



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

REPORT

OF THE

AUDITOR-GENERAL

TO THE COUNCIL ON THE

GROUP FINANCIAL STATEMENTS

OF THE

**CITY OF JOHANNESBURG METROPOLITAN
MUNICIPALITY**

FOR THE

YEAR ENDED 30 JUNE 2005



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**The report is subject to finalization of the review by the
Corporate Executive and Auditor General**

**REPORT OF THE AUDITOR-GENERAL TO THE COUNCIL ON THE
GROUP FINANCIAL STATEMENTS
OF THE CITY OF JOHANNESBURG METROPOLITAN MUNICIPALITY
(MUNICIPALITY) FOR THE YEAR ENDED 30 JUNE 2005**

1. AUDIT ASSIGNMENT

The group financial statements as set out on pages to, for the year ended 30 June 2005 have been audited in terms of section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996), read with sections 4 and 20 of the Public Audit Act, 2004 (Act No. 25 of 2004), section 126(3) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) and section 300 of the Companies Act, 1973 (Act No. 61 of 1973). These group 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 group financial statements, based on the audit.

2. NATURE AND SCOPE

The audit was conducted in accordance with Statements of South African Auditing Standards. 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, and
- 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.

The municipality was a pilot site for the implementation of Generally Accepted Municipal Practice (GAMAP) for the year ended 30 June 2004, and consequently implemented Generally Recognised

Accounting Practice (GRAP). For those matters not covered by GAMAP or GRAP, the applicable South African Statements of Generally Accepted Accounting Practice were applied. Furthermore, the guideline for the implementation of GAMAP issued by National Treasury as part of MFMA Circular No. 18 was used in addressing certain aspects of property, plant and equipment.

I believe that the audit provides a reasonable basis for my opinion.

3. QUALIFICATION

3.1 Unreconciled accounting records

(i) Consumer debtors with credit balances

Debtors whose accounts reflected credit balances amounting to R496.4 million (2004: R 464.5 million) were included in the debtors age listing at year-end. An analysis of these accounts by management indicated that approximately R162.7 million of the account balances were valid credit balances relating to the clearance certificate process. A plan to address the remaining credit balances was implemented subsequent to year-end including the establishment of a proactive refunds unit.

Furthermore, debtors with credit balances amounting to R44 million were included in accounts payable at City Power Johannesburg (Pty) Ltd.

(ii) Inventory

Johannesburg Water (Pty) Ltd did not conduct a physical count of inventories at certain depots as at 30 June 2005 and the completeness and existence of inventory amounting to R18.1 million could therefore not be established.

The physical count of inventories at 30 June 2005 at Metropolitan Bus Services (Pty) Ltd was not attended by this Office, but roll back procedures performed by management during the audit, indicated that deficiencies occurred in the physical count. The completeness and existence of inventory amounting to R7.7 million at 30 June 2005 could therefore not be confirmed.

(iii) Johannesburg Fresh Produce Market (Pty) Ltd

A breakdown of the system of internal and financial controls

resulted in unreconciled differences in the deposit and business bank accounts, the guaranteed buyers subsidiary ledger and the debtors ledger. This led to incorrect disclosures in the financial statements. A forensic investigation and other interventions were instituted.

(iv) City Housing Company (Pty) Ltd

A serious breakdown of the system of internal controls occurred and an improper accounting system was used. Consequently, I was unable to verify assertions in respect of property, plant and equipment, grant income and accruals for the year under review.

The unsigned financial statements of this company were prepared on a going concern basis notwithstanding the municipality's shareholder unit decision on 15 November 2005 to liquidate the company. Consequently, the financial statements included in the group financial statements were prepared on the incorrect basis.

(v) Johannesburg Social Housing Company (Pty) Ltd

Due to significant control weaknesses, and the lack of information and appropriate explanations, the completeness, existence and valuation of property, plant and equipment could not be verified. In addition, the City of Johannesburg did not provide the appropriate guarantee for the inter-company debt and the recoverability of this debtor was therefore doubtful. The company's taxation appeared to be incorrectly calculated for the financial period.

Various significant weaknesses existed in the control over accounts payable and general expenditure, and as such the completeness, accuracy and validity of the account balances could not be verified. Concern was raised as to the impact of the above errors on the solvency of the company.

3.2 Fixed assets

3.2.1 Write-off of assets contained insufficient data and global amounts and their replacement with assets at fair value in terms of GAMAP 17 and the guideline issued by National Treasury as per MFMA Circular No.18

As reported in the previous year, the various fixed asset records held by the municipality were incomplete, reflecting global amounts and vague asset descriptions and as a result certain assets could not be traced. During this year, the municipality followed the guideline for the implementation of accounting standards issued by National Treasury. Chapter 3 of this guide outlines two methods of

determining values of property, plant and equipment at the date of implementation of the standards, and three options to be considered when dealing with incomplete data and global amounts in the asset registers.

The municipality adopted method 2 by valuing land, furniture and office equipment at fair value and option 3 for the adjustments arising out of the fair valuing of land, furniture and equipment against the opening balance of the accumulated surplus in the Statement of Changes in Net Assets. The revalued assets were captured with a new acquisition date of 30 June 2005. In line with the GAMAP implementation guide issued by National Treasury as part of MFMA Circular No. 18, the approach adopted when fair valuing the assets was discussed with my office and approved by the council of the municipality.

Consequently, and as detailed in note 11 to the group financial statements, the municipality revalued their land assets and movable assets at their fair values. As a result assets containing insufficient data and global amounts with a net book value of R1 290.1 million were written-off, and assets with a fair value of R6 353.5 million were capitalised. The net adjustment was made against the accumulated surplus in the Statement of changes in equity as per GAMAP 17.

A forensic audit report dated 7 November 2005 commissioned by CJMM indicated that certain assets written off were subsequently identified. This matter is receiving further attention.

For the purpose of the fair valuation exercise, land assets held by the municipality were identified through old records which were not reconciled to the accounting records, title deeds held by the municipality and information from the deeds office. For movable assets, physical verification was undertaken, and the assets identified were then fair valued.

The land assets belonging to the municipality were principally identified from the deeds information by using a combination of names. Taking into account the historic devolution of the municipality and the infinite naming combinations possible when registering land assets with the deeds office, audit could not confirm the completeness of the naming combinations used to establish the fair values for land assets. It was therefore not possible to establish the completeness of the land assets with a fair value of R6 190.1 million.

3.2.2 Impairment of assets and rehabilitation of landfill sites

The impairment exercise required in terms of International Accounting Standard 36 (IAS 36) was not undertaken for the three utility companies.

Furthermore, a provision was not made for the rehabilitation costs of various closed landfill sites at Pikitup Johannesburg (Pty) Ltd.

3.3 Completeness of revenue

The following matters were identified which impacted on the completeness of revenue:

3.3.1 Assessment rates and taxes - Differences between the valuation roll and billing system

A reconciliation of properties as per the valuation roll compared to the properties as per the debtors' billing system performed by the municipality indicated differences between the two systems. The estimated impact on assessment rates could therefore not be determined. Significant progress was however made with the reconciliation process since the previous year.

3.3.2 Water and sewerage income

- (a) In the absence of a suitable reconciliation between the water consumption points and the billing system, I was unable to assess whether all properties within the boundaries of the municipality were included or validly excluded from the billing systems of Johannesburg Water (Pty) Ltd. The impact of this on the revenue base of the municipality could not be determined.
- (b) In the absence of detailed prior year accounting records for collections on behalf of Johannesburg Water (Pty) Ltd by the core municipality, it was not possible to express an opinion on the completeness and accuracy of collections by the core municipality totalling R58,0 million. These collections were recorded in the statement of changes in equity as a prior year adjustment.

3.3.3 Consumer debtors opening balances

The audit opinion on electricity and water consumer revenue and consumer debtors was disclaimed in the preceding financial year due to significant weaknesses in respect of the completeness of the customer database. Neither of the two affected UACs, nor the core municipality was able to provide detailed supporting schedules and other documentation to substantiate the opening balances. The financial effect on the current year financial statements could not be quantified.

3.3.4 Emergency services

A new billing system was introduced for emergency services during the year and inadequate audit trails existed between the emergency service despatches and the billing system. Audit was therefore not able to test the completeness of the emergency services income. Consequently, no conclusion could be reached on the completeness of emergency services fees amounting to R7.7 million.

3.4 Amounts owing between the municipality and the Ekurhuleni Metropolitan Municipality

Take-on balances from the former Midrand and Modderfontein Local Councils, which related to the Ekurhuleni Metropolitan Municipality, were still reflected on the municipality's books and that of City Power Johannesburg (Pty) Ltd. Final adjustments were not passed to write-off these balances.

3.5 Limitation of scope on the amounts written off as part of the indigent debtors policy

The municipality and its UACs implemented an indigent debtor's write-off project with effect from 4 May 2005, the details of which are fully explained in note 30 to the annual financial statements. At the time of the audit, the supporting documentation for these indigent debtor's write-offs were collected from the regions and the various core and people centres where the physical applications were processed and sent for filing. Other applications were with teams carrying out home visits and teams carrying out extended audit procedures on the applications. Consequently, I was unable to test the write-offs against the council approved policy. I am therefore unable to express an opinion on the indigent debtor's write-offs exclusive of Value Added Tax amounting to R636.0 million (R176.7 million for the core municipality, R358.4 million for Johannesburg Water (Pty) Ltd and R100.9 million for City Power Johannesburg (Pty) Ltd).

