



Auditor-General of South Africa

# Newcastle Municipality - Audit report 2015-16

# **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 audited the financial statements of the Newcastle Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2016, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget with actual information for the year then ended, as well as 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, 2015 (Act No. 1 of 2015) (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 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.

## **Opinion**

6. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Newcastle Municipality as at 30 June 2016 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**

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

## **Significant uncertainties**

8. The municipality is the defendant in a number of civil lawsuits as disclosed in note 45 to the financial statements. The municipality is opposing these claims as it believes them to be invalid. The ultimate outcome of these matters was not determinable at year-end and no provision for any liability that may result was made in the financial statements.

## **Restatement of corresponding figures**

9. As disclosed in note 48 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of errors discovered during 30 June 2016 in the financial statements of the Newcastle municipality at, and for the year ended during the year ended, 30 June 2015.

## **Material losses and impairments**

10. As disclosed in note 59 to the financial statements, the municipality incurred material water losses of 15,21 million (2014-15: 14,15 million) kilolitres amounting to R38,94 million (2014-15: R35,23 million) as a result of technical distribution losses.
11. As disclosed in note 60 to the financial statements, the municipality incurred material electricity losses of 53,48 million (2014-15: 44,37 million) kilowatts amounting to R29,24 million (2014-15: R21,47 million) as a result of technical and non-technical distribution losses.
12. As disclosed in note 14 to the financial statements, the municipality provided for impairment of receivables amounting to R596,32 million (2014: R400,96 million) due to poor collection practices.

## **Additional matter**

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

## Unaudited disclosure notes

14. 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

15. 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 findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

## Predetermined objectives

16. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the infrastructure and service delivery development priority presented in the annual performance report of the municipality for the year ended 30 June 2016.
17. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
18. I evaluated the usefulness of the reported performance information to determine whether it was consistent with the planned development priorities. 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).
19. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
20. The material findings in respect of the selected development priority are as follows:

### ***Infrastructure and service delivery***

Usefulness of reported performance information

Measurability of indicators and targets

Performance indicators not well defined and verifiable and targets not measurable

21. The FMPPI requires that performance indicators should be well defined by having clear definitions so that data can be collected consistently and are easy to understand and use. Important indicators were not well defined.

22. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 23% of the indicators were not verifiable.
23. The measurability of 23% of planned targets and indicators could not be assessed due to a lack of technical indicator descriptions, proper systems and processes, formal standard operating procedures and documented system descriptions.

### Reliability of reported performance information

24. The FMPPI requires municipality's to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. Adequate and reliable corroborating evidence could not be provided for the reported achievements against planned targets of important indicators.

### Additional matters

25. I draw attention to the following matters:

### Achievement of planned targets

26. The annual performance report on pages x to x includes information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected development priority reported in paragraphs 21 to 24 of this report.

### Adjustment of material misstatements

27. I identified material misstatements in the annual performance report submitted for auditing on the reported performance information for the infrastructure and service delivery development priority. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information.

### Compliance with legislation

28. I performed procedures to obtain evidence that the municipality complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

### Annual financial statements

29. 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 non-current assets, current assets and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided subsequently, resulting in the financial statements receiving an unqualified audit opinion.

## Procurement and contract management

30. Awards were made to providers who were in the service of other state institutions or whose directors were in the service of other state institutions, in contravention of section 112(j) of the MFMA and supply chain management (SCM) regulation 44. Similar awards were identified in the previous year and no effective steps were taken to prevent or combat the abuse of the SCM process, as required by SCM regulation 38(1).

## 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 and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

## 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.

## Consequence management

34. Irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person was liable for the expenditure, as required by section 32(2)(b) of the MFMA.

## **Internal control**

35. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the findings on the annual performance report and the findings on compliance with legislation included in this report.

## Leadership

36. Oversight over financial and performance reporting as well as compliance with legislation, was inadequate, as the positions of the accounting officer and chief financial officer were vacant for majority of the year. Leadership was slow in responding to the filling of these key positions.

## Financial and performance management

37. Management did not undertake adequate reviews of registers, reconciliations and schedules supporting amounts reported in the financial statements. Furthermore, management did not adequately prepare complete and accurate performance reports and monitor compliance with legislation due to key positions being vacant.

## Governance

38. The risk assessment processes and reviews were not adequate to ensure that key financial, performance and compliance risks were mitigated and responded to in good time by management due to instability at senior management level.

## Other reports

39. I draw attention to the following engagements that could potentially impact on the municipality's financial, performance and compliance related matters. My opinion is not modified in respect of these engagements that are either in progress or have been completed.

## Investigations

40. KwaZulu-Natal Provincial Treasury is performing five investigations which covered the period June 2013 to June 2015. The investigations were initiated based on allegations of irregularities in the procurement processes. These investigations are currently in progress.
41. The Legal Services Department at the municipality, at the request of the municipal council conducted an investigation relating to two suspended employees, which covered the period May 2015 to March 2016. The investigation was finalised in the current year and the employees have been re-instated.

*Auditor - General*

Pietermaritzburg

30 November 2016



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SOUTH AFRICA

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