matter was also included in paragraph 5.1 (a) of the audit report for the previous financial year dated 7 October 2005. The average recovery rate of debtors is calculated at 248 days instead of 492 days as disclosed in note 9 to the financial statements.

**(iii) Contingent liabilities**

Contingent liabilities were disclosed as R74 600 in note 34 to the financial statements. The figure reflected only guarantees in respect of housing loans, the same as the previous year. A list to verify the information was requested and could not be obtained. The following additional contingent liabilities were discovered when the court cases against the municipality were investigated:

- Buildings were erected on a site the lessee was renting from the municipality. The municipality (lessor) did not condone the erection of buildings and ended the lease contract. The lessee claims compensation for buildings constructed of ± R250 000.
- The municipality cancelled a tourism contract prematurely. Possible claim for outstanding fees ± R150 000.
- The municipality intended to cancel the contract with the tenderer due to dissatisfaction relating to service delivery. A final amount of R105 000 has to be settled.

It would therefore seem that the contingent liabilities had not been correctly disclosed in the financial statements.

#### 5.4 Matters in the public interest

##### (a) Legal expenses

Legal expenses amounting to R667 141 were incurred during the financial year under review, mainly to represent the municipality in disciplinary enquiries. These expenses are considered to be high and could have been limited if the municipality had implemented proper policies and procedures in this regard.

##### (b) Loss of income

Interest was not raised on service outstanding accounts for the period January to June 2005, due to a system upgrade which affected the billing and the late issuing of accounts. According to the report the estimated loss was calculated at R4 423 868.

##### (c) Water services not charged

- (i) Many consumers in the area were not charged for the water service they received from the municipality. According to the municipality it is the responsibility of the service provider. About 10 000 water meters were since installed at households and they would in future be charged for water consumption. Based on the average consumption calculated for a year, the losses could amount to R46 million.
- (ii) The municipality paid the water service provider for the services rendered but the income received by the service provider was not paid over to the municipality. The calculated amount was R8 million for the year under consideration. It therefore seems that the municipality does not exercise effective control to ensure that amounts are collected from the service provider.

##### (d) Electricity and water losses

- (i) The total water losses suffered amounted to R35,04 million. This is regarded as very high and it seems that the provision of water and the collecting of income for the service provided were not adequately controlled.
- (ii) Electricity losses amounted to R5,45 million which represents 21% units lost in distribution as a percentage of units sold. This is regarded as high and it would seem that the provision of electricity and the collecting of income for the service provided were not adequately controlled.

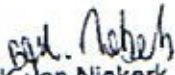


(e) **Special investigation**

On request of the Department of Local Government and Housing, an investigation into alleged irregularities involving the procurement of a revenue management contract was conducted. A final report has not yet been issued and once the results have been finalised the matter will be reported to the said department and the council. This matter was also included in paragraph 3.4(e) of the previous report.

6. **APPRECIATION**

The assistance rendered by the staff of the Maluti-A-Phofung Local Municipality during the audit is sincerely appreciated.

  
BJK van Niekerk  
for Auditor-General

06 December 2006



AUDITOR - GENERAL

2007-05-31

**REPORT OF THE AUDITOR-GENERAL TO THE MEMBERS OF  
THE COUNCIL ON THE FINANCIAL STATEMENTS OF THE  
MALUTI-A-PHOFUNG LOCAL MUNICIPALITY FOR THE YEAR  
ENDED 30 JUNE 2004** ✓

**1. AUDIT ASSIGNMENT**

The financial statements as set out on pages 4 to 20, for the year ended 30 June 2004, have been audited in terms of section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996), read with sections 4 and 20 of the Public Audit Act, 2004 (Act No. 25 of 2004).

These financial statements, the maintenance of effective control measures and compliance with relevant laws and regulations are the responsibility of the accounting officer. My responsibility is to express an opinion on these financial statements, based on the audit.

