

REPORT OF THE AUDITOR-GENERAL TO THE COUNCIL AND THE GAUTENG PROVINCIAL LEGISLATURE ON THE GROUP FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF THE CITY OF TSHWANE METROPOLITAN MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2007

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying group financial statements of the City of Tshwane Metropolitan Municipality (CTMM) which comprise the consolidated statement of financial position as at 30 June 2007, consolidated statement of financial performance, consolidated statement of changes in net assets and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx].

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 note 1 and in the manner required by the Local Government: 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 the MFMA, my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with the International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements 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 entity's internal control.

6. An audit also includes evaluating the:
 - appropriateness of accounting policies used
 - reasonableness of accounting estimates made by management
 - overall presentation of the financial statements.
7. Paragraph 11 et seq. of the Statement of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is still in the process of being developed, I have determined that my audit of any disclosures made by the CTMM in this respect will be limited to reporting on non-compliance with this disclosure requirement.
8. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis of accounting

9. The metropolitan 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 qualified opinion

10. Property, plant and equipment

As previously reported in paragraph 4.2 of the 2005/06 audit report, the CTMM implemented a comprehensive property, plant and equipment register, and a position paper was approved by the council to take advantage of the transitional arrangements in GAMAP 17 *Property, Plant and Equipment*. The CTMM is still busy purifying the data in the property, plant and equipment register, as disclosed in note 8 to the financial statements.

However, I identified the following shortcoming relating to property, plant and equipment:

- Due to the current status of the property plant and equipment register, I was unable to perform all the procedures I considered necessary on the property, plant and equipment acquired before 1 July 2004 amounting to R1 334 million which is recorded as a globular and/or capital ledger figure classification within the register. For this property, plant and equipment, I was unable to evaluate the existence, rights and obligations, completeness, valuation (only land and buildings) and allocation as required by GAMAP 17.
- The CTMM has expensed property, plant and equipment that has a purchase value of less or equal to R100 000. For the year under review it is estimated that the value of this property, plant and equipment is at least R49 million. If this property, plant and equipment is capitalised it would increase the value of property, plant and equipment and decrease expenditure with the amount. Furthermore, depreciation will be calculated over the useful life as determined by the accounting policy and the amount will be expensed as depreciation and the carrying amount will decrease with that amount of property, plant and equipment. The depreciation amount and the effect on the net surplus could not be determined.

The current status of the property, plant and equipment register of the CTMM did not permit the application of alternative audit procedures regarding the above items.

11. Creditors

GRAP 1 *Presentation of Financial Statements* paragraph 30 requires that an entity should prepare its financial statements, except for cash flow information using the accrual basis of accounting. This requires that the effects of transactions are recognised when they occur. The CTMM did not accrue an amount of approximately R40 million for invoices and goods or services received before year-end. As a result of unadjusted errors relating to transactions not being included, the amount disclosed for expenditure and creditors in the financial statements is understated. Sufficient internal controls were also not in place, as individual creditors' reconciliations were not performed for all creditors.

12. Material losses as well as irregular or fruitless and wasteful expenditure

Sufficient appropriate audit evidence could not be obtained to confirm the completeness, accuracy, allocation, presentation and disclosure of material losses, irregular or fruitless and wasteful expenditure and any criminal or disciplinary steps taken as required by section 125(2)(d)(i) and (ii) of the MFMA. No reasonable alternative audit procedures could be performed to quantify the material losses as well as the irregular or fruitless and wasteful expenditure.

13. Provision for rehabilitation of landfill sites

The provision for the final rehabilitation of landfill sites amounting to at least R57 million was not raised as required by GAMAP 19 *Provisions, Contingent Liabilities and Contingent Assets*.

14. Assessment rates and property values disclosed

The CTMM is currently still in the process of following up and reconciling the valuation roll and the valuation roll values with the relevant billing system regarding assessment rates. There were no satisfactory alternative audit procedures that could be performed to obtain reasonable assurance that all assessment rates had been properly recorded and that the site values included in note 16 to the financial statements are fairly stated. Consequently, I was unable to satisfy myself as to the completeness, occurrence and accuracy of the assessment rates income as well as site values as on 30 June 2007, totalling R1,719 billion and R21,333 billion, respectively.

