

Auditor-General of South Africa

Newcastle Municipality

Audit Report 2018-19

# Report of the auditor-general to the KwaZulu-Natal Provincial Legislature and council on Newcastle Municipality

## Report on the audit of the financial statements

### Opinion

1. I have audited the financial statements of the Newcastle Municipality set out on pages xx... to xx..., which comprise the appropriation statement, the statement of financial position as at 30 June 2019, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual information for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Newcastle Municipality as at 30 June 2019 and financial performance and cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practice (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 (Act no.1 of 2018)(Dora).
3. 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 financial statements section of this auditor's report.
4. I am independent of the municipality in accordance with sections 290 and 291 of the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* and, parts 1 and 3 of the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA codes) as well as 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 codes.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

### Material uncertainty relating to financial sustainability

6. I draw attention to the matter below.
7. I draw attention to note 49 to the financial statements, which indicates that the municipality incurred a deficit of R310,46 million during the year ended 30 June 2019 and, as of that date the municipality's current liabilities exceeded its current assets by R127,43 million. As stated in note 49, these events or conditions, along with other matters as set forth in note 49, indicate that a material uncertainty exists that may cast significant doubt on the municipality's ability to continue as a going concern.

## **Emphasis of matters**

8. I draw attention to the matters below.

### **Uncertainty relating to the future outcome of exceptional litigation**

9. With reference to note 44 to the financial statements, the municipality is the defendant in various lawsuits. The ultimate outcome on these matters could not be determined and no provision for any liability was made in the financial statements.

### **Restatement of corresponding figures**

10. As disclosed in note 46 to the financial statements, the corresponding figures for 2017- 18 were restated as a result of errors in the financial statements of the municipality at, and for the year ended, 30 June 2019.

### **Material losses/ impairments – trade debtors**

11. As disclosed in note 12 to the financial statements, material losses of R36,86 million (2017-18: R30,02 million) were incurred as a result of a provision for impairment of receivables from non-exchange revenue.

12. As disclosed in note 13 to the financial statements, material losses of R933,90 million (2017-18: R843,76 million) was incurred as a result of an allowance for impairment of consumer debtors.

### **Material losses – water**

13. As disclosed in note 57 to the financial statements, material water losses of R45,10 million (2017-2018: R45,49 million) were incurred, which represents 47% (2017-2018: 49%) of total water purchased. The losses are mainly due to leaks, burst pipes and illegal connections.

## **Other matters**

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

### **Unaudited disclosure notes**

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

## **Responsibilities of accounting officer for the financial statements**

16. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the Standard of GRAP and the requirements of the MFMA, 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.

17. In preparing the financial statements, the accounting officer is responsible for assessing the Newcastle 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 financial statements**

18. My objectives are to obtain reasonable assurance about whether the 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 financial statements.
19. A further description of my responsibilities for the audit of the 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 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 selected objectives presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
21. 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/ measures 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.
22. 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 basic service delivery and infrastructure presented on pages xx – xx in the annual performance report of the municipality for the year ended 30 June 2019:
23. 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.

24. I did not raise any material findings on the usefulness and reliability of the reported performance information for this objective.

### **Other matters**

25. I draw attention to the matters below.

### **Achievement of planned targets**

26. Refer to the annual performance report on page(s) x to x; x to x for information on the achievement of planned targets for the year. This information should be considered in the context of the opinion expressed on the usefulness and reliability of the reported performance information in paragraph(s) x; x; x of this report.

### **Adjustment of material misstatements**

27. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of basic service delivery and infrastructure. As management subsequently corrected the misstatements, I did not raise any material findings on the usefulness and reliability of the reported performance information.

## **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 compliance of the municipality 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 legislations 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 non-current assets, current assets, current liabilities, disclosure items and the cash flow statement identified by the auditors in the submitted financial statement were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion.

## **Expenditure management**

31. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
32. Reasonable steps were not taken to prevent irregular expenditure amounting to R86,89 million as disclosed in note 53 to the annual financial statements, as required by section 62(1)(d) of the MFMA. The majority of the irregular expenditure was caused by payments made on contracts where SCM procedures were not followed.
33. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R28,64 million, as disclosed in note 52 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed fruitless and wasteful expenditure was caused by late payments on expenditure.

## **Procurement and contract management**

34. Some of the goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of by SCM regulation 17(a) and (c).
35. Some of the goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by 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). Similar non-compliance was also reported in the prior year.
36. Bid specifications for some of the tenders were drafted in a biased manner and did not allow all potential suppliers to offer their goods or services, in contravention of SCM regulation 27(2)(a).
37. Some of the bid documentation for procurement of commodities designated for local content and production, did not stipulated 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.
38. Competitive bids were adjudicated by a bid adjudication committee that was not composed in accordance with SCM regulation 29(2).
39. Commodities designated for local content and production, were procured from suppliers who did not meet the prescribed minimum threshold for local production and content, as required by the 2017 preferential procurement regulation 8(5). Similar non-compliance was also reported in the prior year.

## **Consequence management**

40. Some of the unauthorised expenditure incurred by the municipality was investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a) of the MFMA. Internal investigations are currently in progress on some of the unauthorised and fruitless and wasteful expenditure.

41. Some of the irregular expenditure and fruitless and wasteful expenditure incurred by the municipality were not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA. Internal investigations are currently in progress on some of the irregular and fruitless and wasteful expenditure.

#### Other information

42. The accounting officer is responsible for the other information. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report which includes the accounting officer's foreword and the audit committee's report. The other information does not include the financial statements, the auditor's report and those selected objectives presented in the annual performance report that have been specifically reported in the auditor's report.
43. My opinion on the 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.
44. 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 financial statements and the selected objectives presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
45. I did not receive the other information prior to the date of this audit 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 the auditor's report and re-issue an amended report as appropriate. However, if it is corrected this will not be necessary.

#### Internal control deficiencies

46. I considered internal control relevant to my audit of the 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 findings on compliance with legislation included in this report.
47. Lack of adequate reviews and reconciliation of information reported in the financial statements resulting in material misstatements being identified during the audit, these were subsequently corrected by management resulting in an unqualified audit opinion. Supply chain management policies and procedures along with applicable legislation were not adhered to, resulting in increased irregular expenditure and non compliance with legislation. Furthermore, consequences for transgressions were not investigated to ensure that responsible officials were appropriately disciplined.

## 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 financial statements, reported performance information, compliance with applicable legislation and other related matters. These reports did not form part of my opinion on the financial statements or my findings on the reported performance information or compliance with legislation.
49. Investigations were undertaken by an independent firm from September 2018 in respect of certain projects. This investigation was in progress at the date of this auditor's report.

*Auditor General*

30 November 2019



**AUDITOR - GENERAL  
SOUTH AFRICA**

*Auditing to build public confidence*



## **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 financial statements, and the procedures performed on reported performance information for selected objective and on the municipality’s compliance with respect to the selected subject matters.

### **Financial statements**

2. In addition to my responsibility for the audit of the financial statements as described in this auditor’s report, I also:
  - identify and assess the risks of material misstatement of the 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 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 Newcastle 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 financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the 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 financial statements, including the disclosures, and whether the 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.

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.