**2. NATURE AND SCOPE**

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

An audit includes:

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

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

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



### **3. QUALIFICATION**

#### **3.1 Inventory**

- (a) The internal control systems regarding inventory were not properly developed and documented, which resulted in electrical stock of R1,8 million not being included in the balance disclosed in the financial statements.
- (b) With reference to paragraph 3.8(a) of my previous report dated 21 December 2004, and owing to material weaknesses in the internal control system regarding the stocktaking process in the 2003-04 financial year, no reliance was placed on the results thereof. Accordingly, I could not confirm the balance of inventory of R454 209 in the financial statements.
- (c) Live stock at a dairy farm was not included in inventory, resulting in the understatement of stock by an unknown amount.

#### **3.2 Value added tax (VAT)**

The closing balance of the VAT control account of R11 million at year-end could not be verified as correct because no reconciliation has been performed between the VAT returns and the figures in the balance sheet due to a lack of internal control procedures.

#### **3.3 Cash flow statement**

The non-operating expenditure of R22,2 million in the cash flow statement could not be verified owing to a lack of supporting documentation. The verification of the cash flow statement amounts of non-operating expenditure in the previous year could also not be verified and was reported on in paragraph 3.7 of my previous report dated 21 December 2004.

#### **3.4 Procurement of goods and services**

- (a) Due to inadequate management controls payment vouchers were not properly filed and could not be traced for audit purposes, which had the result that expenditure amounting to R5 950 866 could not be audited. In other instances, progress certificates that work had actually been completed for payments totalling R1 845 620 could not be submitted. The non-submission of these vouchers placed a material limitation on the extent of testing.
- (b) Management policies and procedures were not in all instances followed by the responsible persons, which resulted in a contract having been awarded to a contractor for electrical services notwithstanding it being against the scoring allowed in terms of the council's preferential procurement policy. This resulted in additional expenditure of R464 710 (2003: R760 021). Documented resolutions as well as a proper rotation plan for the awarding of tenders also did not exist.



- (c) Approval and a contract for the provision of a delivery service to the municipality for which payments totalling R147 188 were made could not be submitted, while in other instances tenders or quotations for payments totalling R348 585 could not be submitted.
- (d) The finance committee was responsible for the adjudication of tenders for the period 1 July 2003 to 23 February 2004 but the minutes of meetings held by this committee could not be submitted for audit. This resulted in a limitation on the scope of audit procedures performed on contracts awarded by the council for the 2003-04 financial year.

Problems regarding the procurement process at the municipality have been reported on numerous occasions in my previous reports of 2001-02 and 2002-03.

- (e) On request of the Department of Local Government and Housing, I am currently conducting a special investigation into alleged irregularities involving the procurement of a revenue management contract. The results of this investigation will be reported to the Department and the Council once it becomes available. The effect that this investigation might have on the 2003-04 financial year could at this stage not be determined.

### **3.5 Insurance for possible liabilities**

As the insurance agreement was not signed by the council and insurance broker, a material uncertainty existed regarding possible liabilities in this regard.

### **3.6 Payments made to water and electricity providers**

- (a) The municipality made payments of R7,4 million and R6,2 million in respect of services provided by a water service provider, which could not be verified in the absence of appropriate supporting documentation.

A similar problem was also identified and reported on in paragraph 3.5(a)(i) of my report dated 21 December 2004 but to no avail.

- (b) Differences in figures between invoices and computer information had the effect that payments of R15,4 million could not be confirmed. This was also reported in paragraph 3.4(a)(iii) of my previous report.
- (c) In terms of existing agreements between the council and two water and electricity suppliers audited financial statements should be submitted to the council within three months after their financial year-end. The municipality could not prove that these statements have been received and evaluated. The possible effect it may have on the financial statements of the municipality was not determined.

### **3.7 Fixed assets**

- (a) No internal control processes or frameworks were in place to ensure that expenditure capitalised in the ledger was also updated in the asset register.



Capital expenditure of R81,5 million could therefore not be verified owing to a lack of supporting documentation. A similar finding was also reported on in paragraph 3.2(c) of my previous report.

