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Trans-Caledon Tunnel Authority (TCTA)

WSP4 (LHWP) ZAG000020009
WSP5 (LHWP) ZAG000020017

As established by Notice No 2631 in Government Gazette No 10545 of 12 December 1986 and revised by Notice No 277 in Government Gazette No 21017 of 24 March 2000 (the *Notice of Establishment*). A Schedule 2 Public Finance Management Act No. 1 of 1999 (PFMA) entity.

RELEASE OF ANNUAL FINANCIAL STATEMENTS AND QUALIFIED AUDIT OPINION

Investors are advised that TCTA's Annual Financial Statements for (AFS) the year ended 31 March 2019 have been released:

(a) The Annual Financial Statements are available for inspection at TCTA's registered office and are also available on TCTA's website (www.tcta.co.za) at http://www.tcta.co.za/annual-report

(b) On 20 December 2019, the Auditor-General of South Africa ("**AGSA**"), the Auditors of TCTA, issued a qualified audit opinion with respect to TCTA's AFS for the year ended 31 March 2019, to which this letter relates.

1. The AGSA provided the following reasons as a basis for the qualified audit opinion:

   1.1. That he was unable to obtain sufficient appropriate audit evidence regarding the Acid Mine Drainage ("**AMD**") receivables, because the financial models provided as audit evidence for the receivables, did not substantiate the amounts disclosed in the AFS. Consequently, he was unable to determine whether any adjustments were necessary to the AMD receivables as disclosed in note 14 to the AFS;

   1.2. That he was unable to obtain sufficient appropriate audit evidence to substantiate the provision for compensation to individuals affected by a loss of income as a result of re-appropriation of land in respect of the Lesotho Highlands Water Project ("**LHWP**"). As a consequence, he was unable to determine whether any adjustments were required to the amounts provided for compensation as disclosed in note 17 to the AFS; and

   1.3. That he was unable to obtain sufficient appropriate audit evidence for Capital commitments, as disclosed in note 22 to the AFS as the Capital commitments schedule provided as audit evidence, did not substantiate the amounts disclosed in the AFS. Consequently, he was unable to determine whether any adjustments were necessary to commitments as stated in the AFS.

2. TCTA's response/explanation on the reasons for the qualification is as follows:

   2.1. With respect to the AMD Receivables matter referred to in 1.1 above, TCTA submitted to the AGSA detailed workings and calculations of the receivables to support the amounts disclosed in the financials. The AGSA identified differences between the financials and the workings which resulted in the financials not balancing. The mistake was caused by an error in the preparation of the information which could not be corrected and resubmitted before the deadline for resubmission;

   2.2. With respect to the provision for compensation matter in 1.2 above, it occurred due to TCTA having reflected a transaction between a 3rd party, the Lesotho Highlands Development Authority (**LHDA**) and impacted persons in Lesotho, in its financial statements and thus being unable to produce sufficient and appropriate audit evidence as required in time. ; and

   2.3. Finally, with respect to the provision for Capital Commitments in 1.3 above, TCTA excluded provisions for the outer years (5 years and beyond) from the financials and this resulted in differences between the provisions disclosed in the financials and those reflected in the Capital Commitments schedule that was submitted as evidence of the workings.. This error was corrected and the numbers revised, however it was too late to resubmit the revised provision to the AGSA as the submission deadline had passed.

TCTA intends to engage with the AGSA ahead of the next audit to unpack the finding in 1.2 in order to avoid a repeat finding or any finding related to TCTA's role in LHWP. TCTA will also strengthen internal controls to avoid similar findings as in 1.1 and 1.3.

RESTATEMENT OF ANNUAL FINANCIAL STATEMENTS

In the current year, management amended the accounting policy relating to the measurement of tariff receivables. The tariff receivable is a financial asset that is measured at amortized cost. The old policy required management to calculate the effective interest rate which is a rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset. When calculating the effective interest rate, management estimated the expected cash flows by considering all the contractual terms of the financial instrument. When the expected cash flows were re-estimated, management recalculated the gross carrying amount of the financial asset and recognised a modification gain or loss in surplus or deficit previously referred to as imputed interest. Management has amended the accounting policy by opting to re-estimate the effective interest rate when the expected cash flows of the assets are re-estimated thus no modification gain/ loss will impact surplus or deficit. This has resulted in the restatement of the Tariff Receivable balance.

In addition, the provision for compensation has been revised to include an additional amount relating to compensation for host communities where households affected by the project have elected to be resettled. This amount is intended to fund infrastructure projects for the benefit of the host communities. The impact of this revision increases the provision for compensation and tariff receivable on the Statement of Financial Position.

Further, the LHDA makes payments to 3rd parties for the implementation of the community infrastructure development. These payments are disclosed as prepaid expenses until the 3rd party has delivered the infrastructure to the community. This has resulted in the restatement of the Provision for Compensation balance.

The findings referred to in 1.1 and 1.3 will result in a restatement in next year's financial statements. With regards to 1.2, TCTA will reflect on how it accounts for payments made to LHDA on behalf of the Republic of South Africa, so that it is properly accounted for in subsequent years. Addressing 1.2 will either result in a restatement if the figures were to change or a review of the accounting treatment of third-party expenditure will be performed. Ultimately it does not change TCTA's ability to perform the Government of South Africa's financial obligations to Lesotho in terms of the Treaty and/or the Phase II agreement.

In our considered view, the qualified audit opinion does not indicate a deterioration in TCTA's credit profile nor a reflection of TCTA's ability to perform its obligations under the Facility Agreement or any of its other financial obligations. As such TCTA is able to meet its loan obligations to the lenders and will continue to do so, with government support through explicit guarantees on LHWP and AMD, and government commitment to step-in and fulfil TCTA's obligations if it is unable to do so on other projects.

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3 March 2020