REPORT OF THE GROUP AUDIT COMMITTEE OF THE CITY OF JOHANNESBURG METROPOLITAN MUNICIPALITY ON THE PROGRESS TO DATE IN THE EVALUATION OF THE DRAFT ANNUAL FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 30 JUNE 2011 AND MONITORING THE YEAR END AUDIT

1. STRATEGIC THRUST
A well-governed and managed City

2. OBJECTIVE
The purpose of this report is to communicate to the Mayoral committee and therefore Council, the Group Audit Committee's (GAC) progress to date in carrying out its oversight responsibilities over the statutory audit process for the financial year ended 30 June 2011, as mandated in terms of section 166 (2)(b) of the Municipal Finance Management Act (MFMA).

3. SUMMARY

3.1 Background

The mandate of the Group Audit Committee is legislated in terms of section 166 of the Municipal Finance Management Act, which requires the Committee to advise the Accounting Officer and Council on matters relating to internal financial control and internal audits; risk management; accounting policies; adequacy, reliability and accuracy of financial reporting and information; performance management and performance evaluation; effective governance; compliance with the Municipal Finance Management Act (MFMA), the Annual Division of Revenue Act, and any other applicable legislation; and any other issues referred to it by the municipality. The Act also requires the Audit Committee to review the annual financial statements, respond to Council on matters raised by the Auditor General, and carry out investigations into the financial affairs of the municipality. The responsibilities of the GAC include oversight of the Municipal Entities of the City of Johannesburg from a group perspective, although each of the Municipal Owned Entities ("MOE's") of the City have their own Audit Committees which report to their Boards of Directors.

3.2 Discussion

The GAC reports that it has complied with its responsibilities arising from section 166 (2)(b) of the Municipal Finance Management Act ("MFMA"), and the Council approved Terms of Reference which require the Audit Committee of the City to review the annual financial statements.

3.2.1 Evaluation of Annual Financial Statements for the year ending 30th June 2011
The GAC has reviewed and discussed with the Auditor-General SA (AGSA) and the management of the City:

- the unaudited annual financial statements of the City of Johannesburg Core

Administration, prior to the submission hereof to the Auditor General (SA) for year end audit purposes; and subsequently the audited annual financial statements of the Core Administration;

- the unaudited consolidated annual financial statements of the City of Johannesburg for the financial year ending 30 June 2011, prior to the submission hereof to the Auditor General (SA); and subsequently the audited group annual financial statements of the City
- the draft and final AGSA management reports on the regularity audit and the audit of performance information of the City of Johannesburg Municipality and its entities, and management's response thereto;
- the draft and final AGSA reports on the regularity audit of the municipal owned entities, the core administration and the consolidated Annual Financial Statements for the year ending 30 June 2011;
- the basis of the final AGSA audit opinions and the emphasis of matter;
- accounting policies and practices;
- the year-end accruals for revenue, related journals and potential impact on prior year figures; and
- material or significant adjustments resulting from the audit.

3.2.2 Group Audit Committee Observations and Recommendations

(a) Submission of draft unaudited annual financial statements

- The City of Johannesburg Core Administration and its Municipal Entities met the mandatory deadlines in terms of the MFMA for the submission of unaudited annual financial statements and the consolidated annual financial statements.
- The annual financial statements were prepared on the going concern basis.

(b) GAC recommendation for approval of the submission of the Core Administration's unaudited AFS to the Accounting Officer

- At its meeting held on the 29th August 2011, the GAC recommended the submission of the unaudited AFS of the core administration to the AGSA, subject to the following provisions:
  - the members understanding that the annual revenue total and debtors balances as at 30th June 2011 have not been finalized, since Group Finance is still working on the opening figures or balances for the year; and it is expected that these shall have been finalized at the date of submission of the consolidated annual financial statements this being the 30th September 2011; and
  - the adjustments that were highlighted and agreed to at the meeting relating to:
    - Value Added Taxation (VAT)
    - Library books to be re-classified in the Statement of Financial Performance
    - Net Impairment losses to be transferred to Revenue
    - Correction of grammatical errors in the Accounting Policies,
    - Provision for debt impairment

- Prior Period Errors which require an explanation in the notes to the financial statements
- Fruitless and wasteful expenditure which requires more detailed explanation in the notes to the financial statements.

(c) GAC recommendation for approval of the submission of the CoJ Group unaudited consolidated AFS to the Accounting Officer

As the draft unaudited consolidated annual financial statements of the City for the financial year ended 30 June 2011 (draft AFS) were not yet finalized, that recommendation to approve the draft AFS be subject to the acting Group Chief Financial Officer effecting the adjustments that were highlighted and agreed to at the meeting; and therefore approval would be by way of round robin provided that the amended draft AFS would be circulated together with an analysis of the changes made subsequent to the version of the draft that had been presented to the GAC, and with all the changes requested at the GAC meeting of the 29th September 2011.

(d) GAC consideration and recommendation for approval of the audited consolidated group annual AFS, the AGSA final Management Letter and the AGSA audit report for the year-ending 30 June 2011

The GAC held its meetings on the 29th November and 15th December 2011 to review finalization of the year-end audit for 2010/11:

(i) The GAC has not observed any material disagreements between the City's officials and the AGSA, except for the following issues:

- Management information that was submitted to the Auditor General late in November 2011 but was not audited. Upon enquiry by the Group Audit Committee, the AGSA provided the reason that previously there had not been compliance with the MFMA :
  - the AGSA had not issued a separate audit opinion on the audit of the core administration 5 months after end of financial year (end November 2011);
  - but would continue the audit hereof along with the audit of the consolidated group annual financial statements in respect of which the deadline would have been the end December 2011.

