

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 financial statements of the Newcastle Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2012, the statement of financial performance, statement of changes in net assets and the cash flow statement 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, 2011 (Act No. 6 of 2011) (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 qualified audit opinion.

Basis for qualified opinion

Property, plant and equipment

6. I was unable to obtain sufficient appropriate evidence for the valuation of capital work in progress (CWIP) stated at R360,372 million (2010-11 R261,027 million) in note 3 to the financial statements. This arose because capital projects that were completed during the year were not identified, recognised and transferred out of CWIP and measured in terms of SA Standards of GRAP 7 and 17, on *Investments in associates* as well as

Property, plant and equipment, respectively. Consequently I was unable to determine whether any adjustment relating to the CWIP, infrastructure assets, investments in associates as well as depreciation and impairment in the financial statements was necessary.

Accumulated surplus

7. I was unable to obtain sufficient appropriate audit evidence for the correction of prior period errors totalling R187,853 million in note 19 to the financial statements, which are included in the accumulated surplus of R2,905 billion. Therefore, the accuracy of the prior period errors could not be confirmed by alternative means. Consequently I was unable to determine whether any further adjustments to the accumulated surplus balance were necessary.

Opinion

8. In my opinion, except for the possible effect 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 2012, 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 19 to the financial statements, the corresponding figures for 30 June 2011 have been restated as a result of errors discovered during 30 June 2012 in the financial statements of the Newcastle Municipality at, and for the year ended 30 June 2011.

Irregular expenditure

11. The municipality incurred irregular expenditure of R14,609 million as disclosed in note 37 to the financial statements, as the expenditure incurred was in contravention of the Local Government: Municipal Supply Chain Management Regulations, 2005 (MSCMR).

Significant uncertainties

12. With reference to note 32 to the financial statements, the municipality is a defendant in a land-claim lawsuit. The ultimate outcome of the matter cannot presently be determined and no provision for any liability that may result has been made in the financial statements.

Material losses and impairments

Impairment of consumer debtors

13. As disclosed in note 10 of the financial statements, the municipality provided for impairment losses on consumer debtors of R443,707 million, as the recoverability of these amounts was considered doubtful.

Electricity losses

14. As disclosed in note 26 to financial statements, electricity losses to the amount of

R14,190 million were incurred as a result of faulty meters, theft of electricity, as well as transmission losses.

Additional matter

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

Unaudited supplementary schedules

16. The supplementary information set out on pages xx to xx do 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

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 information in the annual performance report as set out on pages xx to xx of the annual report.

19. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury annual reporting principles and whether the reported performance is consistent with the planned development priorities or objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the *National Treasury Framework for managing programme performance information*. The reliability of the information in respect of the selected development priorities or objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

20. There were no material findings on the annual performance report concerning the usefulness and reliability of the information.

Additional matter

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

Achievement of planned targets

22. Of the total number of 289 targets planned for the year, 113 of the targets were not achieved during the year under review. This represents 39% of total planned targets that were not achieved during the year under review. This was due to under spending of the budget relevant to the capital programme in the extent of 41%.

Compliance with laws and regulations

23. I performed procedures to obtain evidence that the municipality has complied with applicable laws and regulations 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

24. 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 identified by the auditors in the submitted financial statements were not adequately corrected and the supporting records could not be provided subsequently, which resulted in the financial statements receiving a qualified audit opinion.

Procurement and contract management

25. Awards were made to providers who are persons in the service of the municipality and/or whose directors/ principal shareholders are persons in service of the municipality in contravention of MSCMR 44. Furthermore the provider failed to declare that he/she was in the service of the municipality, as required by MSCMR 13(c).
26. Awards were made to providers who are persons in service of other state institutions or whose directors/ principal shareholders are persons in service of other state institutions, in contravention of MSCMR 44.

Expenditure management

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

Asset management

28. An effective system of internal control for assets (including an updated asset register) was not in place, as required by section 63(2)(c) of the MFMA.

Audit committee

29. The audit committee did not advise the council on matters relating to internal financial control and internal audits, risk management, accounting policies, effective governance, performance management and performance evaluation, as required by section 166 (2) (a) of the MFMA.

Internal control

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

Leadership

31. The accounting officer did not exercise adequate oversight over financial reporting and compliance as well as internal control. In this regard, the accounting officer did not regularly assess whether staff members had essential skills and knowledge to support the achievement of credible reporting and comply with designed policies and procedures, as well as legislative requirements.

Financial and performance management

32. Adequate processes were not in place to communicate timely and relevant information to those charged with governance, in that monthly reporting and reconciliation processes were not at desired levels. In addition, records management and review processes were not designed and implemented in a manner to improve accountability and credibility in financial and compliance reporting. This is evidenced by material corrections in the financial statements, as well as delays in the availability of certain audit documentation that arose during the auditing process.

Governance

33. The audit committee did not promote accountability and service delivery through evaluating and monitoring responses to risks and provide oversight over the effectiveness of the internal control environment, including financial and compliance with laws and regulations.

OTHER REPORTS

Investigations

34. A forensic investigation into fictitious cheque payments was conducted by an independent consulting firm at the request of the municipality. The investigation was initiated based on the allegation of possible misappropriation by employees of state funds. The investigation resulted in criminal proceedings being instituted against three employees.

Auditor - General

Pietermaritzburg

30 November 2012



**AUDITOR - GENERAL
SOUTH AFRICA**

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