

Sheltered Employment Factories
Annual Financial Statements for the year ended 31 March 2006

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1. AUDIT ASSIGNMENT

The financial statements as set out on pages 123 to 135, for the year ended 31 March 2006, have been audited in terms of section 188 of the Constitution of the Republic of South Africa, 1996, read with sections 4 and 20 of the Public Audit Act, 2004 (Act No. 25 of 2004). These financial statements, the maintenance of effective control measures and compliance with relevant laws and regulations are the responsibility of the Accounting Officer. My responsibility is to express an opinion on these financial statements, based on the audit.

2. SCOPE

2.1 Audit of financial statements

The audit was conducted in accordance with International Standards on Auditing read with General Notice 544 of 2006, issued in Government Gazette no 28723 of 10 April 2006 and General Notice 808 of 2006, issued in Government Gazette no 28954 of 23 June 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.

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 Audit of financial statements

Due to a lack of appropriately documented and approved policy and procedure framework, as well as the lack of independent checks and reconciliations at the Sheltered Employment

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Factories (the factories), the following shortcomings relating to the financial statements were noted:

- **Property, plant and equipment:** The fixed asset register was inaccurate and incomplete and contained duplicate entries. As a result, not all assets could be verified. We draw your attention to accounting policy note 1.5 stating that property, plant and equipment were not depreciated to residual value.
- **Inventories:** With reference to accounting policy note 1.6, inventories were valued at the lower of cost and net realisable value. Cost price did not include direct and related production overheads. Furthermore, obsolete stock was recorded at cost price and not at net realisable value.
- **Accounts receivable:** The validity, accuracy and completeness of accounts payable of R 1, 88 million could not be verified due to lack of supporting evidence.
- **The impairment of debtors disclosed in the financial statements could not be verified due to a lack of supporting documentation.** The provision for impairment of debtors of R13,8 million included R1,58 million that did not qualify as an asset and R400 000 that was recoverable.
- **Cash and cash equivalents:** 11 bank accounts amounting to R245 639 were not recognised in the financial statements.
- **Accounts payable:** Not all present obligations arising from past events were recognised as liabilities in the financial statements.

The accounts payable disclosed in the financial statements of R6,09 million included a provision for leave of R1,88 million. The validity and accuracy of the provision could not be verified due to inadequate supporting evidence.

- **Suspense accounts:** The annual financial statements were compiled from a ledger that contained suspense accounts of R1,82 million. These suspense accounts could not be verified due to a lack of supporting documentation.
- **Revenue:** Revenue was recognised before significant risks and rewards of ownership of goods had transferred to buyers. This was in contravention of IAS 18. Due to a lack of supporting documentation, related-party transactions disclosed in note 11 to the financial statements could also not be verified.

This was in contravention with section 40(1)(a) of the PFMA, which requires that the entity must keep full and proper records of the financial affairs.

3.2 Supply chain management

Due to a lack of policy framework to require documented contracts with major service providers, the validity of payments for operating leases of R189 200 and transport costs of

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R5 911 532 could not be verified.

3.3 Basis of accounting

The factories are required to prepare financial statements in accordance with the statements of South African Generally Accepted Accounting Practices (GAAP). The factories have departed from GAAP in the following respects:

- As described in note 1, the financial statements were prepared on a basis other than GAAP. The reasons for, and the nature and the financial impact of the departure were not disclosed as required by International Accounting Standards (IAS1).
- Inventories were not accounted for at the lower of cost or net realisable value. Furthermore, costs did not include costs of conversion and direct overheads (IAS2).
- Government grants: Accounting policies and conditions relating to government assistance were not disclosed (IAS20).
- Changes in accounting policy were not disclosed and prior year figures were not restated accordingly (IAS8).
- Related-party transactions were not fully disclosed (IAS24).
- Financial instruments: Accounting policies and the nature of financial instruments were not adequately disclosed (IAS32).
- Fixed assets were not appropriately accounted for and disclosed (IAS16).
- Leases were not appropriately accounted for and disclosed (IAS 17).
- Provisions were not accurately accounted for and appropriately disclosed (IAS37).

4. DISCLAIMER OF AUDIT OPINION

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

5. EMPHASIS OF MATTER

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

5.1 Non-compliance with laws and regulations

The following non-compliance with laws and regulations was identified:

- Effective and appropriate steps to collect all money were not taken by the factories,

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which was in contravention of section 38(1)(c) of the PFMA.