- (b) As reported on in paragraph 3.2(a) of my previous report municipal assets valued at R341 million (2003: R260 million) could not be verified for completeness and accuracy because the municipality could again not prove that it has verified the total assets under the control of the council. This matter has been reported on numerous occasions but to no satisfactory finalisation.
- (c) Owing to inadequate management framework regarding control over the fixed asset register, the current register did not contain information that supported easy tracing and identification of fixed assets. This matter was also reported on in paragraph 3.2(d) of my previous report. Management did indicate that the process of updating the asset register had commenced after year-end.
- (d) With reference to paragraph 3.2(f) of my previous report dated 21 December 2004 I could again not verify the existence or the ownership evaluation of assets totalling R75 million that had been transferred from the former Qwa-Qwa Government to the Maluti-A-Phofung Municipality. This matter has been reported since 1994.
- (e) Management did not implement measures to accurately record any capital commitments and therefore commitments of R15 million, according to the financial statements, could again not be verified against appropriate records. This matter was also reported paragraph 3.2(g) in my previous report dated 21 December 2004.

### 3.8 Receipts

- (a) Adequate management controls were not in place over the issuing of receipts on the computer system. Sequence gaps have been identified in the receipt numbers from one month to the next. As a result an amount of R665 000 could not be audited, which is of serious concern as it could be indicative of fraudulent actions.
- (b) Owing to inadequate management controls over grants received proof that R2,3 million, earmarked by the provincial government for the council, has been received at the municipality could not be submitted for auditing and therefore the completeness and validity of grants received could not be confirmed.

### 3.9 Assessment rates income and related matters

- (a) Management processes to reconcile the valuation rolls with the financial statements were not in place and owing to a difference between the trial balance and the financial statements of R790 682, the completeness of assessment rate income of R60 085 873 at year-end could not be confirmed.
- (b) In 28.75% of the cases tested consumers were billed for assessment rates income in cases where their properties were valued at less than R25 000, which



was contrary to the council's policy that stipulates that charges in respect of rates and taxes on such properties should not be raised. As a result assessments rates income is overstated by an unknown amount.

- (c) With reference to paragraph 3.5(b)(iv) of the previous report council approval for the selling of sites at Thlolong Extension 5 amounting to R52 390 could still not be obtained for audit purposes. In the year under review even of R259 165 were sold for which no supporting records such as a register or council approval could be submitted.

The above shortcomings have been reported on year after year but management did not take the necessary actions to resolve these matters. Continued practices of the aforementioned could ultimately lead to irrecoverable losses to the council.

### 3.10 Debtors

- (a) Grants received and spent in respect of a municipal infrastructure pilot project of R8,6 million were erroneously included in year-end balances.
- (b) Evidence that an amount of R11,4 million was a valid amount owed by the South African Revenue Service could not be submitted. The amount included R550 000 allegedly owed on capital items and reported on by the AG since the 2001-02 financial year. As a result the validity of this amount could not be verified.
- (c) Owing to unidentified direct deposits of R3 855 441 (which accounted for 13.22% of deposits received during the year) the debtors balance at-year end is overstated and income could also be understated by at least this amount.
- (d) As a result of an inadequate management framework that was not functioning at the time of compiling the financial statements the consumer debtors balance of R173 899 091 could not be verified in the absence of a reconciliation at year-end that agreed with the financial statements.
- (e) Based on the average percentage non-payment of 40% in the 2003-04 financial year the provision for bad debt was understated by approximately R4,7 million at year-end.

This matter was also reported on in paragraph 3.4(f) of my previous report dated 21 December 2004.

- (f) Owing to weaknesses in control credit notes could not be submitted for auditing in all instances. According to management there were problems with the safe keeping of files that resulted in a number of missing files that could not be traced. The detail of these files would be submitted to the council for consideration.
- (g) Measures introduced by management to identify and recover monies registered in the names of "the occupier" were not functioning properly because account



balances of R992 428 (2003: R617 051) have been identified. This matter was previously reported on in paragraph 3.4(a) of my report dated 21 December 2004.

### **3.11 Long-term debtors**

- (a) The short-term portion of the long-term debtors of R855 255 at year-end could not be verified owing to weaknesses in the internal control system that resulted in the relevant supporting documentation not being submitted to the AG.
- (b) Arrear contract account balances of consumers amounting to R11,4 million (2003: R11,7 million) at year-end could not be verified against relevant supporting documentation and as a result the accuracy, completeness and recoverability of this balance could not be confirmed. It is of concern that, after three years of reporting, the municipality could still not provide proof of what these account balances consisted of.

This matter has also been reported on in paragraph 3.9 of my previous report dated 21 December 2004 but has not been addressed by the municipality.

### **3.12 Creditors**

- (a) Owing to a lack of management processes over creditors the creditors balance of R54 077 306 in the financial statements could, in the absence of supporting documentation, not be verified as complete and therefore the validity of this commitment could not be confirmed.
- (b) Owing to inadequate management controls over the verification and follow up of creditors an amount of R189 910, representing outstanding orders are included in the creditors balance in the financial statements. The validity of this amount could not be verified since it represented an obligation for services not rendered before year-end.

### **3.13 Investments**

Owing to a difference between the financial statements and investments certificates the completeness of investments of R32 551 445 could not be confirmed. A similar problem was also reported in paragraph 3.11(b) of my previous report dated 21 December 2004.

### **3.14 Income**

- (a) Owing to a calculation error clinic services income was incorrectly stated in the income statement as R1 430 906, instead of R2 430 906. Management was afforded the opportunity to correct this, but they did not.
- (b) The trading and economic services income of R142 805 336 were not reconciled with the financial statements owing to inadequate management procedures. As a result the completeness of this income could not be verified.



### 3.15 Long-term liabilities

- (a) Owing to incorrect calculations not detected due to a lack of internal control regarding internal checking, the capital charges expensed in the income statement of R5,6 million did not agree with the capital charges disclosed in the cash flow statement of R16,8 million. Differences in capital charges have also been reported on in paragraph 3.12(a) of my previous report dated 21 December 2004.
- (b) In the absence of appropriate supporting records for an amount of R1 475 650 the short-term portion of long-term liabilities of R2,2 million could not be verified.
- (c) Owing to inappropriate measures to secure records at the municipality supporting records for a loan of R1 million, included in the total balance of external loans, could not be submitted to verify the validity thereof.
- (d) Proof that endowment policies have been ceded to third parties as collateral for a R20 million loan could not be submitted to me owing to the fact that management did not have an internal framework of monitoring in place over this transaction, which placed uncertainty over the enforceability of this amount.

### 3.16 Cash and bank balances

Management procedures to reconcile the bank statements with the cash book were not functioning properly and as a result differences between the two records with a net value of R6 366 126 existed at year-end. Owing to these differences the completeness of the cash book balance of R2 368 398 could not be confirmed.

### 3.17 Personnel expenditure

- (a) The various leave regulations applicable to municipal employees made provision that leave credits are forfeited should leave not be taken within a certain period. These provisions were not enforced by the municipality and the fact that working papers substantiating the balance could not be submitted placed doubt on the accuracy of the accumulated leave balance of R4 861 061 at year-end as disclosed in the financial statements.
- (b) Management controls did not detect a difference that existed between the financial statements and the salary schedules of R1 109 801, which could not be resolved at year-end. As a result of this the accuracy of salaries and wages in the financial statements could not be confirmed.
- (c) Owing to weaknesses in the internal control system regarding the control over personnel files the verification of personnel data, auditing of leave transactions and service terminations could, in 91% of the cases tested, not be done as personnel files requested were not submitted for auditing. Management acknowledged that there was a problem with the controlling of personnel files and intended assigning an official to exercise control over personnel files but at time of writing this report these files had still not been submitted for auditing.



- (d) Management did not apply procedures to ensure that two suspense accounts with outstanding balances of R757 757 were cleared at year-end and owing to that the personnel expenditure was overstated by this amount.

**3.18 Balances from the previous year not corrected in the current year**

Owing to inadequate management processes in place at the municipality numerous findings reported in paragraph 3 of my previous report, which had a financial influence of that year's financial statements, have not been corrected. The effect it may have on the 2003-04 financial statements was not considered by management.

**4. DISCLAIMER OF AUDIT OPINION**

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

**5. EMPHASIS OF MATTERS**

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

**5.1 Matters affecting the financial statements: going concern**

The following examples which have a effect on the viability of the Council is a concern:

**(a) Debtors**

The period to collect monies owed to the council deteriorated significantly to 492 days in the 2003-04 financial year, which had a negative influence on the cash flow and service delivery of the council. In the previous year the debt collection period was 369 days and this was reported on in paragraph 3.1(a) of my previous report dated 21 December 2004.