3.6 Provision for leave pay

A breakdown of accounting controls over the recording of leave at Pikitup Johannesburg (Pty) Ltd occurred and I was unable to perform alternative procedures to confirm the completeness and validity of leave balances amounting to R28.2 million. The provision will be adjusted by the Bargaining Council agreement which provides for forfeiture of accumulated leave under certain conditions.

3.7 Retirement benefit funding

It was not possible to obtain the actuarial valuations for the various open retirement funds to which some of the staff of the municipality and its utilities, agencies and corporations, contributed. The closed retirement fund information for funds covering the majority of employees were obtained, and were accounted for in the group annual financial statements accordingly. The funds whose actuarial valuations were outstanding are listed below:

- Municipal Employees Pension Fund
- Joint Municipal Pension Fund
- South African Local Authority Pension Fund
- Soweto National Pension Fund
- Deepmeadowlands Pension Fund

Consequently, the extent of any deficit or surplus relating to these funds could not be ascertained.

The core municipality undertook to carry all pension obligations up to 30 June 2005 for the municipality and its UACs.

3.8 Regional Services Council Levies (RSC-levies)

The municipality recognised all RSC-levy income on the receipt basis which is contrary to GAMAP which prescribes the accrual basis..

As a result, a reliable age-analysis for RSC-levy debtors could not be submitted during the audit and the impact of the misstatement of RSC-levy income as well as RSC-levy debtors could therefore not be quantified. Due to the announcement of the scrapping of the RSC levies, management considered it prudent not to update the RSC levies billing system to make it GAMAP compliant.

3.9 Operating leases

Operating lease expenses and income were misstated as they were not recognised on a straight line basis over the lease terms as required by GAAP, statement IAS 17 (AC 105) - leases.

Amounts disclosed for operating lease commitments (note 44) were not in terms of the relevant lease agreements; accordingly, the lease commitments were misstated.

Amounts relating to operating lease income receivables were not disclosed.

3.10 Housing debtors and housing development fund

The collection rate on housing income was 30% (2004: 33%) for the year ended 30 June 2005, and 92% of the rental debtors' balance of R381.9 million was provided for as doubtful at the end of the year.

The municipal and service charges relating to housing stock amounted to R44.7 million whilst the total charged to the tenants was R40.0 million, resulting in the municipality subsidising the tenants to an extent of R4.6 million before taking into account the non recovery of debtors referred to above. This matter was reported previously.

Contrary to the accounting policy, the Housing Development Fund did not reflect the necessary movements in the current year.

4. DISCLAIMER OF AUDIT OPINION

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

5. EMPHASIS OF MATTER

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

5.1 Contingent liability

Cognisance should be taken of the estimated contingent liabilities of R1 179.0 million disclosed in note 51 of the group financial statements, the finalisation of which might have a significant impact on the financial results in future.

5.2 Debt collection

A provision for doubtful debt of R 7 097.7 million (2004: R 7 030.1 million) existed at year-end. During the year indigent debtors amounting to R 636.0 million were written off. Under-collections negatively impacted on the cash flows of the municipality and its UAC's. The introduction of certain initiatives aimed to improve collections were reflecting positive results.

5.3 Electricity distribution loss

A difference existed during the year between electricity purchased of 11,727 billion kwh (2004: 11,559 billion kwh) and electricity sold of 10,278 billion kwh (2004: 9,430 billion kwh). This represented an

estimated distribution loss of 12.36 per cent (2004: 18.42 per cent) of the total electricity purchased.

5.4 Regional electricity distributor

The process of restructuring the electricity industry provided for the creation of regional electricity distributors (RED's). The RED's will be used as entities to merge the electricity distribution business of ESKOM with that of municipalities. The future financial impact of this process on the municipality could not be quantified.

5.5 Unaccounted for water

The percentage of unaccounted for water was estimated at 33 percent (2004: 36 per cent). Calculated at the average cost of water purchased, the loss amounted to approximately R417,6 million (2004: R423,4 million).

5.6 Regional Services Council (RSC) levies

RSC levies comprised approximately 11 percent of the consolidated gross revenue of the municipality for the year under review. It has been announced that these levies have been scrapped and the impact on the cash flows of the municipality will take effect from 01 July 2006. The long-term impact of the scrapping of these levies on the revenue of the municipality is uncertain.

5.7 Value added tax

City Power was registered on the payment basis in terms of section 15 of the Value Added Tax Act, 1991 (Act No. 89 of 1991). However, input Value Added Tax (VAT) was claimed on the invoice basis due to an incorrect configuration of the accounting application system.

At Pikitup Johannesburg (Pty) Ltd, amounts journalised from the unallocated deposit account were not flagged as customer receipts, and were not taken into account for output VAT purposes.