- Error rate and quantification of the errors that resulted in the qualification, but which qualification was based on the total amount instead of the amount of the error
  - AGSA could not quantify the quantum of the error, nor could it audit the differences and therefore the exact impact of the error on the total amount could not be confirmed;
  - The actual amount of the misstatement could therefore not be independently confirmed, but the qualification has specified the variables that have had an influence

- Management submitted the information quantifying the errors and therefore that could have been used to effect adjustment after the end of November, at which date the AGSA was no longer able to verify this information.

Rates overbilling	R81 million
Joburg City Power under-billing by	R40 million
Joburg Water under-billing by	R14 million

- Regarding the information and supporting documentation for the audit of leave administration was submitted on the 28th November 2011, the GAC enquired what was therefore the AGSA's audit approach and procedures; and whether the audit concern was that of inadequate and ineffective internal control systems.
  - Management concern that although information was made available to the AGSA prior to end November 2011, the AGSA did not audit this information
  - AGSA reported that the methodology and process followed is consistent with prior year, for example, exceptions were issued to management and subsequently escalated to the management letter. As at date of GAC meeting, the AGSA reported that not all management information had been actually received.

GAC recommendations:

- The GAC acknowledged that the AGSA could not audit the estimated error as quantified by management, but recommended that the AGSA considers the re-wording of the qualification to more appropriately refer to the extent of the error instead of qualifying on the total revenue amount.
- The wording should ensure that the qualification should ensure that any person reading the AGSA audit report and who may not have full understanding of accounting and /or auditing standards should be able to understand that it is not the total revenue amounts that could not be audited.
- The leave management information was submitted but AGSA appears to have elected not to audit this information, then management and the AGSA should ensure that these differences be resolved appropriately in the current financial year 2011/12 so as to avoid recurrence of these findings.

(ii) There has been a measure of delays in the audit resulting from the audit of revenue for the current year for completeness, which necessitated the re-evaluation of prior year-end closing balances. However, the AGSA has commended the City on the substantial resolution of the queries raised in the prior year as a result of which there were no findings raised in the current year that are similar to prior year.

(iii) The GAC noted the high number of audit queries raised by the AGSA in the management letter, and the reasons or basis for a potential qualification. However, management and the AGSA made an undertaking to ensure the completion of the management letter within two days of the GAC meeting.

(iv) Final AGSA Management Report and the Audit Opinion of the City and its municipal entities

- The AGSA completed the audit of the final consolidated Annual Financial Statements of the City and its Municipal Entities, and issued its final management report and the audit opinion within the set deadlines.
- The City's municipal entities had 13 out 15 unqualified audit opinions for the financial year ending 30 June 2011. The Municipal Entities that had qualified audits opinions are Johannesburg Water and City Power.

(v) The AGSA how however expressed a qualified audit opinion on the Core Administration and the Consolidated Annual Financial Statements on the basis of:

- Property Rates Revenue,
- Service Charges Revenue,
- Consumer Debtors, and
- Leave Accrual

(vi) The Group Audit Committee accepts the final audit opinions, the final management reports and recommendations of the Auditor General.

(vii) The GAC would like to again express concerns around:

- The matters of emphasis included in the Auditor General's report, the attention that ought to be paid to audit findings and the quality of management comments and action plans.

4. POLICY IMPLICATIONS

Group Audit Committee Charter and Terms of Reference.

5. LEGAL AND CONSTITUTIONAL IMPLICATIONS

Municipal Finance Management Act.

6. FINANCIAL IMPLICATIONS

None.

7. COMMUNICATION IMPLICATIONS

Group Risk Management Committee, and Audit Committees of Municipal Entities.

8. CONSULTATION WITH OTHER STAKEHOLDERS

None.

IT IS RECOMMENDED:

1. That the Mayoral Committee

a) Notes the outcomes of the Auditor General external audit of the City and its municipal entities for the year-ended 30 June 2011.

b) Approves the audited Group Annual Financial Statements for the financial year 30 June 2011, the Auditor General SA (AGSA) Management Letter and

the Auditor General audit opinion as contained in the audit report.

2. **That it be noted that this report of the Group Audit Committee will also inform the annual statement of the Group Audit Committee that should be included in the integrated annual report of the City of Johannesburg for the financial year ending 30th June 2011.**

3. **That the Central Strategy Unit (CSU) ensures the inclusion in the integrated annual report of the City the governance reports by the Group Audit Committee and the Group Risk Management Committee, assisted by the Group Risk & Audit Services Department.**

4. **That the Management of the City designs and implements adequate systems of internal controls to address the reported internal control weaknesses, instances of non-compliance with applicable legislation, instances of irregular expenditure, as well as the City's IT governance and IT control environment; and a comprehensive action plan is put in place to address and monitor implementation hereof.**

5. **That the Group Risk and Internal Audit Services function of the City conducts the planned follow-up audits to assess the adequacy of the management action plans and the effective implementation of the systems and controls to mitigate the associated risks and therefore avoid recurrence of audit queries. The internal audit outcomes be reported to management, the Audit Committee(s), the Cluster Sub-Mayoral Committees, and the Mayoral Committee.**

(GROUP AUDIT COMMITTEE)
(J. Armstrong)