**(b) Losses of economic services and trading services**

- (i) Due to inadequate management policies the dumping site, which is classified as an economic service in terms of the IMFO requirements and should break even, suffered a loss. The council budgeted for a deficit of R432 559 and realised a loss of R311 309 (2003: R274 893) contrary to the prescripts. The same matter was also reported on in paragraph 3.1(b) of my previous report dated 21 December 2004.
- (ii) Management procedures were lacking to accurately measure electricity distribution losses, which resulted in a calculated loss of R6,9 million.

## **5.2 Matters not affecting the financial statements**

### **5.2.1 Weaknesses in Internal control**

Various shortcomings in internal control were found during the audit, including the following:

#### **(a) Budgetary process**

- (i) As the results of the financial accounting process were not followed properly the approved budget of R281 million was incorrectly captured on the computer system as R181 million, which was not corrected.
- (ii) Adequate measures for the capturing and monitoring of the approved budget were not in place and resulted in material under- and overspending in certain months of the financial year.
- (iii) The budget for repairs and maintenance and contributions to funds and reserves of R37,4 million was exceeded by R5,8 million during the year under review. No council approval for the excess could be provided for audit purposes.

#### **(b) Computer systems environment**

- (i) Owing to an inadequately developed management framework and a lack of policies and procedures with regard to the computer system environment there were no security policies, strategic plan for information systems, a business continuity and disaster recovery plan, the setup of users on the system and appropriate segregation of duties at the municipality. An IT steering committee did also not exist.

I reported on this previously in paragraph 5.1(b) in the previous report dated 21 December 2004.

- (ii) Weaknesses in the physical security environment of the computer systems have been identified but owing to inadequate management policies and procedures to address these weaknesses, the safeguarding of information and computer systems was compromised at the municipality. A similar matter was also reported on in paragraph 5.1(b) of the previous report dated 21 December 2004.

#### **(c) Financial accounting processes**

Management has not developed and documented job descriptions and/or written policies to provide full guidance for financial accounting processes of each of the main cycles such as municipal services, investments, debtors, income, etc. that



were in line with relevant laws and regulations to regulate the day-to-day activities at the municipality.

**(d) Asset management**

- (i) Management did not have appropriate policies and procedures regarding the maintenance, safeguarding and timely disposal of redundant, obsolete or damaged assets of the council in place for the year under review.
- (ii) Instances of irregularities and misuse of municipal vehicles could not be excluded owing to the material internal control weaknesses that were identified with the fleet management system during the audit. Similar findings have also been reported on by the internal audit section but have not been cleared by management.

This office also reported on internal control weaknesses over municipal vehicles in paragraph 5.1(c)(i) of my previous report dated 21 December 2004.

**(e) Personnel management**

- (i) Management did not put measures in place to ensure that leave balances were maintained off line in the event of system failures and as a result leave credits could not be verified owing to the unavailability of the computer system at the time of the audit.
- (ii) Owing to weaknesses in the internal control regulating overtime work and overtime pay employees were remunerated in excess of 30% of their basic salaries, which exceeded the limit prescribed by the Basic Conditions of Employment Act, 1997 (Act No. 75 of 1997). Normal time was booked as overtime and overtime approvals and time records could not be submitted in all instances.
- (iii) Management controls over the issuing and receipt of payrolls were lacking and resulted in numerous payrolls not being returned to the pay office.

**(f) Investments**

- (i) Investments increased from R81,4 million to R97 million during the year under review although proof that quotations were invited for new investments made in the 2003-04 financial year could not be submitted due to a lack of investment policy.
- (ii) The investment register balance of R51 021 051 could not be agreed with the investments of R97 077 961 in the financial statements owing to the incompleteness thereof.

**(g) Retained income**

Notwithstanding having reported on this in paragraph 3.13(a) in my previous report dated 21 December 2004, I again identified that transactions of R873 000 involving the appropriation account were not authorised properly.

**(h) Payment for goods and services**

Owing to weaknesses in the internal control payments totalling R763 248 were made on non-original invoices for which the possibility existed that some of these payments were duplicated. Value added tax (VAT) was also claimed on non-ratable supplies during the year under review.

