

REPORT OF THE AUDITOR-GENERAL

TO THE WESTERN CAPE PROVINCIAL PARLIAMENT AND THE COUNCIL ON 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 76, which comprise the statement of financial position as at 30 June 2018, the statement of financial performance, statement of changes in net assets, cash flow statement and the 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 2018, and its financial performance and cash flows for the year then ended in accordance with the South African Standards of General Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act, 2003 (Act. No 56 of 2003) (MFMA) and the Division of Revenue Act, 2016 (Act No. 3 of 2017) (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 consolidated and separate financial statements section of this auditor's 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) and 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 which, in my professional judgement, were of most significance in my audit of the financial statements of the current period. These matters were addressed in the context of my audit of the financial statements as a whole and in forming my opinion. I do not provide an opinion or conclusion on these matters.

Key audit matter	How the matter was addressed during the audit
Provision for rehabilitation of landfill sites	
<p>Given the nature of its operations, the municipality has obligations 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. 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>I performed the following key procedures:</p> <ul style="list-style-type: none"> • Evaluated the competence and objectivity of the specialists based on their experience and use of industry accepted methodology; • Evaluated the economic assumptions used in the calculation, including the discount rate applied to calculate the present value of the provision • Tested compliance with the accounting standards (GRAP19) relating to the provision for rehabilitation of landfill sites; • Evaluated the accounting treatment applied to changes in the closure and rehabilitation provisions, including whether the impact is expensed or capitalised; • Evaluated the reasonability of inputs, including the measurement assumptions to determine future costs and the assumptions used to determine the inflation and discount rate.

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Report on the audit of the financial statements (continued)

Key audit matter	How the matter was addressed during the audit
Infrastructure assets	
<p>Infrastructure assets of R27 billion, as disclosed in note 2, are accounted for on the cost model, which consists 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.</p>	<p>I performed the following key procedures:</p> <ul style="list-style-type: none"> • I obtained an understanding of how the municipality's infrastructure network functions for the following services: <ul style="list-style-type: none"> - Electricity - Water and sanitation - Roads and drainage • My approach in testing infrastructure assets involved ascertaining the value chain for the services mentioned above. With the assistance of experts, I verified by physical inspection that the services were provided from the infrastructure assets in the network. 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 was functioning optimally within households in respect of the sewerage system for sanitation. I inspected all the roads within the service site for the state and condition thereof and functionality linking them to main roads within the road network. No impairment was necessary based on the functionality thereof. • For telecommunications infrastructure, I selected a sample for physical inspection of assets and utilised management's as-built reports and invoice reports to determine the valuation thereof. • I also carried out audit procedures to confirm that management is professionally qualified and competent and has the relevant experience to conduct the impairment assessment. • I reviewed the detailed impairment reports and 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.

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Report on the audit of the financial statements (continued)

Emphasis of matters

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

Material losses/impairments

8. As disclosed in note 9 to the financial statements, receivables have been significantly impaired. The impairment allowance amounts to R4,4 billion (44% of the gross balance of receivables) (2017: R3,9 billion – 44% of the gross balance of receivables) of which R2,7 billion (27% of the gross balance of receivables) (2017: R2,3 billion – 26% of the gross balance of receivables) relates to service debtors.
9. As disclosed in note 10 to the financial statements, other receivables have also been significantly impaired. The impairment allowance amounts to R3 billion (69% of the gross balance of other receivables) (2017: R2,4 billion – 70% of the gross balance of other receivables).

Restatement of corresponding figures

10. As disclosed in note 37 to the financial statements, the corresponding figures for 30 June 2018 have been restated as a result of an error in the financial statements of the municipality at, and for the year ended, 30 June 2018.

Underspending of the capital budget

11. As disclosed in the statement of comparison of budget and actual amounts (note 38.3.1), the municipality materially underspent the capital budget by R2 billion (27%).

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 in pages 77 to 90 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 in the financial statements. 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 accounting officer for the financial statements

15. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with 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 appropriate governance structure either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

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Report on the audit of the financial statements (continued)

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 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 this 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 objectives 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 objectives presented in the annual performance report of the municipality for the year ended 30 June 2018:

Objectives	Pages in the annual performance report
Objective 3 – Caring City	286 – 291
Objective 4 – Inclusive City	292 – 295

22. I performed procedures to determine whether the reported performance information was properly presented and whether performance 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 these objectives:

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Report on the audit of the financial statements (continued)

Other matter

24. I draw attention to the matter below.

Achievement of planned targets

25. Refer to the annual performance report pages 284 to 295 for information on the achievement of planned targets for the year.

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 on compliance with specific matters in key legislations are as follows:

Expenditure management

28. Reasonable steps were not taken to prevent irregular expenditure amounting to R236 million as disclosed in note 39.1.2.1 to the annual financial statements, as required by section 62(1)(d) of the MFMA. The majority of the disclosed irregular expenditure was caused by non-compliance with section 116(3) of the MFMA.

Procurement and contract management

29. 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 the Municipal Supply Chain Management Regulations (SCM), 2005, regulation 27(2)(a). Similar non-compliance was reported in the prior year.

Annual financial statements, performance and annual reports

30. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of revenue from exchange transactions identified by the auditors in the submitted financial statements were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion.

Other information

31. The 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 and those selected objectives presented in the annual performance report that have been specifically reported 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.

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Report on the audit of the financial statements (continued)

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 objectives presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
34. I did not receive the other information prior to the date of this auditor's report. After I receive and read this information, and if I conclude that there is a material misstatement, 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 reissue an amended report as appropriate. However, if it is corrected this will not be necessary.

Internal control deficiencies

35. 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 on it. The matters reported below are limited to the significant internal control deficiencies that resulted in the findings on compliance with legislation included in this report.
36. Acquisition procedures to ensure that bid specifications were set in accordance with the requirements of the SCM Regulations were not adhered to which resulted in non-compliance with SCM regulation 27(a).
37. Controls within the project management process were not designed to identify or trigger all legislative approvals and processes before amendments were effected to projects, which would have prevented non-compliance with the MFMA and the resultant irregular expenditure.
38. Management did not through its risk assessment process identify the misalignment between the GRAP reporting requirements and accounting practices adopted by the City of Cape Town as a result of council policies. This resulted in the misstatement of revenue recognised in the financial statements, which was corrected subsequent to the submission of the financial statements.

Other reports

39. I draw attention to the following engagements conducted by various parties that had, or could have, an impact on the matters reported in the municipality's 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.

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Report on the audit of the financial statements (continued)

Investigations

40. The Public Protector is conducting 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 City's Forensic Services Department issued on 21 October 2014. The investigation is still ongoing.
41. The City initiated an investigation based on allegations of a contractor receiving preferential treatment as well as tender irregularities. The investigation was concluded on 28 September 2018 and recommendations were made relating to actions to be taken regarding the allegations raised.

Auditor-General

Cape Town

19 December 2018



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence