

**REPORT OF THE AUDITOR-GENERAL
TO THE
SOL PLAATJE COUNCIL
ON THE FINANCIAL STATEMENTS AND
ON THE RESULTS OF PERFORMANCE
MEASUREMENT OF SOL PLAATJE
MUNICIPALITY
FOR THE YEAR ENDED
30 JUNE 2007**

**REPORT OF THE AUDITOR-GENERAL TO THE NORTHERN CAPE PROVINCIAL
LEGISLATURE ON THE FINANCIAL STATEMENTS AND PERFORMANCE
INFORMATION OF SOL PLAATJE MUNICIPALITY FOR THE YEAR ENDED
30 JUNE 2007**

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of Sol Plaatje Municipality which comprise the statement of financial position as at 30 June 2007, 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, and the accounting officer's report, as set out on pages ___ to ___.

Responsibility of the accounting officer for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting determined by the National Treasury, as set out in accounting policy note 1 and in the manner required by the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). 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
 - making accounting estimates that are reasonable in the circumstances.

Responsibility of the Auditor-General

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126 of Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA), my responsibility is to express an opinion on these financial statements based on my audit in accordance with the International Standards on Auditing. Because of the matters discussed in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis of accounting

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

Basis for disclaimer of opinion

5. Property, plant and equipment

The completeness, existence and valuation of property, plant and equipment (including infrastructure assets) totalling R391 791 266, as disclosed in note 10 to the financial statements, could not be verified due to the following matters:

- The estimated cost of restoration and accompanying accounting policy were not disclosed in the financial statements as required by paragraph 76 of GAMAP 17

Property, Plant and Equipment, with specific reference to the landfill site of the municipality.

- With the initial setup of the financial accounting system the location tab for assets were not activated, resulting in all assets on the asset register being allocated the same location reference. This restricted the ability to verify the existence of municipal assets.
- Assets purchased/constructed during the financial year were stated in the asset register as having been purchased on the last day of the financial year. This resulted in accumulated depreciation and depreciation being understated as a result of depreciation periods not commencing on actual date of purchase.
- As a result of assets to the value of R32 529 143 being capitalised as global assets in the asset register, the classification and accuracy of amounts disclosed could not be verified. This matter had been raised in the prior year and no progress has been made in the current year to address this issue. This global capitalisation of assets also resulted in the inability to verify additions of capital assets to the value of R 29 295 656.
- The municipality did not account for intangible assets, including website costs and software, in accordance with IAS 38 (AC129), *Intangible Assets*.

6. Long-term liabilities

- The accounting policy for retirement benefits and the relating disclosures in note 39 do not comply with the requirements of IAS 19 (AC 119), *Employee Benefits* since information that enables users of financial statements to evaluate the nature of the municipality's retirement plans, the financial effects of changes in those plans during the period and a general description of the plan were not disclosed. The accounting policy note makes no mention of whether it is in accordance with the exemptions granted in *General Notice 552 of 2007*, issued in *Government Gazette no. 30013* of 29 June 2007.

7. Employee costs

The accuracy, completeness and occurrence of employee-related costs to the value of R209 019 018 could not be verified due to the following inconsistencies and scope limitations:

- Fifty-eight employees could not be physically verified. Nine employees with invalid identification numbers were identified on the system. The existence of these employees could therefore not be confirmed.
- Eighteen employee and three salary files were not presented for audit purposes.
- A conclusive list of employees who received leave gratuity payments could not be provided for audit purposes.
- The accuracy and occurrence of appointments could not be verified as documentation pertaining to the appointments tested could not be provided for audit purposes.

8. Employee benefit liabilities

- The municipality did not recognise the undiscounted amount of short-term employee benefits expected to be paid in exchange for services rendered by employees during the year as an accrued expense, or if the amount already paid exceeded the undiscounted amount of the benefits, a prepaid expense at year-end as required by paragraph 10 of IAS 19 (AC 119), *Employee Benefits*.

- The expected cost of short-term employee benefits in the form of compensated absences was not recognised as the employees rendered services that increased their entitlement to future compensated absences as required by paragraph 11 of IAS 19 (AC 119), *Employee Benefits*.

