

Auditor-General of South Africa

Newcastle Municipality

Audit report 2017-18

# Report of the auditor-general to the KwaZulu-Natal Provincial Legislature and the 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 ... to ..., which comprise the statement of financial position as at 30 June 2018, the statement of financial performance, statement of changes in net assets, cash flow statement, statement of comparison of budget information with actual information 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 2018, and its financial performance and cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of 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, 2017 (Act No. 3 of 2017) (Dora).

### Basis for opinion

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 the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* (IESBA code) and 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 code.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

### Emphasis of matters

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

### Restatement of corresponding figures

7. As disclosed in note 43 to the financial statements, the corresponding figures for 30 June 2017 were restated as a result of an error in the financial statements of the municipality at, and for the year ended 30 June 2018.

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

8. As disclosed in note 41 to the financial statements, various legal claims were lodged against the municipality. The ultimate outcome of these claims was not determinable at year-end, hence the financial statements did not include any liabilities that could have resulted from them.

## Material debt impairments and losses

9. As disclosed in note 34 to the financial statements, material losses of R177,93 million (2016-17: R69,52 million) was incurred as a result of an impairment of consumer debtors.
10. As disclosed in note 53 to the financial statements, material water losses of R45,49 million (2016-2017: R 31,99 million) was incurred, which represents 48.9% (2016-2017: 44.2%) of total water purchased. Losses incurred were due to leaks, burst pipes, illegal connections, meter inaccuracies and errors in manual reading and capturing of readings from meters.

## Other matter

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

## Unaudited disclosure notes

12. 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 the accounting officer for the financial statements

13. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the SA Standards of GRAP and the requirements of the MFMA and 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.
14. 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

15. 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.
16. A further description of my responsibilities for the audit of the financial statements is included in the annexure to this auditor's report.



## Introduction and scope

17. 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 the selected objective presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
18. 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 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.
19. 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 the following selected objective presented in the annual performance report of the municipality for the year ended 30 June 2018:

Objective	Pages in the annual performance report
Objective 2: basic service delivery and infrastructure	x – x

20. 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.
21. The material findings in respect of the usefulness and reliability of the selected objective are as follows:

### Basic service delivery and Infrastructure

#### Number of business plans submitted for funding for the compilation of comprehensive infrastructure master plans (roads and storm water, water and sanitation)

22. The indicator approved in the Service Delivery and Budget Implementation Plan (SDBIP) was the submission of a business plan to obtain funding for the preparation of the comprehensive infrastructure master plan roads and storm water . However, the indicator reported in the annual performance report was number of business plans submitted for funding for the compilation of comprehensive infrastructure master plans (roads and storm water, water and sanitation).

## Various indicators

23. The method of calculation for achieving the planned indicators listed below was not clearly defined. Additionally, the municipality did not report on the achievement for these indicators as it did not have adequate processes to validate the baseline of the targets. As a result, I was unable to obtain sufficient appropriate audit evidence for the indicators listed below. I was unable to obtain sufficient appropriate audit evidence for the reported achievement of these targets. This was due to limitations on the scope of my work.

Indicator number	Indicator description
OSCBS004	Percentage of households with access to a basic level of water
OSCBS005	Percentage of households with access to a basic level of sanitation
OSCBS009	The percentage of households with access to basic level of solid waste removal
OSCBS016	Percentage of households with access to a basic level of electricity

## Other matters

24. I draw attention to the matters below.

## Achievement of planned targets

25. The annual performance report on pages ... to ... includes information on the achievement of 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 in paragraphs 26 and 27 of this report.

## Adjustment of material misstatements

26. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of the basic service delivery and infrastructure objective. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are reported above.

## Report on the audit of compliance with legislation

### Introduction and scope

27. 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.
28. The material findings on compliance with specific matters in key legislation are as follows:



## Financial statements

29. 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, liabilities, expenditure and disclosure items identified by the auditors in the submitted financial statement were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion.

## Procurement and contract management

30. 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 municipal supply chain management (MSCM) regulation 17(a) and (c).
31. Some of the quotations were accepted from bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by MSCM regulation 13(c).
32. Awards were made to providers who were in the service of other state institutions in contravention of MFMA section 112(j) and MSCM regulation 44. Similar awards were identified in the previous year.
33. Some of the goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by MSCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of MSCM regulation 36(1).
34. Some of the construction contracts were awarded to contractors that did not qualify for the contract in accordance with Construction Industry Development Board (CIDB) regulations 17 and 25(7A).
35. 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 regulation 8(2) of the preferential procurement regulations of 2017.
36. Some of the commodities designated for local content and production, were procured from suppliers who did not submit a declaration on local production and content, as required by the preferential procurement regulations of 2017. Similar non-compliance was also reported in the prior year.
37. Some of the 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 regulation 8(2) of the preferential procurement regulations of 2017.

## Expenditure management

38. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

39. Reasonable steps were not taken to prevent unauthorised expenditure of R124,18 million, as disclosed in note 48 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by incorrect budgeting of employee costs, contracted services and general expenses.
40. Reasonable steps were not taken to prevent irregular expenditure of R95,69 million as disclosed in note 50 to the annual financial statements, as required by section 62(1)(d) of the MFMA. The majority of the irregular expenditure was caused by non-compliance with procurement legislation.
41. Reasonable steps were not taken to prevent fruitless and wasteful expenditure of R8,48 million, as disclosed in note 49 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.

### Consequence management

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

### Other information

43. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements, the auditor's report and the selected objective presented in the annual performance report that have been specifically reported in this auditor's report.
44. 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.
45. 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 the financial statements and the selected objective presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
46. If, based on the work I have performed, I conclude that there is a material misstatement in this other information, I am required to report that fact. I have nothing to report in this regard.

### Internal control deficiencies

47. 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.
48. 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.



49. Leadership did not exercise adequate oversight responsibility regarding financial and performance reporting and compliance with legislation. The prior year action plan was not timeously implemented to ensure that repeat findings were avoided. In this regard, the accounting officer did not design appropriate policies and procedures to support the achievement of credible performance and financial reporting and compliance with legislative requirements. Management did not diligently undertake routine monthly reconciliations and reviews, to support amounts reported in the financial statements and the annual performance report. Furthermore, there was no proper systems and processes and formal standard operating procedures in place to enable reliable reporting of key service delivery indicators included in the annual performance report. This was due to management not fully understanding the requirements of the financial and performance reporting framework.

### Other reports

50. 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.

### Investigations

51. An independent consultant has commenced with an investigation in February 2018 into reviews of the Supply chain management quotations process covering the 2016-17 financial period. These proceedings were in progress at the date of this auditors report.

*Auditor-General SA*

Pietermaritzburg

30 November 2018



*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.





50. 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 development priorities and on the municipality's compliance with respect to the selected subject matters.

### **Financial statements**

51. 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 eMadlangeni municipality 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**

52. 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.
53. 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.

