

# **Buffalo City Metropolitan Municipality (Cons.)**

## **Audit Report**

For the year ended 30 June 2018

# Report of the auditor-general to the Eastern Cape Provincial Legislature and the council on Buffalo City Metropolitan Municipality

## Report on the audit of the consolidated and separate financial statements

### Qualified opinion

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 2018, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the consolidated and separate financial statements, including a summary of significant accounting policies.
2. In my opinion, except for the effects of the matter described in the basis for qualified opinion section of my report, 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 2018, and its financial performance and cash flows for the year then ended in accordance with the 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 Division of Revenue Act of South Africa, 2017 (Act No.3 of 2017) (Dora).

### Basis for qualified opinion

#### Revenue from exchange transactions

3. The municipality did not recognise all items that met the definition of revenue from exchange transactions in accordance with SA Standard of GRAP 9, *Revenue from exchange transactions*. Revenue from service charges was not accounted for at the fair value of the consideration received or receivable, as required by this standard. Service charges, specifically arising from the sale of water was not measured reliably due to faulty water meters and inaccurate meter readings. In addition, I was unable to obtain sufficient appropriate evidence that all revenue from service charges had been recorded accurately, as the municipality did not have adequate systems, and I could not confirm this by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the service charge revenue from exchange transactions of R436,6 million and the related receivables from exchange transactions of R479,3 million, as disclosed in notes 27 and 15 to the consolidated and separate financial statements, respectively.

### Context for the opinion

4. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the consolidated and separate financial statements section of this auditor's report.



5. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* (IESBA code) and the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.
6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

### **Emphasis of matters**

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

### **Restatement of corresponding figures**

8. As disclosed in note 55 to the consolidated and separate financial statements, the corresponding figures for 30 June 2017 have been restated as a result of errors identified in the consolidated and separate financial statements of the municipality at, and for the year ended, 30 June 2018.

### **Irregular expenditure**

9. As disclosed in note 61 to the consolidated and separate financial statements, irregular expenditure of R213,3 million (2016-17: R287,3 million) was incurred due to supply chain management (SCM) transgressions that occurred in the current and prior financial years. The cumulative balance as at 30 June 2018 was R2,6 billion.

### **Material losses and impairments**

10. As disclosed in note 63 to the consolidated and separate financial statements, the municipality incurred material electricity and water losses as reflected below.
  - Electricity losses totalling R236,5 million (2016-17: R218,8 million), which represented 17,7% (2016-17: 16%) of total electricity purchased of which non-technical losses comprised R149,6 million (2016-17: R130,4 million) were incurred due to theft, faults and billing errors.
  - Water losses totalling R140,3 million (2016-17: R100,8 million), which represented 43,7% (2016-17: 34%) of total water purchased of which non-technical losses comprise R31,2 million (2016-17: R36,9 million) were incurred due to bulk water meters not being installed in all rural and semi-rural areas.
11. As disclosed in note 15 to the consolidated and separate financial statements, cumulative debt impairment provisions amounted to R1,1 billion (2016-17: R1,1 billion) due to the slow recovery of old consumer debts.

### **Other matter**

12. I draw attention to the matter below. My opinion is not modified in respect of this matter.

### **Unaudited disclosure note**

13. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit

of the consolidated and separate financial statements and, accordingly, I do not express an opinion thereon.

### **Responsibilities of accounting officer for the consolidated and separate financial statements**

14. The accounting officer is responsible for the preparation and fair presentation of the consolidated and separate financial statements in accordance with the SA Standards of GRAP and the requirements of the MFMA and Dora, and for such internal control as the accounting officer determines is necessary to enable the preparation of consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.
15. In preparing the consolidated and separate financial statements, the accounting officer is responsible for assessing the Buffalo City Metropolitan Municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the appropriate governance structure either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

### **Auditor-general's responsibilities for the audit of the consolidated and separate financial statements**

16. My objectives are to obtain reasonable assurance about whether the consolidated and separate financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated and separate financial statements.
17. A further description of my responsibilities for the audit of the consolidated and separate financial statements is included in the annexure to this auditor's report.

## **Report on the audit of the annual performance report**

### **Introduction and scope**

18. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance information against predetermined objectives for the selected development priority presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
19. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be



included as part of the reported performance information. Accordingly, my findings do not extend to these matters.

20. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected development priority presented in the annual performance report of the municipality for the year ended 30 June 2018:

Development priority	Pages in the annual performance report
KPA 2: basic service delivery and infrastructure development	x – x

21. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
22. The material findings in respect of the usefulness and reliability of the selected development priority are as follows:

### **KPA 2 – basic service delivery and infrastructure development**

#### **Number of waste cells constructed**

23. I was unable to obtain sufficient appropriate audit evidence to support the measures taken to improve performance against the target *Number of waste cells constructed* as reported in the annual performance report. This was due to limitations placed on the scope of my work. I was unable to confirm the reported measures taken by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported measures taken to improve performance.

#### **Comparison between performance of the year under review and previous year**

24. A comparison per indicator between the performance of the year under review and previous year was not included for any of the indicators in the annual performance report.

#### **Number of formal dwellings (RDP) provided with a basic service of electricity**

25. The achievement for the target *Number of formal dwellings (RDP) provided with a basic service of electricity* reported in the annual performance report was 1 330. However, the supporting evidence provided did not agree to the reported achievement and indicated an achievement of 340.

#### **Various indicators**

26. I was unable to obtain sufficient appropriate audit evidence for the reported achievements of the indicators listed below as reported achievements were not supported by sufficient appropriate audit evidence. This was due to limitations placed on the scope of my work. I was

unable to confirm the reported achievements by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievement of the following indicators:

- Percentage of households with access to basic solid waste removal services.
- Number of households earning less than R3200 per month with access to free basic services.
- Percentage of households with access to basic level of sanitation.
- Percentage of households with access to basic level of water supply.
- Kilometres of roads surfaced.

### **Other matters**

27. I draw attention to the matters below.

#### **Achievement of planned targets**

28. Refer to the annual performance report on pages x to x for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs 23 - 26 of this report.

#### **Adjustment of material misstatements**

29. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of the development priority, basic service delivery and infrastructure development. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are reported above.

## **Report on the audit of compliance with legislation**

### **Introduction and scope**

30. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.

31. The material findings on compliance with specific matters in key legislations are as follows:

#### **Consolidated and separate financial statements**

32. The consolidated and separate financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of non-current assets, current assets, current liabilities and expenditure



identified in the submitted consolidated and separate financial statements were subsequently corrected, but the uncorrected material misstatement resulted in the consolidated and separate financial statements receiving a qualified audit opinion.

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

33. The performance management system and related controls were inadequate as the described processes of planning, measurement and reporting were not conducted and managed as intended, as required by municipal planning and performance management regulation 7(1).

### **Revenue management**

34. An effective system of internal control for receivables and revenue was not in place, as required by section 64(2)(f) of the MFMA.

### **Procurement and contract management**

35. Some of the contracts were awarded to bidders based on preference points that were not allocated and calculated correctly in accordance with the requirements of the Preferential Procurement Policy Framework Act, 2000 (Act No.5 of 2000) and its regulations. The eventual winning bidder was not affected as a result of the incorrect calculation of preference points.
36. Sufficient appropriate audit evidence could not be obtained that persons in the service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality disclosed such interest, as required by supply chain management regulation (SCMR) 46(2)(e).
37. Awards were made to providers who were in the service of other state institutions or whose directors / principal shareholders were in the service of other state institutions, in contravention of section 112(j) of the MFMA and SCMR 44.

### **Expenditure management**

38. Reasonable steps were not taken to prevent unauthorised expenditure of R160,4 million, as disclosed in note 59 to the annual consolidated and separate financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by non-cash items such as depreciation and impairment of assets.
39. Reasonable steps were not taken to prevent irregular expenditure of R213,3 million as disclosed in note 61 to the annual consolidated and separate financial statements, as required by section 62(1)(d) of the MFMA. The majority of the irregular expenditure was caused by contravention of supply chain management regulations.
40. Monies owed by the municipality were not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

### **Asset management**

41. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

## Consequence management

42. Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA and section 75(1) of the municipal budget and reporting regulations.

### Other information

43. The Buffalo City Metropolitan Municipality's accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the consolidated and separate financial statements, the auditor's report and the development priority presented in the annual performance report that has been specifically reported in the auditor's report.
44. My opinion on the consolidated and separate financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
45. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated and separate financial statements and the selected development priority presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
46. I did not receive the other information prior to the date of this report. When I do receive and read this information, if I conclude that there is a material misstatement therein, I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to retract this auditor's report and re-issue an amended report as appropriate. However, if it is corrected this will not be necessary.

### Internal control deficiencies

47. I considered internal control relevant to my audit of the consolidated and separate financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance on it. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.
- Leadership did not adequately respond to prior year findings relating to the annual consolidated and separate financial statements and annual performance report. Furthermore, repeat and additional material compliance findings were identified. The implementation of the audit intervention plan to address internal and external audit findings was not adequately monitored.
  - Leadership did not ensure that instances of fruitless and wasteful expenditure were investigated to determine if any officials are liable for such expenditure.



- Management did not ensure that monthly exception reports and reconciliations for service charges were properly reviewed and as a result abnormal billing of customers was not detected and corrected timeously. This contributed to the material misstatement identified in sale of water revenue.

## Other reports

48. I draw attention to the following engagements conducted by various parties that had, or could have, an impact on the matters reported in the municipality's consolidated and separate financial statements, reported performance information, compliance with applicable legislation and other related matters. These reports did not form part of my opinion on the consolidated and separate financial statements or my findings on the reported performance information or compliance with legislation.

## Investigations

49. The report of the public protector into allegations of financial misconduct relating to the Nelson Mandela funeral was finalised on 4 December 2017. The municipality was in the process of addressing the recommendations from the investigation.
50. The municipality appointed an external service provider to investigate all instances of irregular expenditure incurred from the 2012-13 to 2016-17 financial years. The draft report on the investigation was issued in July 2018 and submitted to the municipal public accounts committee for consideration.

*Auditor - General*

East London

10 December 2018



AUDITOR - GENERAL  
SOUTH AFRICA

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## **Annexure – Auditor-general’s responsibility for the audit**

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the consolidated and separate financial statements, and the procedures performed on reported performance information for the selected development priority and on the municipality’s compliance with respect to the selected subject matters.

### **Consolidated and separate financial statements**

2. In addition to my responsibility for the audit of the consolidated and separate financial statements as described in this auditor’s report, I also:
  - identify and assess the risks of material misstatement of the consolidated and separate financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control
  - obtain an understanding of internal control relevant to the audit 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 municipality’s internal control
  - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer.
  - conclude on the appropriateness of the accounting officer’s use of the going concern basis of accounting in the preparation of the consolidated and separate financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Buffalo City Metropolitan Municipality’s ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor’s report to the related disclosures in the consolidated and separate financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the consolidated and separate financial statements. My conclusions are based on the information available to me at the date of this auditor’s report. However, future events or conditions may cause a municipality to cease continuing as a going concern
  - evaluate the overall presentation, structure and content of the consolidated and separate financial statements, including the disclosures, and whether the consolidated and separate financial statements represent the underlying transactions and events in a manner that achieves fair presentation

### **Communication with those charged with governance**

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and, where applicable, related safeguards.