15. Regional services council (RSC) levies

I was unable to obtain sufficient appropriate audit evidence on the completeness, accuracy and occurrence and existence on the RSC levy debtors and income totalling R236 million and R102 million, respectively. This was due to the two systems, namely the subsystem (Unix) and the accounting system (SAP), not matching with regards to payments received. Furthermore monthly differences are not followed up for correction. The unreconciled Unix RSC debtor balance for the 2007 year was used as a 2006 final closing balance, which had a material impact on the RSC Income for the 2006 as well as a provision for bad debts.

Qualified opinion

16. In my opinion, except for the effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the City of Tshwane Metropolitan Municipality as at 30 June 2007 and its financial performance and cash flows for the year then ended, 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 MFMA.

Emphasis of matters

I draw attention to the following matters:

17. Significant uncertainty

17.1 Municipal entity: Housing Company Tshwane

The audit opinion of the Housing Company Tshwane was disclaimed. As a result of the disclaimer no assurance could be given on the items consolidated into the financial statements.

17.2 Short-term portion of arrangement debtors

The council failed to disclose the short-term portion of arrangement debtors as a current asset. In terms of the requirement of IAS 1 *Presentation of Financial Statements*, amounts receivable within one year must be disclosed separately and not included in long-term receivables. Although the short-term portion debtors exist I was unable to clearly establish the amount of the short-term portion of arrangement debtors, as the council did not provide this information.

17.3 Grants and subsidies paid

I was unable to verify the occurrence and accuracy of grants and subsidies paid amounting to R8 million as disclosed in note 25 to the financial statements. The supporting information to this matter could not be provided at the date of this report the supporting information to this matter could also not be provided. No alternative audit procedures could be performed.

17.4 Samrand Development (Pty) Ltd

Included in note 11 to the financial statements is an amount of R18,152 million outstanding in respect of Samrand Development (Pty) Ltd. The CTMM has for some years tried, and is still currently trying to resolve the payment of this amount. The outcome of the matter can presently not be reasonably established, and no provision for this debt has been made.

18. Basis of accounting

As set out in accounting policy note 1 Basis of presentation, the National Treasury approved a deviation from the basis of accounting applicable to the municipality in terms for *Government Notice 522 of 2007* issued in *Government Gazette 30013 of 29 June 2007*.

OTHER MATTERS

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

19. Non-compliance with applicable legislation

19.1 Local Government: Municipal Finance Management Act

Certain tender files did not have copies of tenderers financial statements, details of the municipal rates owed to the municipality, copies of tax clearance certificates and details of the respective tender advertisements as required by the supply chain management policy of the CTMM, This in turn resulted to non-compliance with section 111 of the MFMA.

19.2 Property Valuers Profession Act

Supervisors did not perform a timeous and consistent review on the work done by the valuation officers, as per the provisions of section 19(3) of the Property Valuers Profession Act, 2000 (Act No. 47 of 2000), mainly due to fact that there was a backlog and the section was understaffed.

19.3 National Credit Act

Sections 40 to 42 of the National Credit Act, 2005 (Act No. 34 of 2005) were not complied with, as the CTMM could not provide evidence that it was registered with the National Credit Regulator, although the CTMM provided interest-bearing loans exceeding the R500 000 threshold. For more detail on the loans refer to note 11 to the financial statements.

20. Matters of governance

20.1 Audit committees

For the period 1 July to 27 September 2007 the CTMM did not have an audit committee as required by section 166(1) of the MFMA. This resulted in the audit committee not being in a position to review the financial statements to be submitted to the Auditor-General as required by section 126 of the MFMA.

For the municipal entities under the control of the CTMM, a functioning governance structure and process for an audit committee also did not exist, as required by section 166 of the MFMA.

20.2 Internal audit

A functioning system of internal audit did not exist during the year under review for any the municipal entities of the CTMM, as required by section 165 of the MFMA.