- Invoices were not settled within 30 days as required by Treasury Regulations 8.2.3.
- Several payments, in excess of R2 000, were made by cheque, which was in contravention of TR 15.12.3.
- The factories were conducting the business of a medical scheme by effecting salary deductions from factory workers and defraying some or all of their medical expenses, in contravention of the Medical Schemes Act, 1998 (Act No. 131 of 1998).
- In terms of the Treasury Regulations, paragraph 6.1, the entity must submit annual budgets through the Accounting Officer of the Department. The factories did not have a proper policy and procedure framework to prepare budgets as required.

5.2 Internal control weaknesses

- Policies and procedures: There were no documented and approved policies and procedures framework at the factories for the year under review.
- Monitoring controls: Controls to reconcile accounts with supporting documentation, to pre-authorise and review journal entries and to investigate and clear suspense accounts, were lacking. This was due to lack of a control framework to perform independent checks and reconciliations.
- Formal security and disaster recovery plans have not been developed, tested and documented to ensure that information system disasters are prevented, detected or recovered from on time.

5.3 Performance audit

In terms of section 20(2)(c) of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) the information related to performance against predetermined objectives is subject to auditing by the Auditor-General.

The factories did not have a proper policy and procedure framework in place to manage the process of preparing and presenting their performance information for audit purposes.

5.4 Special investigation

In the previous financial year the Department commissioned a special investigation into material irregularities at the factories. The investigation was completed and the Department was awaiting a final decision on sanctions for the official concerned. The South African Police Services are investigating criminal aspects of the irregularities.

During the financial year another special investigation was instituted into additional irregularities that occurred at the Bloemfontein factory. The investigation was completed.

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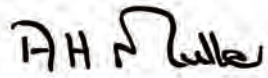
I will report on the progress made with the above investigations in my next report.

5.5 SCOPA resolutions

A SCOPA hearing was held in June 2006, but no resolution has been passed.

6. APPRECIATION

The assistance rendered by the staff of the Sheltered Employment Factories during the audit is sincerely appreciated.



A H Muller
for Auditor-General

Pretoria
31 July 2006

Sheltered Employment Factories

Statement of Responsibility by the Accounting Officer for the year ended 31 March 2006

The Director-General is responsible for the maintenance of adequate accounting records and the preparation and integrity of the Financial Statements and related information. The Auditor-General is responsible for reporting on the fair presentation of the Financial Statements. The Financial Statements have been prepared by incorporating accounting conventions other than those in South African Statements of Generally Accepted Accounting Practices. The convention applied is outlined in the notes to the financial statements. The Accounting Officer is of the opinion that the Financial Statements thus prepared will not mislead the users of the Financial Statements.

The Director-General is also responsible for the system of internal financial control. These are designed to provide reasonable, but not absolute, assurance as to the reliability of the Financial Statements, and to adequately safeguard, verify and maintain accountability of the assets, and to prevent and detect misstatement and loss. Nothing has come to the attention of the Director-General to indicate that any material breakdown in the functioning of these controls, procedures and systems has occurred during the year under review.

The Financial Statements have been prepared on the going concern basis, since the Director-General has every reason to believe that the factories have adequate resources in place to continue in operation for the foreseeable future.

The Financial Statements will be audited by the Auditor-General, who will be given unrestricted access to all financial records and related data, including minutes of all management meetings held. The Auditor-General will issue a separate report on his findings.

The Financial Statements were approved by the Director-General on 26 May 2006.



Director-General of Labour
Date: 26 May 2006

Sheltered Employment Factories
Report from the Accounting Officer for the year ended 31 March 2006

Nature of operations

Sheltered Employment Factories (SEF) were established by Cabinet in 1956 (Cabinet Memorandum, 1956). The objective of the Sheltered Employment Factories is to provide economic empowerment to people with mental and/or physical disabilities, employing an average of 1 276 people with disabilities.

Income is generated from sales of manufactured goods in the various factories, ranging from wood and metal furniture, linen and bedding, upholstery and bookbinding. Income from sales as well as government grants is used to fund the expenses of the SEF. It is the vision of the SEF to enable its workers to be co-responsible for the economic success of the factories in order to reduce their dependence on government funding while simultaneously enhancing their quality of life.

Results of operations

The result of the operations is summarised in the Statement of Financial Performance and the Statement of Changes in Net Assets.

Accounting Officer

The Director-General of Labour is the Accounting Officer.

Auditor

The Auditor-General will continue to audit.

