

# REPORT OF THE AUDITOR-GENERAL TO THE KWAZULU-NATAL PROVINCIAL LEGISLATURE AND COUNCIL ON NEWCASTLE MUNICIPALITY

## REPORT ON THE FINANCIAL STATEMENTS

### Introduction

1. I have audited the financial statements of the Newcastle Municipality set out on pages ... to ..., which comprise, the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets and the cash flow statement and the statement of comparison of budget information with actual information 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 financial statements

2. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2013 (Act No. 2 of 2013) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of 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 the 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 financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the municipality's preparation and fair presentation of the 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 municipality'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 financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

## **Basis for qualified opinion**

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

6. I was unable to obtain sufficient appropriate audit evidence for infrastructure assets and work in progress due to inadequate underlying records to support these amounts. I could not confirm these amounts by alternative means. Consequently, I was unable to determine whether any adjustment relating to infrastructure assets and work in progress stated at R1 488,35 million and R597,91 million respectively, included in note 4 in the financial statements was necessary.

### **Leave provision**

7. The municipality did not have adequate systems in place to maintain records of leave transactions taken during the year, as a result, I could not confirm the leave pay provision amounting to R33,06 million included in the payables from exchange transactions balance of R300,60 million. Consequently, I was unable to determine whether any adjustment relating to the leave pay provision was necessary.

### **Qualified opinion**

8. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Newcastle Municipality as at 30 June 2014 and its financial performance and cash flows for the year then ended, in accordance with the 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.

### **Restatement of corresponding figures**

10. As disclosed in note 43 to the financial statements, the corresponding figures for 30 June 2013 have been restated as a result of an error discovered during 2014 in the financial statements of the Newcastle municipality at, and for the year ended 30 June 2013.

### **Material losses and impairments**

11. As disclosed in note 53 to the financial statements, material losses in electricity of 45,49 million kilowatts amounting to R20,3 million were incurred as a result of transmission losses and illegal connections.
12. As disclosed in note 12 to the financial statements, the municipality provided for impairment of Value Added Tax of approximately R25,6 million as recoverability is considered doubtful due to it being disputed by the South African Revenue Services.
13. As disclosed in note 13 to the financial statements, the municipality provided for impairment of consumer debtors of approximately R15,5 million, due to poor collection practices.

## Significant uncertainties

14. With reference to note 42 to the financial statements the municipality is a defendant in various supplier and staff lawsuits. The municipality is defending these claims as it believes that the claims are invalid. The ultimate outcomes of these matters cannot presently be determined and no provision for any liability that may result has been made in the financial statements.

## ADDITIONAL MATTER PARAGRAPH

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

## Unaudited disclosure notes

16. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

## REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

17. 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

18. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected objectives presented in the annual performance report of the municipality for the year ended 30 June 2014:

Objective 4: technical services on pages x to x

Objective 5: community Services on pages x to x

Objective 6: developments planning and human settlements on pages x to x

19. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
20. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned objectives. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
21. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
22. I did not raise any material findings on the usefulness and reliability of the reported performance information for the selected objectives.

## **Additional matters**

23. Although no material findings concerning the usefulness and reliability of the performance information were identified in the annual performance report, I draw attention to the following matters below.

## **Achievement of planned targets**

24. Refer to the annual performance report on pages x to x and x to x for information on the achievement of the planned targets for the year.

## **Unaudited supplementary schedules**

25. The supplementary information set out on pages x to x does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not express a conclusion thereon.

## **Compliance with legislation**

26. I performed procedures to obtain evidence that the municipality has complied with applicable legislation 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:

## **Annual financial statements**

27. The 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 four items identified by the auditors were subsequently corrected. However, supporting documents for the provision for leave and property, plant and equipment that could not be provided resulted in the annual financial statements receiving a qualified opinion.

## **Procurement and contract management**

28. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by supply chain management (SCM) regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).

29. Awards were made to bidders other than those recommended by the bid evaluation committee without adequate ratification by the accounting officer, as required by SCM regulation 29(5)(b).

30. Contracts were awarded to bidders that did not score the highest points in the evaluation process, as required by section 2(1)(f) of Preferential Procurement Policy Framework Act, 2000 (Act No.5 of 2000).

31. Awards were made to providers who are in the service of other state institutions or whose directors/principal shareholders are in service of the state institutions, in contravention of section 112(j) of the MFMA and SCM regulations 44.

32. Awards were made to providers who are in the service of the municipality in contravention of section 112(j) of the MFMA and SCM regulation 44. Furthermore, the provider failed to declare that he/she was in the service of the municipality, as required by SCM regulation 13(c).

## **Asset management**

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

## **Expenditure management**

34. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA.

35. 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.

## **Consequence management**

36. Appropriate action was not taken against officials and role players in the SCM system where investigations proved failure to comply with the SCM system, as required by SCM regulation 38(1)(b).

## **Internal control**

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

## **Leadership**

38. Management did not exercise adequate oversight over financial reporting and compliance with laws and regulations, as well as internal control. In this regard, management did not ensure that the municipality was able to prepare credible financial reports that are supported and evidenced by reliable information and that all procurements of goods and services are done in accordance with SCM regulations.

## **Financial and performance management**

39. Daily and monthly controls were not operational throughout the period. Management did not prepare regular, accurate and complete financial statements that are supported and evidenced by reliable information as year-end procedures were not carried out in accordance with the applicable financial reporting framework. Adequate review and monitoring over compliance with legislation was not undertaken due to staff not understanding their respective roles and responsibilities.

## **Governance**

40. The risk assessment process did not adequately address the accuracy and completeness of financial reporting resulting in material misstatements and non-compliance with legislation.

41. Internal audit and the audit committee did not adequately review the financial statements, as evident by the errors that arose during the auditing process.

## OTHER REPORTS

### Investigations

42. The department of Cooperative Governance and Traditional Affairs conducted investigations regarding procurement irregularities which relates to cellphone contracts and public viewing screens entered into in the year under review. The investigations were finalised in July 2014. Irregularities were discovered and disciplinary action was recommended against the relevant officials.

Pietermaritzburg

28 November 2014



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*