21. Material corrections made to the financial statements submitted for audit

The financial statements, approved by the accounting officer and submitted for audit purposes on 31 August 2007, have been significantly revised in respect of the following misstatements identified during the audit:

21.1 Proper provisions for RSC levies were not made due to subsequent additional information received from the South African Revenue Service (SARS) in respect of levy payers not registered for RSC levies resulting in a understatement of RSC levies income and debtors to the amount of R236 729 088. A correction for an amount of R236 729 088 was effected. Furthermore, a provision for an amount of R53 868 841 for RSC levies was also effected.

21.2 An amount of R139 935 286 in respect of short-term loans was not separately disclosed in the financial statements. The short term loan liability was therefore understated and the long-term loan overstated.

21.3 Intangible assets to the value of R125 348 933 were not separately disclosed, but included in components of property, plant and equipment.

22. 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 as well as 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 exist in more than one internal control component as indicated.

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
Basis for qualification					
Property Plant and Equipment	✓		✓	✓	✓
Creditors			✓	✓	
Material losses, irregular or			✓		

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
fruitless and wasteful expenditure					
Provision for rehabilitation of landfill sites			✓		
Assessment Rates and property values disclosed			✓	✓	
Regional Services Council (RSC) Levies			✓	✓	
Emphasis of matter					
Municipal Entities	✓		✓		
Short term arrangement debtors			✓		
Grants and subsidies paid			✓	✓	
Basis of accounting			✓		
Other matters					
Non compliance with applicable legislation			✓		
Matters of Governance			✓		
Material corrections of the financial statements			✓		

Information system controls and communication: general control and SAP R/3 baseline and authorisation review.

The most significant weaknesses identified during a general control review were the following:

- Logical security controls were inadequate.
- Duties were ineffectively segregated due to the developer, and basis and system administrators having access to security administration functions.
- A large number of users (174) had been granted access to modify tables that had been customised but not assigned to specific authorisation groups. A number of users also had access to maintain client-independent tables in the production environment.
- Change control was ineffective as the developer had access to the production environment, which allowed the developer to customise, correct and transport a system. Change control documents were not always signed off at the appropriate level of management before and after implementation.
- Users were allowed access to sensitive and high-risk transactions, which resulted in users being able to perform conflicting transactions on the system.

23. Investigations in progress or completed

Various investigations are currently in progress within the CTMM, in conjunction with the internal audit division and various departmental heads. The investigations covered a wide range of activities of the CTMM were still ongoing at the date of this report and the effect therefore on the financial statements is unknown.

24. Unaudited supplementary schedules

The supplementary information set out on pages XX to XX does from part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express and opinion on them.

OTHER REPORTING RESPONSIBILITIES

Reporting on performance information

25. I have audited the performance information as set out on pages [XX] to [XX].

Responsibilities of the accounting officer

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 PAA, read with *General Notice 646 of 2007*, issued in *Government Gazette No. 29919 of 25 May 2007* and section 45 of the MSA.

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.

Audit findings (performance information)

30. Performance information report not received in time
- I was not able to complete an evaluation of the quality of the reported performance information as set out on pages [xx] to [xx] of the annual report, since the information was not received in time.
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31. Internal auditing of performance information
- Not all the quarterly reports were audited by the internal audit division of the CTMM in the financial year under review as required by section 45 of the MSA.
32. Performance audit committee
- The performance audit committee did not review all the quarterly reports during the financial year under review as the functions of the performance audit committee were not clearly defined.
33. Inadequate or lack of policies and procedures
- The policies and procedures relating to the performance management system did not in all instances include all laws and regulations applicable to the performance management system. Examples of laws and regulations not included in the policies and procedures are the following:
- Section 44 of the MSA requiring that the targets set by the municipality must be made known internally and to the general public.
 - Regulation 6 of the Performance Planning and Performance Management Regulations of 2001 requiring the allocation of resources in the municipal annual budget based on the development priorities and objectives as well as the performance targets set by the municipality.
34. Non-compliance with laws and regulations
- Section 46 of the MSA was not adhered to when preparing the quarterly performance reports of the CTMM, as performance was not compared to the targets set or the performances in the previous financial year. Measures taken to improve performance were also not included in the quarterly reports.

APPRECIATION

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

Auditor - General

Pretoria

21 December 2007