9. **Leave accrual**

The valuation and completeness of leave accrual of R12 187 984, as disclosed in note 6 to the financial statements, could not be verified due to the following matters:

- Annual leave was accrued in total on the first of January every year for the entire year. This resulted in an overstatement of the leave accrual, as the accrual includes leave for the period 1 July 2007 -31 December 2007 to which employees were not yet entitled as at 30 June 2007.
- Leave accrual was understated by R1 345 186 as a result of employees having substantial amounts of negative leave day balances.
- Unreconciled long service days included in the calculation of the provision for leave pay as at 30 June 2007 resulted in an overstatement of the provision by R62 505.
- No reconciliation was performed between the leave forms submitted, the attendance register and the leave captured on the accounting system. Various differences were noted between leave taken per the leave forms and leave captured on the system.

10. **Revenue and receivables**

- Debtors and Revenue: Service charges at year-end were understated by the service charges regarding the period between the last meter reading date and the year-end date. As meter readings was taken from the 26th day of each month until approximately the 19th day of the following month debtors and service charge revenue were understated by service charges for a period between 11 and 34 days.
- Debtors with credit balances of R7 547 263 were included in the debtors balance in the statement of financial position. This resulted in an understatement of debtors and creditors by the stated amount.
- The debtors age analysis exceeded the consumer debtors balance as per note 15 to the financial statements by R1 716 351.
- Supporting documentation could not be provided for receipts of R1 701 856 classified as other income in the statement of financial performance. The occurrence, accuracy and completeness of these amounts could therefore not be confirmed.
- Income of R4 410 680 from land sales that occurred prior to 2005 was recognised in the current year. Other income was therefore overstated by this amount as revenue should have been recognised when the sale contract was finalised.

11. **Irregular expenditure**

The completeness of irregular expenditure as per note 36 to the financial statements could not be confirmed as a result of the following:

- A list of contracts that were extended during the year and the approval of these extensions, a list of cleaning contracts awarded during the year and all the relating supporting documentation, supply chain management documents relating to the prepaid electricity meter tender that was awarded during the year and several signed contracts for infrastructure were not presented for audit purposes.
- Sufficient documentation could not be provided to evaluate whether the approval of a contract for an international sports promoter was in accordance with supply chain management requirements. It could also not be confirmed whether municipal funds

were correctly expensed in accordance with sections 11 and 15(a) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and whether the conditions of section 33 were complied with as the contract was signed for five years, which was beyond the three years covered in the annual budget for that financial year. It could also not be confirmed whether section 163 of the MFMA was complied with as the liability was payable in a foreign currency and there was not evidence that the rand value was determined at the time of procurement, or that the risk was low at the time of payment.

- Several project files did not contain information to enable the audit team to determine the commencement and completion date of the contract, the date of the first invoice and first payment, information regarding any payments that may have been made before the signing of the formal contract by both parties, an advertisement for a tender, proof that the successful candidate was not in the employ of the state and/or proof that the points system for selecting projects was utilised.
- The information relating to the deviations from the procurement policy as disclosed in the financial statements for the year ended 30 June 2007 (appendix G) could not be provided for audit purposes.
- No explanations could be obtained for the reasons for awarding two contracts more than three months after the closing date for submissions.
- Information regarding the related parties and declarations of interest for two projects could not be obtained.

Since the above information was not available for audit purposes there was a limitation on our ability to confirm or dismiss the existence of possible fraud. There was an increase in the risk of fraud within the procurement process due to an ongoing investigation by the Scorpions relating to deviations from the procurement policy.

12. **Long-term receivables**

The balance of housing debtor loans of R55 170 964 was increasing each year as the amount of interest capitalised was greater than the actual payments received during the year. The valuation of this balance was therefore uncertain and was overstated by R14 199 393.

13. **Cash and cash equivalents**

- The cash and cash equivalents balance as per note 18 to the financial statements differed from the cash book balance by R5 135 528.

14. **Contingent liabilities**

- A contingent liability disclosed by the municipality as R400 000 in note 40 to the financial statements was confirmed to have been understated by R1 378 326 as a result of an oversight by the attorneys on a legal confirmation submitted to the municipality.
- The municipality did not have a policy in place for identifying the completeness of contingent liabilities at year-end. No correspondence from the various attorneys relating to the contingent liabilities for claims that were disclosed in the financial statements at year-end could be presented for audit purposes. Confirmations were received from the attorneys to confirm year-end contingencies, but there was no supporting documentation for the underlying facts and status of the claims.

15. **Leases**

No disclosure relating to finance and operating leases were made as required by paragraphs 47 and 56 of IAS 17 (AC 105), *Leases*.

16. **Accumulated surplus/deficit**

Adjustments were made to the opening balance of the accumulated surplus/deficit recorded in note 29.1 to the financial statements resulting in a nett decrease of R3 224 073 of the accumulated surplus/deficit. The disclosure required by GRAP 3 *Accounting Policies, Changes in Accounting Estimates and Errors*, was not provided.

17. **Value-added tax (VAT)**

As a result of the limitations of the financial system in that VAT levied by the system could not be traced to individual transactions, the accuracy of the VAT payable at year-end of R26 534 171 could not be confirmed.

With effect from 1 July 2006, section 40(1) of the Small Business Tax Amnesty and Amendment of Taxation Laws Act, 2006 (Act No. 9 of 2006) has amended paragraph (a) of the enterprise definition per section 1 of the Value-Added Tax Act, 1991 (Act No. 89 of 1991) (VAT Act). The transitional provisions contained in Regulation no. R270 required the municipality to apply a revised input VAT apportionment percentage. The revised apportionment percentage was, however, implemented by passing VAT correcting journals to account for the differences that arose due to the VAT Act amendments. The limitations within the financial system related to VAT reported in the previous paragraph, also resulted in a limitation of our scope to test the application of the new apportionment percentage implemented by the municipality.

18. **Disclosure**

- The municipality did not disclose information about its exposure to, and management of, risks as required by IAS 32 (AC 125), *Financial Instruments: Disclosure and Presentation*. The terms, conditions and accounting policies for each class of financial asset, financial liability and equity instrument, both recognised and unrecognised, were not disclosed as required by IAS 32 (AC 125), *Financial Instruments: Disclosure and Presentation*.
- Contrary to GRAP 2 *Cash Flow Statements*, paragraph 15, the municipality did not report cash flows from operating activities using the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed.
- *General Notice 552* of 2007, issued in *Government Gazette No. 30013* of 29 June 2007 relating to GAMAP 12 *Inventories*, states that any water purification costs incurred for non-purchased water must be capitalised as part of inventory. Narrative disclosure must be included in the 'Inventory' note stating that the municipality has capitalised all purchased water inventory, but that only purification costs were capitalised in respect of non-purchased water inventory. The municipality disclosed water stock as R0 (2006: R225 000) in note 14 to the financial statements.

Disclaimer of opinion

19. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have been unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of Sol Plaatje Municipality. Accordingly, I do not express an opinion on the financial statements.

EMPHASIS OF MATTER

I draw attention to the following matter:

Significant uncertainty

20. An unsuccessful tenderer intends to take the awarding of a tender for the provision and installation of a pre-paid electricity vending system on review in the High Court. The ultimate outcome of the matter cannot presently be determined, and no provision for any

liability that may result has been made in the financial statements. As reported in paragraph 11, no documentation relating to the supply chain management process was made available during the audit.

OTHER MATTERS

I draw attention to the following matters that are ancillary to my responsibilities in the audit of the financial statements:

Non-compliance with applicable legislation

21. Municipal Finance Management Act, 2003 (Act No. 56 of 2003)

- The annual report of 2005-06 was not submitted and tabled as required by section 127 of the MFMA. The document was made public by posting it on the municipality's website. The posted copy, however, was not signed by the accounting officer, it contained no report of the audit committee (non-compliance with section 166(b) of the MFMA), the annexures to the financial statements were not included and the report of the Auditor-General, even though signed, was marked as confidential not for publication.
- The municipality did not implement sufficient processes to ensure the effective management of consumer debtors as required by section 64(1) and (2) of the MFMA.
- No interest was levied on outstanding receivable balances of R4 972 535 as required by section 64 of the MFMA.

22. Municipal Systems Act, 2000 (Act No. 32 of 2000)

No audit of performance measures was conducted by internal audit during the 2006-07 financial year as required by section 45(a) of the Municipal Systems Act, 2000 (Act No. 32 of 2000).

23. **Matters of governance**

Effectiveness of internal audit

- The 2007-08 (for financial period beginning 1 July 2007) internal audit plan had not been approved by the time of reporting.
- Two of the five members did not have the appropriate experience or qualifications.
- There was no attendance register to confirm the training that the internal audit members have received.

