

**REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL  
LEGISLATURE AND THE COUNCIL ON THE BUFFALO CITY METROPOLITAN  
MUNICIPALITY**

**REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS**

**Introduction**

1. I have audited the consolidated and separate financial statements of the Buffalo City Metropolitan Municipality set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2013, the consolidated and separate statement of financial performance, statement of changes in net assets, cash flow statement, statement of comparison of budget and actual amounts for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

**Accounting officer's responsibility for the consolidated financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these consolidated and separate financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2012 (Act No. 5 of 2012) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of the consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor-General's responsibility**

3. My responsibility is to express an opinion on these consolidated and separate financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated and separate financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated and separate financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated and separate 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 consolidated and separate 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. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated and separate financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

## **Basis for qualified opinion**

### **Property, plant and equipment**

6. The municipality did not recognise and account for all items of property, plant and equipment in accordance with GRAP 17: *Property, plant and equipment*. Certain electrical infrastructure assets and properties belonging to the municipality were not included in the fixed asset register or in the consolidated and separate financial statements. Consequently, property, plant and equipment, as disclosed in note 15, and accumulated surpluses, as included on the statements of financial position and changes in net assets, are understated by R627,5 million (2012: R627,5 million).

### **Irregular expenditure**

7. The municipality did not have adequate systems in place to identify and disclose all irregular expenditure incurred during the year, as required by section 125(2)(d)(i) of the MFMA. The irregular expenditure disclosed in note 55 to the consolidated and separate financial statements is understated in respect of amounts totalling R65,5 million (2012: R161,8 million) incurred during the year that were identified during the audit process, while the opening balance for 2011-12 is also understated by R122,4 million in this regard. Due to the lack of adequate systems and non-availability of sufficient appropriate audit evidence for all awards, it was impracticable to determine the full extent of the understatement of irregular expenditure disclosed at R781,1 million (2012: R664,0 million). I was unable to confirm the disclosure by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the irregular expenditure disclosure note.

### **Qualified opinion**

8. In my opinion, except for the effects and possible effects of the matters described in the basis for qualified opinion paragraphs, the consolidated and separate financial statements present fairly, in all material respects, the financial position of the Buffalo City Metropolitan Municipality as at 30 June 2013 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

### **Emphasis of matters**

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

### **Significant uncertainties**

10. As disclosed in note 61 to the consolidated and separate financial statements, the municipality is a defendant in a number of lawsuits to the amount of R137,8 million (2012: R96,3 million). The outcome of these lawsuits cannot be determined at present as litigation is still in progress.

### **Restatement of corresponding figures**

11. As disclosed in note 49 to the consolidated and separate financial statements, the corresponding figures for 30 June 2012 have been restated as a result of errors only corrected during the year ended 30 June 2013 that existed in the consolidated and separate financial statements at, and for the year ended, 30 June 2012.

### **Material impairments/losses**

12. As disclosed in note 7 to the consolidated and separate financial statements, an amount of R375,9 million (2012: R343,9 million) in respect of receivables from exchange transactions has been impaired as a result of non-payment of consumer debtor accounts.

13. As disclosed in note 8 to the consolidated and separate financial statements, an amount of R189,2 million (2012: R185 million) in respect of receivables from non-exchange transactions has been impaired as a result of non-payment of consumer debtor accounts.
14. As disclosed in note 57 to the consolidated and separate financial statements, the municipality incurred material losses relating to water of R102,9 million (2012: R105,2 million) as a result of non-billed water or non-metered billable water and electricity of R85,3 million (2012: 97,5 million) as a result of technical and non-technical losses.

#### **Material underspending of the capital budget**

15. As disclosed in the statement of comparison of budget and actual amounts and note 4 to the consolidated and separate financial statements, the municipality has underspent its capital budget by R384,6 million in respect of internal and external funding. Of this amount, only R173,1 million relating to unspent conditional grant funding has been approved for roll-over by National Treasury.

#### **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

16. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

#### **Predetermined objectives**

17. I performed procedures to obtain evidence about the usefulness and reliability of the information in the performance report as set out on pages ... to ... of the annual report.
18. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned development priorities. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury *Framework for managing programme performance information (FMPPI)*.

