

#### 4.5 Meeting of Donors' requirements in respect of conditional grants

All the conditions of the grants have been met. The under expenditure on grants have been caused by the delays in implementing the projects due to supply chain management challenges that were experienced during the year.

#### 4.6 Long term contracts entered into by the municipality

The municipality does not have any long term contracts

#### 4.7 Annual performance as per key performance indicators in financial viability

	Indicator name	Target set for the year R(000)	Achievement level during the year R(000)	Achievement percentage during the year
1	Percentage expenditure of capital budget	736,422,501	429,878,630	58%
		Target set for the year (35%) R(000)	Achievement level during the year R(000)	Achievement percentage during the year vs. the operational budget
2	Salary budget as a percentage of the total operational budget	30%	28%	96%
		Target set for the year (20% or less) R(000)	Achievement level during the year R(000)	Achievement percentage during the year vs the actual revenue
3	Total actual trade creditors as a percentage of total actual revenue	R512,381,708 or less	R344,417,869	13,4%
		Target set for the year (80%)	Achievement level during	Achievement percentage



	Indicator name	Target set for the year R(000)	Achievement level during the year R(000)	Achievement percentage during the year
		and more) R(000)	the year R(000)	during the year
4	Total municipal own revenue as a percentage of the total actual budget	2,039,261,134	2,013,053,476	99%
		Target set for the year R(000)	Achievement level during the year R(000)	Achievement percentage during the year
5	Rate of municipal consumer debt reduction	Due to economic recession and other factors the consumer debt increased by R60,184,977 in 2008/2009 financial year		
6	Percentage of MIG budget appropriately spent	165,117,500	124,502,307	75%
7	Percentage of MSIG budget appropriately spent	500,000	280,406	56%

#### 4.8 Arrears in property rates and service charges

As at 30 June 2010 the arrears per service category in respect of rates and service charges is as follows:

SERVICE	TOTAL
Rates	78,658,773
Refuse	57,060,463
Electricity	63,308,269
Water	95,724,257
Sewerage	47,560,518



Housing	869,390
Sundries	40,978,911
Grand total	388,160,580

#### 4.9 Auditor General's Report on the Financial Statements



## AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON BUFFALO CITY MUNICIPALITY

### REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

#### Introduction

1. I was engaged to audit the accompanying consolidated financial statements of the Buffalo City Municipality, which comprise the consolidated and separate statement of financial position as at 30 June 2010, the consolidated and separate statement of financial performance, the consolidated and separate statement of changes in net assets and the consolidated and separate cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory information and the accounting officer's report, as set out on pages ... to ....

#### Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the Statements of Generally Recognised Accounting Practice (GRAP) and in the manner required by the Municipal Finance Management Act of South Africa (Act No. 56 of 2003) (MFMA). This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

#### Auditor-General's responsibility

3. As required by section 188 of the Constitution of South Africa and section 4 of the Public Audit Act of South Africa and section 126(3)(d) of the MFMA my responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with the International Standards on Auditing and General Notice 1570 of 2009 issued in Government Gazette 32758 of 27 November 2009. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

#### Basis for disclaimer of opinion

##### Property, plant and equipment

4. Property, plant and equipment of R12.6 billion (2009: R12.5 billion) is disclosed in the statement of financial position.
5. Documentation to support the disclosure of property plant and equipment of R920.5 million could not be provided. In the previous financial year, a difference of R1.2 billion was identified between the value of electrical infrastructure and the amount disclosed in the financial statements. No reconciliation of this difference or other sufficient appropriate audit evidence for this amount or the corresponding amount of the previous financial year could again be provided. As a consequence it was not possible to obtain satisfaction as to the completeness, valuation and existence of property plant and equipment.

6. Errors in computation resulted in land of R2.2 billion not being recorded under property, plant and equipment in the statement of financial position. Furthermore depreciated replacement costs of various assets that are reflected under property, plant and equipment were recorded at R938.9 million more than the reasonable replacement costs. Land to the value of R192 million that was reflected on the valuation roll as being that of the municipality, had also not been included in the amount disclosed under property, plant and equipment. Consequently, property, plant and equipment and accumulated surplus disclosed in the statement of financial position is overstated by R1.4 billion.

### **Expenditure**

7. Included in note 33 to the financial statements is expenditure of R2.7 billion. The municipality did not provide payment vouchers and source documentation for purchases to the value of R 327.5 million. It was thus not possible to, even through alternative procedures, confirm that these expenditure transactions took place or that all expenditure transactions were recorded in the statement of financial performance. It was also not possible to satisfy ourselves that goods and services totalling R333.5 million were received in the correct quantities and at the correct quality, at the correct location and accepted by the correct officials. As a result sufficient appropriate audit evidence relating to the occurrence, accuracy, completeness of expenditure to the value of R661 million could not be obtained.

### **Irregular Expenditure**

8. No irregular expenditure was disclosed in note 54 (2009: R23.3 million) to the financial statements.
9. Supporting documentation for expenditure of R177.3 million was not submitted. Furthermore contracts, tender deviations, tender files and other supply chain management documentation was found to be either deficient or incomplete and did not support the procurement process followed by the municipality. The tender register was also incomplete. Even through the performance of alternative procedures it was not possible to obtain sufficient appropriate audit evidence to obtain satisfaction as to the completeness and accuracy of irregular expenditure that should have been disclosed in note 54 to the financial statements.
10. Goods and services of R441 million were not procured in the manner that is required by the municipality's supply chain management policy. Annual contracts of R166 million were also renewed with previous suppliers rather than through the procurement processes that are required by the supply chain management policy of the municipality. Furthermore, evidence could not be provided to confirm that a competitive bidding process was followed in respect of Soccer World Cup related expenditure of R21 million that was procured by another organ of state. Section 44 of the Municipal Supply Chain Management Regulations was also contravened as R1.9 million was paid to members of closed corporation and directors of private companies who are also employed by the state. This resulted in irregular expenditure in note 54 to the financial statements being understated by R441 million.

### **Commitments**

11. Sufficient appropriate evidence could not be obtained in respect of commitments totalling R229.2 million that is disclosed in note 47 to the financial statements. In the absence of this

evidence it was not possible to, even through alternative procedures, confirm the completeness and accuracy of the disclosure of commitments in note 47 to the financial statements.

### **Contingent liabilities**

12. Disclosed in note 26 to the financial statements are contingent liabilities of R34.1 million. Contingent liabilities of R 31.2 million, which were identified through confirmations from the legal advisors of the municipality and the municipality's legal section, have been omitted from this disclosure. As a result contingent liabilities in note 26 to the financial statements are understated by R33.4 million.

### **Investment property**

13. Investment property of R 201.1 million (2009: R201.1 million) is disclosed in the statement of financial position.
14. Property of R46.2 million that was reflected in the municipality's records was sold and transferred to new owners. Errors in computation resulted in land of R107.4 million not being recorded under investment property. Consequently, investment property and accumulated surplus disclosed in the statement of financial position is understated by R61.2 million.

### **Inventory**

15. Disclosed as part of inventory in note 5 to the financial statements is housing stock (RDP houses) of R22.3 million.
16. Sufficient appropriate audit evidence to confirm the unit value applied, rights and ownership could not be provided and as a result it was not possible, even through alternative procedures to the confirm the completeness, rights and valuation of housing stock disclosed.
17. In addition to the above GRAP 11 – Construction contracts was not applied by the municipality and as a result inventory is overstated by R22.33 million and expenditure is understated by R22.3 million.

### **Employee cost**

18. Overtime of R50.8 million is disclosed in note 35 to the financial statements. Although according to the Payday System this expenditure is R50.8 million, a comparison of manual records such clock cards, attendance registers, etcetera revealed that the overtime payments amounted to R31 million. Overtime as disclosed in note 35 to the financial statements is thus overstated by R 19.8 million and accounts receivable understated by this amount.

### **Disclaimer of opinion**

Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a

basis for an audit opinion. Accordingly, I do not express an opinion on these consolidated financial statements.

#### **Emphasis of matters**

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

#### **Restatement of corresponding figures**

20. Disclosed in note 49 to the financial statements are misstatements of R4.9 billion in the corresponding figures which were identified during the audit of the financial statements of the current year. These misstatements relate mainly to transactions erroneously processed as a result of the incorrect interpretation of GRAP.

#### **Material losses (through criminal conduct) / impairments**

21. Disclosed in note 9 to the financial statements are impairments of R347.2 million that were recognised in respect of consumer debtors.

22. Disclosed in note 56 to the financial statements are fuel losses of R 6.4 million incurred as a result of the municipality's failure to perform regular reconciliations.

23. Disclosed in note 56 to the financial statements are water and electricity distribution losses of R 71.6 million which have not been recovered from consumer debtors.

#### **Additional matters**

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

#### **Unaudited supplementary schedules**

25. The supplementary information set out on pages ... to .... does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

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

26. As required by the PAA and in terms of *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*, I include below my findings on the report on predetermined objectives, compliance with the following key laws and regulations, and financial management (internal control).

#### **Predetermined objectives**

27. Material findings on the report of predetermined objectives, as set out on pages ... to ..., are reported below:

## **Non-compliance with regulatory and reporting requirements**

### **Lack of adoption or implementation of a performance management system**

28. The municipality did not implement a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players, as required in terms of sections 36, 38 and 41(2) of the MSA, and regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

### **Usefulness of reported performance information**

The following criteria were used to assess the usefulness of the planned and reported performance:

- **Consistency:** Has the municipality reported on its performance with regard to its objectives, indicators and targets in its approved integrated development plan, i.e. are the objectives, indicators and targets consistent between planning and reporting documents?
- **Relevance:** Is there a clear and logical link between the objectives, outcomes, outputs, indicators and performance targets?
- **Measurability:** Are objectives made measurable by means of indicators and targets? Are indicators well defined and verifiable, and are targets specific, measurable, and time bound?

The following audit findings relate to the above criteria:

- Two performance indicators set by the municipality did not include any general key performance indicators applicable to the municipality, as prescribed in terms of section 43(1) of the MSA.
- Forty- four planned and reported targets were not time-bound.

### **Reliability of reported performance information**

The following criteria were used to assess the usefulness of the planned and reported performance:

- **Validity:** Has the actual reported performance occurred and does it pertain to the entity i.e. can the reported performance information be traced back to the source data or documentation?
- **Accuracy:** Amounts, numbers and other data relating to reported actual performance has been recorded and reported appropriately.
- **Completeness:** All actual results and events that should have been recorded have been included in the reported performance information.

The following audit finding relates to the above criteria:



### **Incomplete reporting on all predetermined objectives, indicators and targets**

The actual achievements with regard to seventeen planned indicators and targets specified in the integrated development plan for the year under review were not reported in the annual performance report submitted for audit purposes:

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

#### **Municipal Finance Management Act, 2003 (Act No. 56 of 2003)(MFMA)**

#### **The accounting officer did not adhere to his statutory responsibilities**

29. Contrary to the requirements of section 79 of the MFMA the accounting officer has not developed an appropriate system of delegations.
30. The municipality's systems of risk assessment were inadequate and did therefore not satisfy the requirements of section 62(1)(c)(i) of the MFMA
31. Contrary to sections 62(1)(c) and 74(1) of the MFMA a material amount of supporting documentation could not be provided to support operating expenditure and compliance with the Supply Chain Management Regulations.
32. Contrary to the provisions of sections 62(1)(d) and 111 of the MFMA the accounting officer did not implement the municipality's supply chain management policy and also did not implement a system to prevent, detect and correct and disclose the incurrence of irregular and fruitless and wasteful expenditure.
33. The financial statements submitted for audit did not comply with section 122(1) of the MFMA. Material misstatements were identified during the audit. Certain of these were corrected by management and those that were not are included in the basis for disclaimer of opinion paragraphs.

#### **The audit committee was not properly established**

34. Contrary to the requirements of Section 166(4) the audit committee only consisted of two rather than three members with effect from January 2010.

#### **The Internal Audit Unit was not properly established or not functioning properly**

35. Contrary to the requirements of section 165(2) the internal audit unit did not advise the accounting officer on accounting practices and procedures.

#### **Expenditure was not paid within the parameters set by applicable legislation**

36. Contrary to the provisions of section 65(2)(e) of the MFMA expenditure to the value of R 45.2 million was not paid within the required 30 days from the receipt of an invoice.

**Supply Chain Management legislative requirements were not implemented or not adhered to**

37. Section 62 (f) of the MFMA prescribes that a municipality has and implements a supply chain management policy. Although the municipality has an approved supply chain management policy, it has not been properly implemented. Evidence of this is the material finding on irregular expenditure that is reported in paragraphs 8 to 10 above.