Sheltered Employment Factories
Statement of Financial Performance for the year ended 31 March 2006

	Notes	2006 R'000	2005 R'000
Revenue	1.1	50 304	62 666
Cost of sales		<u>(32 469)</u>	<u>(49 618)</u>
Gross revenue		17 835	13 048
Other income		742	70
Impairment of debtors	1.2	(788)	(12 963)
Provision for accumulated leave	1.3	94	98
Other operating costs		(44 635)	(44 762)
Administration expenses		<u>(5 476)</u>	<u>(5 034)</u>
Operating deficit before departmental grants		(32 228)	(49 543)
Departmental grants	1.4	44 686	45 391
Net surplus/(deficit) for the year		<u><u>12 458</u></u>	<u><u>(4 152)</u></u>

Sheltered Employment Factories
Statement of Financial Position for the year ended 31 March 2006

	Notes	2006 R'000	2005 R'000
Non-current assets			
Property, plant and equipment	2	19 830	16 472
Current assets			
Inventories	3	17 393	17 794
Accounts receivable	4	9 177	11 480
Cash and cash equivalents		17 831	2 725
		<u>64 231</u>	<u>48 471</u>
Net assets and liabilities			
Net assets			
Accumulated funds		58 141	45 683
Fixed asset fund	5	38 311	29 211
		19 830	16 472
Current liabilities			
Accounts payable	6	6 090	2 788
		<u>64 231</u>	<u>48 471</u>

Sheltered Employment Factories
Statement of Changes in Net Assets for the year ended 31 March 2006

	Notes	Accumulated funds R'000	Fixed asset fund R'000	Total R'000
Balance beginning of the year - 1 April 2004		37 604	16 610	54 214
Accumulated leave not accrued in prior years	10	(2 069)	-	(2 069)
Restated balance beginning of year - 1 April 2004		<u>35 535</u>	<u>16 610</u>	<u>52 145</u>
Transfer from fixed asset fund (disposals)		-	(2 310)	(2 310)
Transfer to fixed asset fund (additions)		(2 172)	2 172	-
Net restated deficit for the year	10	<u>(4 152)</u>	<u>-</u>	<u>(4 152)</u>
Restated balance beginning of the year - 1 April 2005		29 211	16 472	45 683
Transfer from fixed asset fund (disposals)		-	-	-
Transfer to fixed asset fund (additions)		(3 358)	3 358	-
Net surplus for the year		12 458	-	12 458
Balance end of the year		<u>38 311</u>	<u>19 830</u>	<u>58 141</u>

Sheltered Employment Factories
Cash Flow Statement for the year ended 31 March 2006

	Note	2006 R'000	2005 R'000
Cash flow from operating activities	8	18 464	3 954
Cash receipts from customers		52 252	57 884
Cash paid to suppliers and employees		(78 622)	(99 328)
Cash deficit from operations		(26 370)	(41 444)
Departmental grants		44 686	45 391
Interest received		148	7
Cash flow from investing activities		(3 358)	(2 172)
Purchase of fixed assets		(3 358)	(2 172)
Net increase / (decrease) in cash and cash equivalents		15 106	1 782
Cash and cash equivalents at beginning of year		2 725	943
Cash and cash equivalents at end of year		17 831	2 725

Sheltered Employment Factories
Notes to the Financial Statements for the year ended 31 March 2006

1. Accounting policies

The Financial Statements have been prepared by incorporating other accounting conventions than those in South African Statements of Generally Accepted Accounting Practices (GAAP) including any interpretations of such Statements issued by the Accounting Practices Board. The financial statements incorporates the prescribed Standards of Generally Recognised Accounting Practices (GRAP) issued by the Accounting Standards Board, replacing the equivalent GAAP statement as follows:

Standard of GRAP	Replaced Statement of GAAP
GRAP 1: Presentation of financial statements	AC101: Presentation of financial statements
GRAP 2: Cash flow statements	AC118: Cash flow statements
GRAP 3: Accounting policies, changes in accounting estimates and errors	AC103: Accounting policies, changes in accounting estimates and errors

The recognition and measurement principles in the above GRAP and GAAP Statements do not differ or result in material differences in items presented and disclosed in the Financial Statements. The implementation of GRAP 1, 2 and 3 has resulted in the following significant changes in the presentation of the financial statements:

a. Terminology differences:

