

Auditor-General of South Africa

**Buffalo City Metropolitan  
Municipality and its municipal  
entity**

**Audit report for the year ending  
30 June 2020**

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

## 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 and its municipal entity (the group) set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2020, consolidated and separate statement of financial performance, statement of changes in net assets, cash flow statement and 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 matters 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 group as at 30 June 2020, 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 56 of 2003 (MFMA) and the Division of Revenue Act 16 of 2019 (Dora).

### Basis for qualified opinion

#### Revenue – service charges and receivables from exchange transactions

3. Included under revenue – service charges is revenue from the sale of water. The municipality did not recognise service charges on the sale of water as required by GRAP 9, *Revenue from exchange transactions*. Properties were identified for which service charges were not billed and recorded in the current and prior year. I was unable to determine the full extent of the understatement of service charges on the sale of water stated at R728,6 million in note 25 to the consolidated and separate financial statements and the related receivables from exchange transactions stated at R540,9 million in note 14 to the consolidated and separate financial statements, as it was impracticable to do so. It was also impracticable to determine the understatement of the corresponding amounts of this class of transaction and account balance. Additionally, there was an impact on the surplus for the period and on the accumulated surplus.

### Irregular expenditure

4. The municipality did not fully record irregular expenditure in the notes to the consolidated and separate financial statements, as required by section 125(2)(d) of the MFMA. This was due to the expenditure incurred in contravention of supply chain management (SCM) requirements not being detected and appropriately disclosed in the consolidated and separate financial statements. Consequently, I was unable to determine the full extent of the understatement of irregular expenditure stated at R2,4 billion (2018-19: R2,9 billion) in note 60 to the consolidated and separate financial statements, as it was impracticable to do so.

### Context for the opinion

5. 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.
6. I am independent of the group in accordance with the International Ethics Standards Board for Accountants' *International code of ethics for professional accountants (including International Independence Standards)* (IESBA code) as well as other 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.
7. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

### Emphasis of matters

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

### Restatement of corresponding figures

9. As disclosed in note 53 to the consolidated and separate financial statements, the corresponding figures for 30 June 2019 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 2020.

### Material losses and impairments

10. As disclosed in notes 12 and 14 to the consolidated and separate financial statements, material impairment allowances of R788,4 million (2018-19: R608,5 million) and R1,4 billion (2018-19: R934,4 million) were made against receivables from non-exchange and exchange transactions, respectively.



11. As disclosed in note 64.1 to the consolidated and separate financial statements, material electricity losses of R295,1 million (2018-19: R302,1 million) were incurred, which represented 19,4% (2018-19: 21,7%) of the total electricity purchased. Technical losses amounted to R88,5 million (2018-19: R80,9 million) and were due to losses within the network that are inherent in the supply of electricity. Non-technical losses amounted to R206,6 million (2018-19: R221,2 million) and were mainly due to illegal connections in informal areas. The remaining losses were due to theft, faults and billing errors.
12. As disclosed in note 64.2 to the consolidated and separate financial statements, material water losses of R126,1 million (2018-19: R158,2 million) were incurred, which represented 36,3% (2018-19: 46,1%) of the total water purchased. Technical losses amounted to R69,3 million (2018-19: R91,3 million) and were due to leakages on transmission and distribution mains, overflows at storage reservoirs, and ageing infrastructure. Non-technical losses amounted to R56,9 million (2018-19: R66,9 million) and were mainly due to authorised unbilled water consumption. The remaining non-technical losses were due to theft or illegal use and inaccurate customer metering and billing.

#### **Material underspending**

13. As disclosed in note 17 to the consolidated and separate financial statements, the municipality materially underspent its allocated conditional grants, namely the urban settlement development grant and the public transport network grant by R223,1 million and R78,4 million, respectively.

#### **Other matter**

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

#### **Unaudited disclosure note**

15. In terms of section 125(2)(e) of the MFMA, the municipality and its municipal entity are 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 the accounting officer for the consolidated and separate financial statements**

16. 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.

17. In preparing the consolidated and separate financial statements, the accounting officer is responsible for assessing the group'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 group 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**

18. 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.
19. 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**

20. In accordance with the Public Audit Act 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 selected strategic objectives presented in the annual performance report. I was engaged to perform procedures to identify findings but not to gather evidence to express assurance.
21. I was engaged to evaluate 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 strategic objective presented in the annual performance report of the municipality for the year ended 30 June 2020:

<b>Strategic objectives</b>	<b>Pages in the annual performance report</b>
A spatially transformed city	x – x

22. 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.