5.8 Registration of freehold land and buildings

Freehold land and buildings transferred to the UACs in terms of the various sale of business agreements were still registered in the name of the municipality. Management of the municipality were reviewing the options of transferring the assets which were cost effective and pragmatic. The net book value of assets affected, per UAC is :

City Power Johannesburg (Pty) Ltd	R 3.2 million
Johannesburg Water (Pty) Ltd	R147.0 million

Pikitup Johannesburg (Pty) Ltd	R 24.8 million
Metrobus (Pty) Ltd	R 12.3 million
Johannesburg Fresh Produce Market (Pty) Ltd	R 77.6 million
Johannesburg Roads Agency (Pty) Ltd	R 3.3 million

The amounts applicable to the City Housing Company (Pty) Ltd could not be determined due to a breakdown of accounting controls in that company.

5.9 Non-compliance with the Municipal Systems Act

Section 93K of the Municipal Systems Amendment Act, 2003 (Act No. 44 of 2003), prohibits a municipal entity from the establishment of and acquisition of interests in corporate bodies. Contrary to this, the Johannesburg Development Agency (Pty) Ltd (JDA), held interests in Greater Newtown Development Company (Pty) Ltd and Constitution Hill Development Company (Pty) Ltd.

5.10 Non-compliance with the Municipal Finance Management Act (MFMA)

Instances of non-compliance with the requirements of the MFMA were noted and communicated to management. The key areas of non-compliance were the following:

- (a) Section 89(a) of the MFMA provides for the core municipality to determine the upper limits of the remuneration of the chief executive officers and senior management of the UACs. Such upper limits were not determined for the year under review.
- (b) The internal audit function at the Johannesburg Fresh Produce Market (Pty) Ltd, Johannesburg Social Housing Company (Pty) Ltd, and the Metropolitan Trading Company (Pty) Ltd, only commenced during this year contrary to section 165 of the MFMA.
- (c) The disclosure of councillors whose municipal accounts were in arrears in the group annual financial statements in terms of section 124(b) was incomplete
- (d) The fixed asset register for moveable and immovable assets held by City Power Johannesburg (Pty) Ltd, Pikitup Johannesburg (Pty) Ltd, Johannesburg Social Housing Company (Pty) Ltd and City Housing Company (Pty) Ltd were incomplete and assets were not adequately detailed to allow identification of the physical assets. This was contrary to section 96(1) of the MFMA.
- (e) Contrary to section 125(2)(d) of the MFMA, fruitless and wasteful expenditure was not disclosed in the notes to the group annual financial statements. A system did not exist to identify, record and disclose all incidences of fruitless and

wasteful expenditure at the core municipality and its UACs. Such incidences were also identified through forensic investigations.

5.11 Disaster recovery and business continuity planning

The Disaster Recovery Plan (DRP) in place at the core municipality did not include the processes that business needed to follow during a disaster.

Contrary to best practices, City Power Johannesburg (Pty) Ltd, City Parks (Pty) Ltd, Johannesburg Fresh Produce Market (Pty) Ltd, Johannesburg Zoo (Pty) Ltd, The Metropolitan Bus Services (Pty) Ltd and Pikitup Johannesburg (Pty) Ltd did not finalise their disaster recovery and business continuity plans to address business issues in the event of business interruption.

5.12 Weaknesses in the information technology (IT) environment

Weaknesses were identified in respect of the general computer controls and application controls that could compromise the overall integrity, reliability and availability of the operating and processing environment at Johannesburg Water (Pty) Limited.

Although some controls were in place at City Power Johannesburg (Pty) Ltd, the most significant control weakness identified was various changes to the SAP application system found on the transaction log files that were not supported by change request forms. It could therefore not be determined if all changes made were appropriately approved.

5.13 High Court judgement

The High Court in a judgement dated 9 September 2005, set aside the decision to award a significant tender for the handling of solid waste. The judge also found that allegations of bias in the tender process were not entirely unfounded. The municipal structures as well as officials of the municipality and Pikitup Johannesburg (Pty) Ltd played a part in the awarding of the tender.

CJMM investigated this matter and significant deviations from the procurement policies were identified. The final investigation report dated 8 February 2006 has made various recommendations.

5.14 Submission of annual financial statements

The group annual financial statements of the municipality were submitted on 30 September 2005 as required by section 126(1)(b) of the MFMA, whilst those of the UACs were submitted on

31 August 2005 in terms of section 126(2) of the MFMA. Due to significant audit findings the statements were amended and a final set submitted to the Auditor-General on 3 March 2006.

6. APPRECIATION

The assistance rendered by the staff of the City of Johannesburg Metropolitan Municipality and its UACs during the audit is sincerely appreciated.

Signature

Auditor-General

Johannesburg

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