**5.2.2 Matters in the public interest**

**(a) Fruitless and wasteful expenditure**

- (i) Interest totalling R158 732 was made and was considered to be fruitless expenditure, owing to accounts not being settled on time as a result of inadequate management policies being in place. This type of expenditure should be avoided.
- (ii) A goods shed rented by the council at a cost of R72 733 was not used by the municipality and reported on by internal audit. This is considered to be fruitless expenditure and could be avoided if proper management procedures were in place. At time of writing this report this matter has not been resolved.
- (iii) Legal costs amounted to R1,1 million, R925 343 (81%) of which constituted labour disputes and placement-related issues as result of the council's placement policy. This expenditure of R925 343 is considered to be wasteful and fruitless expenditure which could have been curtailed if proper management policies were in place.

**(b) Management support team**

The provincial government paid an amount of R510 425 to two consultants to assist the municipality in terms of the management support team programme in the 2003-04 financial year. Of concern to this office is the fact that a number of the matters raised in this report have been identified for ratification by these entities, which did not materialise.

A similar finding was also reported on in paragraph 5.2(c) of my previous report dated 21 December 2004.



### 5.2.3 Non-compliance with laws and regulations

#### (a) *Unauthorised expenditure*

A renovations contract to the value of R125 217 was awarded, but payments totalling R1 134 469 were made to the contractor that were not appropriately approved in terms of council delegations. Evidence that prescribed tender procedures (for example, advertising, considering of quotations/tenders, etc.) were followed could also not be submitted.

This overspending of R1 070 251 is considered to be unauthorised in terms of section 10(G)(2)(j) of the LGTA.

#### (b) *Internal audit/audit committees*

- (i) No reliance was placed on the work of internal audit mainly because management was still in the process of developing and implementing certain measures that were not yet completed owing to a lack of resources.

This matter was also reported on in paragraph 5.3(c)(i) of my previous report dated 21 December 2004.

- (ii) As reported on previously in paragraph 5.3(c)(ii) of the previous report the audit committee appointed during March 2001 was also not fully operational during the 2003-04 financial year. I could therefore not verify that the responsibilities entrusted to this committee in terms of section 129(4) of the standard rules for councillors have been complied with.

#### (c) *Submission of financial statements and issuing of audit report*

The financial statements should have been submitted within three months after year-end on 30 September 2004 in terms of section 10(G)(2)(e) of the LGTA. The financial statements have been accepted on 18 March 2005 after being returned to the municipality on 18 November 2004 as a result of material deviations from the IMFO guidelines. Owing to a lack of management commitment not all the changes were made in the statements that were finally accepted.

Non-compliance with section 10(G)(2)(e) of the LGTA was also reported on in paragraph 5.3(a) of my previous report dated 21 December 2004.

Due to capacity problems, the audit report could not be finalised when the final information was submitted as this Office was at that point in time busy with the completion of other statutory audits.

#### (d) *Appointment of managers directly accountable to the municipal manager*

Remuneration packages for the six directors until 30 June 2004 amounted to R2,2 million, but in the absence of valid performance agreements the validity of payments made in terms of these packages could not be verified owing to non-

compliance with section 57(1) of the Local Government Municipal Systems Act, 2000 (Act No. 32 of 2000). Cognisance was taken that performance agreements were signed during May 2004.

(e) ***Compliance with the Division of Revenue Act (DoRA)***


Reports for grants received from government as prescribed by DoRA could not be made available for audit purposes in all instances. Adherence to the statutory requirements outlined in this act could therefore not be verified.

(f) ***Adherence to other legislation***

With reference to paragraph 5.3(e) of my previous report dated 21 December 2004, I have to report again that the Maluti-A-Phofung Municipality did not provide me with any proof of adherence to laws such as the Housing Act, Water Services Act, Environmental Conservation Act, etc. owing to a lack of management response on questionnaires that I requested them to complete.

6. **APPRECIATION**

The assistance rendered by the staff of the council during the audit is sincerely appreciated.

  
B J K van Niekerk for Auditor-General

Bloemfontein

7 October 2006



AUDITOR - GENERAL