Effectiveness of the audit committee

The audit committee did not prepare a report on the effectiveness of the internal audit for the 2006-07 financial year.

Excessive reticulation losses

The average distribution loss for water according to the *General report of the Auditor-General on the audit outcomes on local municipalities published after the 2005 year-end* was 10%. Sol Plaatje Municipality showed a 36,88% distribution loss for water during the financial year.

Debtors turnover ratio

- The overall consumer debtor turnover ratio (on gross balance of service debtors, excluding rates debtors and rates income and the bad debt provision) based on the GAMAP/GRAP financial statements for the year ended 30 June 2007 was 462 days.

- Debtor turnover ratio (on net balance, including the bad debt provision and excluding rates debtors and income) based on the GAMAP/GRAP financial statements was 116 days after taking into account the bad debt provision made amounting to R297 725 638 or 68% of gross debtors.

24. **Internal control**

Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes of the matters indicated, as they relate to the five components of internal control. In some instances deficiencies existed in more than one internal control component.

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
Basis for disclaimer of opinion					
Property, plant and equipment	✓		✓	✓	✓
Long-term liabilities			✓		
Employee costs	✓		✓		✓
Employee benefits	✓		✓		
Leave accrual	✓		✓		✓
Receivables and revenue	✓		✓	✓	✓
Irregular expenditure	✓	✓	✓		✓
Long-term receivables	✓				✓
Cash and cash equivalents			✓	✓	✓
Contingent liabilities			✓		✓
Leases			✓		✓
Accumulated surplus/deficit			✓		✓
VAT	✓		✓		
Disclosure			✓	✓	✓
Emphasis of matter					
Significant uncertainty	✓		✓		✓
Other matters					

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
Non-compliance with applicable laws and regulations		✓	✓		
Matters of governance	✓	✓	✓		

Control environment

The municipality did not establish the key elements of a control environment to institute effective control activities within its ambit. This gave rise to the numerous qualifications that could have been avoided had there been a more stringent control environment.

Assessment of risks

There was inadequate management of risks facing the municipality as it sought to achieve its mission and objectives. The municipality had a risk management unit that concentrates on occupational health and safety. There was therefore inadequate management of control, fraud and other significant risks within the municipality. Therefore, appropriate responses to risks have not been established.

Control activities

Control activities were generally lacking or were ineffective in mitigating the risk of misstatement specific to the components included in the basis for disclaimer of opinion paragraphs.

A review of the information technology general control environment revealed several weaknesses contributing to the matters included in the disclaimer of opinion paragraphs.

Information and communication

The financial accounting system did not function properly as required by the municipality. The system required significant modification and customisation to be able to meet the financial reporting requirements of the municipality. The controls within the systems were poorly designed and, as a result, were not functioning properly. The limitations of the financial accounting system resulted in numerous variances, inconsistencies and uncertainties.

Monitoring

From the audit findings listed in the current and prior audit reports, it could be concluded that the control activities in place required monitoring to identify ineffective controls, lacking controls and necessary adjustments to controls in order for the municipality to achieve its desired objectives.

25. Unaudited supplementary schedules

The municipality provided supplementary information in the financial statements on whether resources were obtained and used in accordance with the legally adopted budget, in accordance with GRAP 1 *Presentation of Financial Statements*. An accounting standard on the presentation of budget information in the financial statements has not been developed by the local standard setter. In the absence of such a standard, I do not express an opinion on the budget information presented in the financial statements.

OTHER REPORTING RESPONSIBILITIES

Reporting on performance information

I was engaged to audit the performance information.

Responsibility of the accounting officer for the performance information

26. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

Responsibility of the Auditor-General

27. I conducted my engagement in accordance with section 13 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) read with *General Notice 646 of 2007*, issued in *Government Gazette No. 29919 of 25 May 2007*.
28. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
29. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Performance information not received in time

30. I was not able to complete an evaluation of the quality of the reported performance information as set out on pages ___ to ___ of the annual report, since the information was not received in time.

APPRECIATION

31. The assistance rendered by the staff of Sol Plaatje Municipality during the audit is sincerely appreciated.

Auditor-General

KIMBERLEY

11 December 2007



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