The reliability of the information in respect of the selected development priorities is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

19. The material findings concerning the usefulness and reliability of the information are as follows.

#### **Usefulness of information**

##### **Presentation**

##### **Measures taken to improve performance not disclosed**

20. Section 46 of the Municipal Systems Act (MSA) requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved. Measures to improve performance for a total of 45% of the planned targets not achieved were not reflected in the annual performance report. This was due to the lack of inadequate internal policies and procedures for the processes pertaining to the reporting of performance information.

## **Measurability**

### **Performance targets not measurable and specific**

21. The National Treasury FMPPI requires that performance targets be measurable and specific in clearly identifying the nature and required level of performance. A total of 23% of the targets could not be measured and were not specific in clearly identifying the nature and the required level of performance. Management was aware of the requirements of the FMPPI but neglected to apply all these principles. This is due to inadequate quality control processes in place for setting specific and measurable targets.

### **Performance indicators not well defined and verifiable**

22. The National Treasury FMPPI requires that indicators should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. In addition, it must be possible to validate the processes and systems that produce the indicator. A total of 23% of the indicators were not well defined as clear, unambiguous data definitions were not available to allow for data to be collected consistently. Furthermore, the indicators were not verifiable as valid processes and systems that produce the information on actual performance did not exist. This was due to inadequate quality controls to ensure that the indicators were well defined and verifiable.

## **Reliability of information**

### **Development priority 2: Energy and electricity, and Development priority 4: Water and sanitation**

23. The National Treasury FMPPI requires that institutions should have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. Significantly important targets with respect to Development priority 2: Energy and electricity, and Development priority 4: Water and sanitation are not reliable when compared to the source information and evidence provided. This was due to management using the same source documentation to measure and report different indicators and targets.

### **Additional matters**

24. I draw attention to the matters below. These matters do not have an impact on the predetermined objectives audit findings reported above.

### **Achievement of planned targets**

25. Of the 134 targets planned for the year, 64 (48%) were not achieved during the year under review. This was a result of the municipality not considering the requirements of the National Treasury FMPPI during the annual strategic planning process and a lack of in-year monitoring of actual against planned targets.

### **Material adjustments to the performance report**

26. Material audit adjustments in the annual performance report were identified during the audit, some of which were corrected by management. Those that were not corrected have been reported above.

### **Compliance with laws and regulations**

27. I performed procedures to obtain evidence that the entity had complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations, as set out in the general notice issued in terms of the PAA, are as follows:

### **Strategic planning and performance management**

28. The municipality's performance management system was not in line with the priorities, objectives, indicators and targets contained in its integrated development plan (IDP) and did not provide for procedures by which the system is linked to the municipality's integrated development planning processes, as required by section 38(a) of the Municipal Systems Act (MSA) and Local Government: Municipal Planning and Performance Management Regulation 7(2)(e).
29. The municipality did not have and maintain effective, efficient and transparent systems of financial and risk management and internal controls, as required by section 62(1)(c)(i) of the MFMA relating to reporting on predetermined objectives.

### **Annual consolidated and separate financial statements and annual reports**

30. The consolidated and separate financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, current liabilities, current assets, revenue and disclosure items identified by the auditors in the consolidated and separate financial statements were subsequently corrected and the supporting records were provided, but the uncorrected material misstatements and supporting records that could not be provided resulted in the consolidated and separate financial statements receiving a qualified audit opinion.
31. The oversight report, containing comments on the annual report, was not adopted by council within two months from the date on which the 2011-12 annual report was tabled, as required by section 129(1) of the MFMA.

### **Procurement and contract management**

32. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, as required by Municipal Supply Chain Management (SCM) regulation 17(a) & (c)4.
33. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
34. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
35. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were only awarded to and accepted from bidders who submitted a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
36. Awards were made to providers whose directors or principal shareholders are in the service of other state institutions, in contravention of MFMA 112(j) and SCM regulation 44.
37. Measures to combat the abuse of the SCM system were not implemented as per the requirements of SCM regulation 38(1), as declarations of interest were not submitted to assess whether awards were not made to providers who:
  - during the last five years, had failed to perform satisfactorily on a previous contract with the municipality or municipal entity or other organ of state;
  - committed a corrupt or fraudulent act in competing for the contract;
  - abused the SCM system of the municipality;
  - had been convicted of fraud or corruption during the past five years.

