

Report of the auditor-general to the Western Cape Provincial Parliament and the council on the City of Cape Town

Report on the audit of the financial statements

Opinion

1. I have audited the financial statements of the City of Cape Town set out on pages 11 to 65, which comprise the statement of financial position as at 30 June 2017, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. In my opinion, the financial statements present fairly, in all material respects, the financial position of the City of Cape Town as at 30 June 2017, and its financial performance and cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2016 (Act No. 3 of 2016) (DoRA).

Basis for opinion

3. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of my report.
4. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* (IESBA code) together with the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Key audit matters

6. Key audit matters are those matters that in my professional judgement were of most significance in my audit of the current period. These matters were addressed in the context of my audit of the financial statements as a whole and in forming an opinion thereon, and I do not provide a separate opinion or conclusion on these matters.

Key audit matter	How the matter was addressed in the audit
<p><u>Provision for rehabilitation of landfill sites</u></p> <p>The environmental rehabilitation provision is disclosed as R339 million in notes 15 and 17.</p> <p>Given the nature of its operations, the municipality has an obligation to close, restore and rehabilitate landfill sites. Closure and rehabilitation activities are governed by a combination of legislative requirements and entity policies. Significant estimates over the life of the landfill sites are made in determining the rehabilitation provision.</p> <p>The calculation of rehabilitation provisions requires significant judgement due to the inherent complexity in estimating the quantum and timing of future costs and determining an appropriate rate to discount these costs back to their present value.</p> <p>Accordingly, the valuation of the provision for the rehabilitation of landfill sites is considered a key audit matter.</p>	<p><u>I performed the following key procedures:</u></p> <ul style="list-style-type: none"> • I evaluated the competence and objectivity of the specialists based on their experience and use of industry-accepted methodology. • I evaluated the economic assumptions used in the calculation, including the discount rate applied to calculate the present value of the provision. • I evaluated the reasonability of inputs, including the measurement assumptions to determine future costs and the assumptions used to determine the inflation and discount rate. • I tested the appropriateness of the provision for the rehabilitation of landfill sites in terms of the requirements of GRAP 19, <i>Provisions, contingent liabilities and contingent assets</i>. • I evaluated the accounting treatment applied to changes in the closure and rehabilitation provisions, including whether the impact is expensed or capitalised. • Based on the above audit work performed, it can be concluded that the provision for the rehabilitation costs is included at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.
<p><u>Infrastructure assets</u></p> <p>Infrastructure assets of R24,6 billion as disclosed in note 2 are accounted for on the cost model and consist of:</p> <ul style="list-style-type: none"> • Assets under construction • Telecommunications • Drains • Roads • Beach improvements • Sewerage mains and purification • Electricity peak load equipment and mains • Water mains and purification • Reservoirs – water <p>Due to the nature of infrastructure assets, the impairment assessment requires expertise and judgement in determining the nature, condition and operating effectiveness of assets in the infrastructure network, as a result of the complexity involved in determining whether an indication of impairment exists relating to these infrastructure assets. As such, this has been noted as a key audit matter.</p>	<p><u>I performed the following key procedures:</u></p> <ul style="list-style-type: none"> • I obtained an understanding of how the municipality's infrastructure network functions. • My approach in testing infrastructure assets involved me ascertaining the value chain for the mentioned services. With the assistance of experts, I verified that the services were provided from the infrastructure assets in the network by physical inspection. Water was provided from the taps in the households, electricity was supplied from the substation that fed from the main station within the electricity network, and sewerage removal was functioning optimally within households in respect of the sewerage system for sanitation. I inspected all the roads in the service site for their functionality and condition, and linked them to main roads within the road network. • For telecommunications infrastructure, I selected a sample to physically inspect the assets and utilised management's progress reports and invoices reports to determine the valuation thereof. • I also carried out audit procedures to confirm that management members are professionally qualified and competent, and have the relevant

Key audit matter	How the matter was addressed in the audit
	<p>experience to conduct the impairment assessment.</p> <ul style="list-style-type: none"> • I reviewed the detailed impairment reports to obtain an understanding of the assessment conducted by management. Based on this, I am satisfied with management's assessment and consequently the valuation thereof. • I considered whether revenue streams from major infrastructure services were negatively affected as a result of infrastructure capacity failures. Based on the audit procedures performed above, it can be concluded that the assessment conducted by management is appropriate and therefore the valuation thereof is included at the appropriate amounts.

Emphasis of matter

7. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Material losses/impairments

8. As disclosed in note 10 to the financial statements, material losses of R971,6 million (9% of the gross balance of receivables) (2016: R690,7 million – 7% of the gross balance of receivables) were incurred as a result of a write-off of irrecoverable receivables.
9. As disclosed in note 10 to the financial statements, receivables have been significantly impaired. The impairment allowance amounts to R5,1 billion (47% of the gross balance of receivables) of which R3,5 billion (33% of the gross balance of receivables) (2016: R3,2 billion – 32% of the gross balance of receivables) relates to service debtors.
10. As disclosed in note 11 to the financial statements, other receivables have also been significantly impaired. The impairment allowance amounts to R2,4 billion (69% of the gross balance of other receivables) (2016: R1,9 billion – 68% of the gross balance of other receivables).
11. As disclosed in note 44.1.2.3 to the financial statements, electricity losses of R353,5 million (10,89%) were incurred as a result of normal system operations, theft and vandalism.

Other matters

12. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Unaudited supplementary schedules

13. The supplementary information set out on pages 66 to 79 does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

Unaudited disclosure notes

14. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion thereon.

Responsibilities of the accounting officer

15. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the SA Standards of GRAP and the requirements of the MFMA and DoRA, and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
16. In preparing the financial statements, the accounting officer is responsible for assessing the municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the accounting officer either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

Auditor-general's responsibilities for the audit of the financial statements

17. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
18. A further description of my responsibilities for the audit of the financial statements is included in the annexure to the auditor's report.

Report on the audit of the annual performance report

Introduction and scope

19. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected strategic focus areas presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.

20. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.
21. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected strategic focus areas presented in the annual performance report of the municipality for the year ended 30 June 2017:

Strategic focus area	Pages in the annual performance report
Strategic focus area 1: the opportunity city	296 – 297
Strategic focus area 3: the caring city	298 – 301

22. I performed procedures to determine whether the reported performance information was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
23. I did not raise any material findings on the usefulness and reliability of the reported performance information for the following strategic focus areas:
- Strategic focus area 1: the opportunity city
 - Strategic focus area 3: the caring city

Other matter

24. I draw attention to the matter below.

Achievement of planned targets

25. Refer to the annual performance report on pages 296 to 313 for information on the achievement of planned targets for the year and explanations provided for the under- or overachievement of targets.

Report on the audit of compliance with legislation

Introduction and scope

26. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.

27. The material findings in respect of the compliance criteria for the applicable subject matters are as follows:

Revenue management

28. An effective system of internal control for revenue was not in place, as required by section 64(2)(f) of the MFMA. This non-compliance related to the system of internal control over the management of revenue from the MyCiti bus services.

Consequence management

29. Allegations of financial misconduct against senior managers were not always tabled before council, as required by section 120 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) in conjunction with Regulation 5(2) of the Disciplinary Regulations for Senior Managers, 2010.

Procurement and contract management

30. Bid specifications for a tender were drafted in a biased manner and did not allow all potential suppliers to offer their goods or services, in contravention of Regulation 27(2)(a) of the Municipal Supply Chain Management Regulations, 2005.

Other information

31. The municipality's accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements, the auditor's report thereon and those selected strategic focus areas presented in the annual performance report that have been specifically reported on in the auditor's report.
32. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
33. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected strategic focus areas presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
34. If, based on the work I have performed, I conclude that there is a material misstatement of this other information, I am required to report that fact.
35. I have nothing to report in this regard.
36. I did not receive the other information prior to the date of this auditor's report. When I do receive and read this information, and if I conclude that it contains any material misstatements, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to retract this auditor's report and re-issue an amended report as appropriate; however, this will not be necessary if it is corrected.

Internal control deficiencies

37. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance thereon.

Leadership

38. Leadership did not exercise adequate oversight responsibility regarding consequence management to ensure compliance with the provisions of the Disciplinary Regulations for Senior Managers.
39. Leadership did not exercise oversight responsibility by ensuring that the procurement process followed by the municipality was fair and equitable.

Financial and performance management

40. Management did not sufficiently monitor and review the processes implemented to ensure revenue transactions relating to the MyCiti bus services were effective to prevent losses, as required by the MFMA.

Other reports

41. I draw attention to the following engagements conducted by various parties that had, or could have, an impact on the matters reported in the financial statements, reported performance information, compliance with applicable legislation and other related matters. These reports did not form part of my opinion on the financial statements or my findings on the reported performance information or compliance with legislation.

Agreed-upon procedures

42. I performed an agreed-upon procedures engagement on the issue of notes under the municipality's domestic medium-term note programme. I was required to report on compliance with the Commercial Paper Regulations as well as the Municipal Regulations on Debt Disclosure as they related to the placing documents. The report was issued on 17 July 2017.

Investigations

43. Fifteen investigations were ongoing at year-end into allegations relating to financial misconduct, fraud or improper conduct in SCM.
44. The Public Protector is performing an investigation based on the alleged failure by the Cape Town International Convention Centre Company (Pty) Ltd and the City of Cape Town to implement the recommendations of the municipality's forensic services department issued on 21 October 2014. The investigation is still ongoing and has not been finalised yet.

45. An independent consulting firm performed an investigation at the request of the municipality's council. The investigation was initiated based on allegations of fraud and misconduct made by the executive director in the directorate of the mayor, and all other matters served before council on 21 November 2017. The investigation concluded on 29 December 2017 and resulted in disciplinary proceedings.
46. An independent consulting firm performed a forensic investigation at the request of the city manager, which covered the period 1 July 2013 to 31 August 2017. The investigation was initiated based on alleged unauthorised transactions relating to the cash management and payment component of the MyCiti station management contract. The investigation concluded on 10 January 2018 and recommendations were made relating to legal requirements, human resource practitioners and control weaknesses.
47. The municipality initiated an investigation based on allegations of a contractor receiving preferential treatment as well as tender irregularities. The investigation is still ongoing and has not been finalised yet.

Auditor-General

Cape Town

26 January 2018



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

Annexure – Auditor-general’s responsibility for the audit

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for selected strategic focus areas and on the municipality’s compliance with respect to the selected subject matters.

Financial statements

2. In addition to my responsibility for the audit of the financial statements as described in the auditor’s report, I also:
 - identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
 - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality’s internal control.
 - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer.
 - conclude on the appropriateness of the accounting officer’s use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the municipality’s ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor’s report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of the auditor’s report. However, future events or conditions may cause a municipality to cease to continue as a going concern.
 - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
 - obtain sufficient appropriate audit evidence regarding the financial information of the municipality to express an opinion on the financial statements. I am responsible for the direction, supervision and performance of the audit. I remain solely responsible for my audit opinion.

Communication with those charged with governance

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and, where applicable, related safeguards.