Standard of GRAP	Replaced Statement of GAAP
Statement of Financial Performance	Income Statement
Statement of Financial Position	Balance Sheet
Statement of Changes in Net Assets	Statement of Changes in Equity
Net assets	Equity
Surplus/deficit for the period	Profit/loss for the period
Accumulated surplus/deficit	Retained earnings
Contributions from owners	Share capital
Distributions to owners	Dividends
Reporting date	Balance sheet date

b. The Cash Flow Statement has been prepared in accordance with the direct method.

c. Specific information such as:

- i. Receivables from non-exchange transactions, including taxes and transfers
- ii Taxes and transfer payables
- iii Trade and other payables from non-exchange transactions

are disclosed separately on the Statement of Financial Position.

d. The amount and nature of restrictions on cash balances (if any) is disclosed separately.

e. Paragraphs 11 - 15 of GRAP 1 has not been implemented as the budget reporting

Sheltered Employment Factories
Notes to the Financial Statements for the year ended 31 March 2006

standard is in the process of being developed by the international and local standard setters. Although the inclusion of budget information would enhance the usefulness of the Financial Statements, non-disclosure will not affect fair presentation.

The standard applied is outlined in the following notes.

These statements comply with the principles of generally accepted accounting practice except that property, plant and equipment are reflected at historical cost price and is not subjected to depreciation. The valuation of inventories does not include direct and related production overheads.

1.1 Revenue recognition

Revenue comprises the invoiced value for sale of goods net of value-added tax, rebates, and discounts. Revenue from the sale of goods is recognised when significant risks and rewards of ownership of the goods are transferred to the buyer.

1.2 Impairment of accounts receivable

The Department assesses at each reporting date whether there is objective evidence that a debtor is impaired. If any such evidence exists for debtors, the cumulative loss - measured as the difference between the initial fair value and the current fair value, less any impairment loss previously recognised - is recognised in the Income Statement.

1.3 Retirement benefits

Payments to defined contribution plans (if any) are charged as an expense as they fall due. Payments made to the State-managed retirement benefit scheme are dealt with as defined contribution plans where the factories' obligations under the scheme are equivalent to those arising in a defined contribution retirement benefit plan. The factories are also liable for other post retirement benefits, such as accumulated leave, to which the workers become entitled to at retirement.

1.4 Government grants

Departmental grants are recognised as and when received.

1.5 Property, plant and equipment

Property, plant and equipment are stated at historical cost. Being State assets, no provision for depreciation is made to write off the cost of each asset to its residual value on a systematic basis over its estimated useful life.

1.6 Inventories

Inventories are valued at the lower of cost and net realisable value. The cost of finished goods and work in progress comprises only the cost of raw materials. Direct, other costs

Sheltered Employment Factories
Notes to the Financial Statements for the year ended 31 March 2006

and related production overheads have not been apportioned to finished goods and work in progress.

1.7 Accounts receivable

Accounts receivable are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment when there is objective evidence that the Department will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtors may enter bankruptcy or financial reorganisation and default or delinquency in payments are considered indicators that the trade receivable is impaired. The amount of the provision is the difference between the carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision is recognised in the Statement of Financial Performance.

1.8 Cash and cash equivalents

For the purpose of the Cash Flow Statement, cash and cash equivalents comprise cash on hand and cash held in banking institutions.

1.9 Fixed asset fund

Amounts of actual capital expenditure incurred are charged to accumulated funds as a transfer to the fixed asset fund. Similarly the cost of assets written off is charged as a debit to the fixed asset fund. The proceeds on the sale of fixed assets is credited to the Income Statement.

1.10 Related parties

All transactions and balances with national departments of Government are regarded to be transactions with related parties and disclosed separately in the Notes to the Financial Statements.

Sheltered Employment Factories
Notes to the Financial Statements for the year ended 31 March 2006

2. Property, plant and equipment	Office furniture and equipment R'000	Plant and machinery R'000	Total R'000
Year ended 31 March 2006			
Cost price at beginning of the year	1 875	14 597	16 472
Additions	135	3 223	3 358
Disposals	-	-	-
	2 010	17 820	19 830
Year ended 31 March 2005			
Cost price at beginning of the year	2 660	13 950	16 610
Additions	198	1 974	2 172
Disposals	(983)	(1 327)	(2 310)
	1 875	14 597	16 472
		2006	2005
		R'000	R'000
3. Inventories			
Raw materials		11 785	10 344
Work in progress		1 378	1 865
Finished goods		4 230	5 585
		17 393	17 794
4. Accounts receivable			
Trade debtors		18 079	21 136
Unallocated receipts from debtors		(290)	(1 308)
Debtors in dispute		3 588	4 098
Unpaid cheques		545	512
Unpaid cheque control		(270)	-
Debtor - AST Africa (Pty) Ltd group		1 193	-
Staff debtors		-	1
Trade creditors		61	-
VAT		23	4
		22 929	24 443
Impairment		(13 752)	(12 963)
		9 177	11 480
5. Fixed asset fund			
Balance at the beginning of the year		16 472	16 610
Fixed asset additions		3 358	2 172
Disposals		-	(2 310)
		19 830	16 472