### **Human resource management**

38. The municipality did not develop and adopt appropriate systems, policies and procedures to monitor, measure and evaluate performance of staff in contravention of the MSA, section 67(d).
39. The municipal manager and senior managers directly accountable to the municipal manager did not sign performance agreements within one month after the beginning of the financial year, as required by section 57(2)(a) MSA.

### **Expenditure management**

40. Money owing by the municipality was not always paid within 30 days or an agreed period, as required by section 65(2) (e) of the MFMA.
41. An effective system of expenditure control, including procedures for the withdrawal and payment of funds, was not in place, as required by section 65(2)(a) of the MFMA, as evidenced by inadequate controls around electronic funds transfer.
42. An adequate management, accounting and information system which accounted for creditors and payments made was not in place, as required by section 65(2)(b) of the MFMA.
43. Reasonable steps were not effectively taken to prevent irregular, fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

### **Revenue management**

44. An adequate management, accounting and information system which accounts for revenue, debtors and receipts of revenue was not in place as revenue was not consistently recognised when it is earned, as required by section 64(2)(e) of the MFMA.
45. An effective system of internal control for revenue was not in place as revenue was not consistently recognised when it is earned, as required by section 64(2)(f) of the MFMA.

### **Asset management**

46. An adequate management, accounting and information system which accounts for electrical assets and municipal properties was not in place, as required by section 63(2)(a) of the MFMA.
47. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA, as evidenced by the numerous findings on property, plant and equipment.

### **Consequences management**

48. The municipality did not comply with the requirements of section 32 of the MFMA regarding the following:
  - Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine whether any person was liable for the expenditure.
  - The municipality did not adequately follow-up on Council and Municipal Public Accounts Committee (MPAC) reports which determine whether any person is liable for fruitless and wasteful expenditure incurred, resulting in action not being taken to recover such funds.
  - Council reports in which an assessment is made regarding the recoverability of the irregular and fruitless and wasteful expenditure was not produced.

### **Internal control**

49. I considered internal control relevant to my audit of the consolidated and separate financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

### **Leadership**

50. Leadership did not consistently implement processes to verify the credibility of in-year reports, thus not setting the correct tone and enabling efficient and effective oversight during the year.
51. There was a lack of integration and alignment within the municipality, as the different directorates planned, worked and reported in isolation. This had a negative impact on the performance of the municipality and its ability to prepare financial statements and an annual performance report that are free of misstatements.
52. Leadership has not sufficiently addressed the challenges faced by the municipality's SCM. This is as a result of inadequate capacity within the unit, which is further aggravated by poor planning by the different directorates within the municipality. This was evidenced by the irregular expenditure incurred and the amount by which the budget was underspent.
53. Top and middle management positions are vacant for extended periods of time. The continued absence of permanent officials to lead and guide the municipality compromises the effectiveness of the control environment.

### **Financial and performance management**

54. The municipality did not consistently implement and monitor the required daily and monthly financial and performance disciplines to ensure that transactions were appropriately recorded and reported, as required by the financial and performance reporting frameworks. The lack of financial discipline and monitoring during the financial year resulted in key reconciliations and processing only being performed after the financial year-end. If not appropriately addressed by the municipality, this can impact the sustainability of the reported opinion.
55. There was a lack of processes in place to ensure compliance with laws and regulations. As a result, management did not effectively monitor and address areas of non-compliance.

### **Governance**

56. A risk assessment was conducted by the municipality, however risks identified within this assessment were not appropriately addressed with the required mitigating controls.
57. The recommendations of the audit committee and internal audit are not adequately implemented by management with the result that identified deficiencies are not addressed within the control environment.

## REPORTS

### Investigations

58. Three investigations are currently being conducted into allegations of fraud, favouritism, unfair practices and failure to comply with SCM requirements. These investigations were ongoing at the reporting date.

*Auditor - General*

East London

6 December 2013



AUDITOR - GENERAL  
SOUTH AFRICA

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