23. The material findings in respect of the usefulness and reliability of the selected strategic objective are as follows:

### A spatially transformed city

#### Various indicators

24. I was unable to obtain sufficient appropriate audit evidence for the reported achievements in the annual performance report as well as the reasons for variances between the planned targets and reported achievements. This was due to a lack of proper performance management systems and processes and formal standard operating procedures that predetermined how the achievement would be measured, monitored and reported. I was unable to confirm the reported achievements and the reasons for variances by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievements and the reasons for variances for the indicators listed below.

Indicator description	Reported achievement
Percentage of wastewater safely treated	77%
Percentage compliance of water treatment works with SANS 241 requirements	98%

25. I was unable to obtain sufficient appropriate audit evidence for the reported achievements and the reasons for variances in the annual performance report. This was due to limitations placed on the scope of my work. I was unable to confirm the reported achievements and the reasons for variances by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievements and the reasons for variances for the indicators listed below.

Indicator description	Reported achievement
Number of new sewer connections meeting minimum standards	822
Number of new water connections meeting minimum standards	308
Number of formal sites serviced	671
Number of ablution facilities constructed (seats)	200
Percentage of households with access to basic level of sanitation	94%
Percentage of water connections metered	97%

#### Other matter

26. I draw attention to the matter below.

## Achievement of planned targets

27. Refer to the annual performance report on pages ... to ... 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 24 and 25 of this report.

## Report on the audit of compliance with legislation

### Introduction and scope

28. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the municipality's compliance with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.
29. The material findings on compliance with specific matters in key legislation are as follows:

### Annual financial statements

30. The 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 current and non-current liabilities, current assets and expenditure identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records provided, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

### Strategic planning and performance management

31. The performance management system and related controls were inadequate as they did not describe how the performance measurement, review, reporting and improvement processes should be conducted, organised and managed, as required by municipal planning and performance management regulation 7(1).

### Revenue management

32. Revenue due to the municipality was not calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.
33. Accounts for municipal service charges were not prepared on a monthly basis, as required by section 64(2)(c) of the MFMA.
34. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.



## Procurement and contract management

35. Some goods and services with a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Similar non-compliance was also reported in the prior year.
36. Some bid documentation for the procurement of commodities designated for local content and production did not stipulate the minimum threshold for local production and content, as required by the 2017 preferential procurement regulation 8(2). Similar non-compliance was also reported in the prior year.

## Expenditure management

37. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The full extent of the irregular expenditure could not be quantified, as indicated in the basis for qualification paragraph. The majority of the irregular expenditure was as a result of non-compliance arising from transgressions of the SCM Regulations.
38. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R17,6 million, as disclosed in note 58 to the financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was as a result of the incorrect budgeting of debt impairment.

## Consequence management

39. Some of the irregular 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.
40. 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.

<h2>Other information</h2>
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41. The 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 those selected strategic objectives presented in the annual performance report that have been specifically reported in this auditor's report.
42. 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 on it.
43. 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 strategic objectives presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.



44. I did not receive the other information prior to the date of this report. When I do receive and read this information, and 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

45. 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.
46. Leadership's oversight responsibility to ensure credible and reliable financial and performance reporting as well as compliance with legislation was limited due to inadequate coordination and monitoring between the municipality's directorates.
47. The daily and monthly disciplines required by management were inadequate to account for all the financial and performance processes of the municipality. Furthermore, management did not prepare regular, accurate and complete financial and performance reports supported and evidenced by reliable information.
48. Management's review and monitoring processes over compliance were not effective to ensure compliance with legislative requirements.

### Material irregularities

49. In accordance with the PAA and the Material Irregularity Regulations, I have a responsibility to report on material irregularities identified during the audit.

### Material irregularity in progress

50. I identified a material irregularity during the audit and notified the accounting officer thereof, as required by material irregularity regulation 3(2). By the date of this auditor's report, the response of the accounting officer was not yet due. This material irregularity will be included in next year's auditor's report.

## Other reports

51. In addition to the investigations relating to material irregularities, I draw attention to the following engagements conducted by various parties which 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

52. Nine investigations were conducted by various parties during the year under review relating to SCM irregularities and financial misconduct cases, covering the periods 2013-14 to 2018-19. These investigations were ongoing at year-end and therefore no recommendations have yet been communicated to management.

Auditor - General

East London

15 April 2021



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 selected strategic objectives 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 group'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 relating to events or conditions that may cast significant doubt on the ability of the group 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 my 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 group to cease operating as a going concern
  - evaluate the overall presentation, structure and content of the consolidated and separate financial statements, including the disclosures, and determine whether the consolidated and separate financial statements represent the underlying transactions and events in a manner that achieves fair presentation
  - obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group to express an opinion on the consolidated and separate financial statements. I am responsible for the direction,

supervision and performance of the group audit. I remain solely responsible for my audit opinion.

### **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, the actions taken to eliminate threats or the safeguards applied.