**Municipal Systems Act, 2000 (Act No. 32 of 2000)(MSA)**

38. Contrary to the requirements of section 21A of the MSA the 2008/09 annual report has not been distributed for community comment and the final report has not been finalised.

**INTERNAL CONTROL**

I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the MFMA, but not for the purpose of expressing an opinion on the effectiveness of internal control.

39. The matters reported below are limited to the significant deficiencies regarding the basis for disclaimer of opinion paragraph, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

- **Leadership**

The critical positions of municipal manager and chief financial officer remained vacant for the second consecutive financial year. Further instability resulted from the suspension of a number of directors during the year under review and only two of the director positions were filled at year-end. In addition two acting municipal managers were seconded from outside to the municipality during the financial year and these individuals left the entity in controversy. The unfilled and acting positions has destabilised the entity at strategic and operational levels and has had an adverse impact on service delivery in general.

The municipality's organisational structure has not addressed areas of responsibility and established lines of reporting in order to support effective internal control over financial reporting. This is evident in the silo approach between the directorates in respect of their responsibilities and the failure in contributing towards the completeness of the information presented in the financial statements and the notes and disclosures thereto, as evidenced by the audit opinion and the number of material corrections to the financial statements.

In addition, council's effectiveness has been compromised by political infighting within the ruling alliance. This contributed towards an unstable and unhealthy general control environment and was a prime driver of the some of the reportable matters. Leadership at all levels did not sufficiently promote public accountability, confidence and sound governance.

Management have not always acted decisively in addressing audit findings in the previous financial year, resulting in matters not being sufficiently addressed to avoid similar findings being reported again.

The risks relating to predetermined objectives were not adequately identified and addressed by satisfactory action plans. This resulted in material findings being included in this audit report. Inadequate structuring of performance reporting processes, an inability to support actual achievements with reliable and relevant documentation and inadequate monitoring and review also contributed to these findings.

The general disregard of the municipality's supply chain management policy by some officials is an area of grave concern and is a matter that has been carried forward and highlighted in previous audit reports. There was reluctance by management to report on the incurrence of irregular expenditure and this trend continued in 2009-10. The impact of the municipality's inability to deal with this matter has resulted in irregular expenditure of R 441 million.

Management also failed to deal with security management, service level agreements and change controls from an information technology perspective.

- **Financial and performance management**

The position of chief financial officer has long been vacant. The chief financial officer that was acting at the beginning of the financial year was replaced during the financial year. This impacted on the strategic financial management direction and control and has affected most of municipalities accounting cycles. Material misstatements across all cycles and components bear testimony of a lack of review of transactions at all managerial levels within the organisation. The overriding root cause of this is that officials are not in all respects fulfilling their assigned duties and functions. Management also does not have sufficient detection systems in place to alert them to these misstatements. Management use audit findings to correct the control environment instead of monitoring the environment themselves and instituting corrective action based on these reviews. Accounting discipline is not enforced in the form of regular and reviewed monthly reconciliations and reporting. The continuation of a reactive instead of proactive approach towards financial management issues does not serve the municipality. Inadequacies in this regard also contributed to the large amount of irregular expenditure that was not detected by management but rather through the audit process.

The financial statements and supporting processes were not subjected to adequate reviewing by leadership of the municipality. This resulted in R 229.4 million in corrections that had to be made to the financial statements at the end of the audit.

The municipality also does not manage user's access to Venus and Payday financial systems which could lead to the municipality not being able to prevent or detect unauthorised and fraudulent financial transactions from being performed.

- **Governance**

The audit committee continues to play a limited role in governance matters at the municipality, mainly due to the inadequate responses of management to matters that are reported in internal audit reports and the often poor responses that are provided by management at audit committee meetings. The audit committee issue their reports directly to the mayor, but no direct contribution is made by informing council or the oversight committee of its concerns in terms of its legislated mandate.

Although the oversight committee met eight times during the financial year the impact of its activities could not be observed in terms of the reported findings for the 2009-10 financial year.

A number of officials were suspended during the financial year. These suspensions have not always been dealt with in effective way.

A formal information technology risk and control framework does not exist and the municipality has not implemented its IT strategic plan.

## OTHER REPORTS

- **Investigations**

A forensic investigation is in progress relating to supply chain management approvals granted by the former acting municipal manager. The investigation has been outsourced to a service provider and at the date of this report it was still in progress.

*Auditor-General*

East London

30 November 2010



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SOUTH AFRICA

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