Sheltered Employment Factories
Notes to the Financial Statements for the year ended 31 March 2006

6. Accounts payable	2006	2005
	R'000	R'000
Trade creditors	-	330
Trade accruals	1 830	476
Prepayments from debtors	1 104	-
Provision for accumulated leave	1 877	1 971
Accruals	950	11
Sundry creditors	329	-
	<u>6 090</u>	<u>2 788</u>

7. Operating lease commitments

The operating lease agreement for fixed properties is for an indefinite period. The future aggregate minimum lease payments in respect of the buildings are as follows:

Not later than 1 year	209	209
Later than 1 year and not later than 5 years	835	835
Later than 5 years (indefinite)	<u>1 044</u>	<u>1 044</u>

8. Note to Cash Flow Statement

Cash flow from operating activities		
Operating deficit before grants	(32 228)	(49 641)
Grants: Department of Labour	<u>44 686</u>	<u>45 391</u>
Operating surplus before working capital changes	12 458	(4 250)
Inventories	401	3 107
Accounts receivable	2 303	5 871
Accounts payable	3 302	(774)
Cash flow from operating activities	<u>18 464</u>	<u>3 954</u>

9. Comparative information

The Statement of Financial Performance has been restated to incorporate the reclassification of transportation costs as cost of sales:

Cost of sales as previously reported	42 465
Transportation costs	7 153
Restated cost of sales	<u>49,618</u>
Transportation costs as previously reported	8 144
Transportation costs reclassified as cost of sales	(7 153)
Restated transportation costs	<u>991</u>

Sheltered Employment Factories
Notes to the Financial Statements for the year ended 31 March 2006

10. Prior year adjustment

Net deficit as previously reported	(4 250)
Under provision of accumulated leave	98
Restated deficit for the year	<u>(4 152)</u>

11. Related parties

All national departments of Government are regarded to be related parties in accordance with Circular 4 of 2005: Guidance on the term "State-controlled entities" in the context of IAS24 (AC126) - Related Parties, issued by the South African Institute of Chartered Accountants. No transaction is implicated simply by the nature or existence of the relationships between these entities. However, the following transactions and balances were recorded relating to transactions with related parties as defined above:

	2006 R'000	2005 R'000
Sale of goods to related parties	<u> </u>	<u> </u>
Services provided by related parties	<u>1 880</u>	<u>-</u>
Year-end balances arising from sale of goods to related parties		
Receivables from related parties	<u>16 778</u>	<u>-</u>
Year-end balances arising from services provided by related parties	<u>-</u>	<u>-</u>
Remuneration paid to senior management as defined	<u>-</u>	<u>-</u>

Sheltered Employment Factories
Detailed Statement of Financial Performance for the year ended 31 March 2006

	2006 R'000	2005 R'000
Revenue	50 304	62 666
Cost of sales	<u>32 469</u>	<u>49 618</u>
Gross revenue	17 835	13 048
Other Income	742	70
Interest received	<u>148</u>	<u>7</u>
Discount received	<u>594</u>	<u>63</u>
Total income	<u>18 577</u>	<u>13 118</u>
Total expenses	50 805	62 661
Administrative expenses	<u>1 166</u>	<u>629</u>
Consumables	<u>2 488</u>	<u>2 497</u>
Provision for impairment of debtors	<u>788</u>	<u>12 963</u>
Provision for accumulated leave	<u>(94)</u>	<u>(98)</u>
Municipal charges	<u>1 975</u>	<u>2 199</u>
Operating lease expense - buildings	<u>190</u>	<u>190</u>
Printing and stationary	<u>523</u>	<u>562</u>
Professional services	<u>546</u>	<u>806</u>
Personnel expenditure	<u>41 600</u>	<u>40 897</u>
Telecommunication	<u>877</u>	<u>967</u>
Transport and delivery costs	<u>712</u>	<u>991</u>
Travelling costs	<u>34</u>	<u>58</u>
Net deficit for the year before departmental grants	<u><u>(32 228)</u></u>	<u><u>(49 543)</u></u>