

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Newcastle Municipality, which comprise the statement of financial position as at 30 June 2011, the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory information 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 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, 2010 (Act No. 1 of 2010) (DORA), and for such internal control as management determines 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. As required by section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996), section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on the financial statements based on my audit.
4. I conducted my audit in accordance with International Standards on Auditing and *General Notice No. 1111 of 2010* issued in *Government Gazette No. 33872 of 15 December 2010*. 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.
5. 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.
6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Property, plant and equipment

7. The municipality did not review the residual values and useful lives of assets at each reporting date in accordance with SA Standard of GRAP 17, *Property, plant and equipment (PP&E)*, as evidenced by assets with a gross carrying amount of R10,024 million being included in the financial statements at a zero net carrying amount whilst still being in use, thus impacting on the valuation of these assets. Furthermore, the accounting officer undertook an asset verification during 2010-11 in an attempt to correct assets that were not previously recognised. Therefore, as disclosed in note 38 to the financial statements, the 2009-10 corresponding figure for PP&E had been restated by R460,051 million. However, no supporting documentation and records were available for the restatement. In addition, no evidence was provided that assets were assessed at each reporting date for impairment. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the valuation, existence, completeness and rights of PP&E for the amount of R460,051 million included note 7 to the financial statements and also determine whether any adjustments might be necessary to the amounts shown in the financial statements for accumulated surpluses, depreciation, accumulated depreciation and impairment.

Provision for bad debts

8. Note 2 to the financial statements includes an amount of R611,214 million, which is reflected as a bad debt impairment. This impairment was based on a general provision of consumer debtors outstanding at year-end over 60 days, without being supported by a reasonable risk profiling per location or category of the debt, bases and assumptions and in this regard, the accounting officer did not comply with SA Standard of GRAP, IAS 39 (AC 133), *Financial Instruments: Recognition and Measurement*. In addition, financial records and the aging history per debtor were not provided to assess the reasonability of the provision. Consequently, I did not obtain sufficient appropriate evidence to satisfy myself as to the accuracy of the provision for bad debts.

Opinion

9. 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 2011 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

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

Material losses

11. As disclosed in note 50 to the financial statements, material losses to the amount of R59,214 million (32 334 604 kilowatt hours) were incurred as a result of electricity distribution losses.

Irregular expenditure

12. As disclosed in note 53 to the financial statements, the municipality incurred irregular expenditure of R15,437 million as the expenditure incurred was in contravention of the Local Government: Municipal Supply Chain Management Regulations, 2005.

Additional matter

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

Unaudited supplementary schedules

14. The supplementary information set out on pages XX to XX 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

15. In accordance with the PAA and in terms of *General Notice No. 1111 of 2010*, issued in *Government Gazette No. 33872 of 15 December 2010*, I include below my findings on the annual performance report as set out on pages ... to ... and material non-compliance with laws and regulations applicable to the municipality.

Predetermined objectives

16. There were no material findings on the annual performance report.

Compliance with laws and regulations

Annual financial statements

17. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 (1)(a) of the MFMA. Certain misstatements identified with regard to revenue, receivables, payables, cash and cash equivalents and disclosures were subsequently corrected, but, the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.

Expenditure management

18. The accounting officer did not take reasonable steps to prevent irregular expenditure, as required by section 62(1) (d) of the MFMA.

INTERNAL CONTROL

19. In accordance with the PAA and in terms of *General Notice No. 1111 of 2010*, issued in *Government Gazette No. 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the basis for qualified opinion, and the findings on compliance with laws and regulations included in this report.

Leadership

20. The accounting officer did not exercise adequate oversight responsibility over monthly financial reporting and compliance with laws and regulations relating to supply chain management and the relevant internal controls. Consequently actions were not taken to mitigate weakness to timeously respond to financial and compliance related risks.

Financial management

21. Systems and controls were not designed in a manner to prevent, detect and address risks that impact on financial and compliance reporting. In this regard, the accounting officer did

not ensure that regular, accurate and complete monthly financial reports were prepared, which were supported and evidenced by credible and reliable information. In addition, compliance with applicable laws and regulations was not monitored regularly. This resulted in material corrections in financial statements and reportable compliance related issues.

Governance

22. The audit committee did not promote accountability through evaluating and monitoring responses to risks and provide adequate oversight over the effectiveness of the internal control environment, including financial and supply chain management compliance reporting requirements. In addition, the internal audit unit did not perform ongoing monitoring and evaluations to ensure that controls were appropriately designed and implemented.

OTHER REPORT

Investigation

23. An investigation to probe the manner in which cheques to the value of R10,357 million were stolen from the municipality's offices and presented for payment was still in progress at the report date.

Pietermaritzburg

14 December 2011



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence