

Auditor-General of South Africa

Newcastle Municipality
Audit report for the year ended 30 June 2021

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 xx to xx, which comprise the appropriation statement, statement of financial position as at 30 June 2021, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual information for the year then ended, as well as 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 2021, 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, 2020 (Act No. 4 of 2020) (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 my report.
4. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA code) as well as other 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.

Material uncertainty relating to financial sustainability

6. I draw attention to the matter below. My opinion is not modified in respect of this matter.
7. As disclosed in note 50 to the financial statements, the municipality incurred a net loss of R197,16 million during the year ended 30 June 2021 and, as of that date the municipality's current liabilities exceeded its current assets by R141,16 million. As stated in note 50, these events or conditions, along with other matters as set forth in note 50, 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. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

9. As disclosed in note 47 to the financial statements, the corresponding figures for 30 June 2020 were restated as a result of errors in the financial statements of the municipality at, and for the year ended, 30 June 2021.

Material impairments – receivables from non-exchange transactions and consumer debtors

10. As disclosed in note 10 to the financial statements, material impairments of R48,82 million (2019-20: R45,16 million) were raised by the municipality on receivables from non-exchange transactions as the recoverability of this amount was doubtful.
11. As disclosed in note 11 to the financial statements, material impairments of R649,41 million (2019-20: R1,11 billion) was raised by the municipality on consumer debtors as the recoverability of this amount was doubtful.

Material losses - water

12. As disclosed in note 38 to the financial statements, material water losses of R41,82 million (2019-20: R43,68 million) were incurred, which represents 34% (2019-20: 39%) of total water purchased. The losses were incurred due to leaks and burst pipes, unauthorised consumption and illegal connections.

Contingencies

13. As disclosed in note 44 to the financial statements, the municipality is the defendant in various claims and legal disputes. The ultimate outcome of these matters could not be determined and no provision for any liability that may result was made in the financial statements.

Other matter

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

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 the 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 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.

17. In preparing the financial statements, the accounting officer is responsible for assessing the 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 on the usefulness and reliability of the reported performance information against predetermined objectives for selected key performance area presented in the annual performance report. I performed procedures to identify material findings but not to gather evidence to express assurance.
21. My procedures address the usefulness and reliability of the reported performance information, which must be based on the municipality's approved performance planning documents. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures do not examine whether the actions taken by the municipality enabled service delivery. My procedures do not extend to any disclosures or assertions relating to the extent of achievements in the current year or 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 the *basic services key performance area* presented on pages x to x in the municipality's annual performance report for the year ended 30 June 2021.

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 identify any material findings on the usefulness and reliability of the reported performance information for the *basic services key performance area*.

Other matter

25. I draw attention to the matters below.

Achievement of planned targets

26. The annual performance report on pages x to x sets out information on the achievement of planned targets for the year.

Adjustment of material misstatements

27. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were in the reported performance information of the *basic services key performance area*. 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 municipality's compliance 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 legislation are as follows:

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

Expenditure management

31. Reasonable steps were not taken to prevent irregular expenditure amounting to R31,65 million as disclosed in note 54 to the annual financial statements, as required by section 62(1) (d) of

the MFMA. The majority of the irregular expenditure was due to non-compliance with supply chain management legislation.

Other information

32. 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 key performance area presented in the annual performance report that have been specifically reported in this auditor's report.
33. 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 on it.
34. 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 key performance area presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
35. If, based on the work I have performed on the other information that I obtained prior to the date of this auditor's report, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

Internal control deficiencies

36. 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.
37. Management did not undertake routine monthly verifications and reviews to support amounts reported in the financial statements. This was due to management not fully understanding and implementing the requirements of the financial reporting framework. Moreover, management did not adhere to policies and procedures relating to procurement and contract management.

Material irregularities

38. In accordance with the PAA and the Material Irregularity Regulations, I have a responsibility to report on material irregularities identified during the audit.

Material irregularities identified during the audit

Material irregularities identified are as follows:

Escrow account not paid within 30 days

The municipality failed to ensure that the payments due to Eskom were made within 30 days of receiving the relevant invoice or statement for the period July 2019 to September 2019, in contravention of section 65(2)(e) of the MFMA. The municipality incurred interest and penalties as a result of the late payments of R2,38 million in the 2019-20 financial year. The non-compliance has resulted in a material financial loss for the Newcastle Municipality of R2,38 million and this has been disclosed as fruitless and wasteful expenditure in note 52 of the 2019-20 annual financial statements.

The accounting officer was notified of this material irregularity on 26 February 2021 and was invited to make a written submission on the actions taken and that will be taken to address the matter. The accounting officer planned to strengthen controls over creditors and to prioritize third party payments and to reconcile monthly by 30 June 2021.

The accounting officer has entered into an arrangement of debt and repayment plan agreement suspending future interest charges with Eskom signed on 15 July 2020. The accounting officer has prioritised the Eskom account and has ensured that payments are made within 30 days of receiving the invoice or statement thus preventing any further material financial loss by 30 June 2021.

On 25 August 2021, the accounting officer presented to council the section 52(d) of the MFMA report for 30 June 2021, file reference T6/1/1-2020/2021, confirming that the municipality has been experiencing cash flow challenges and that no official could be held liable for the financial loss.

The material irregularity is resolved.

Interest and penalties incurred on SARS account: Value Added Tax

The municipality failed to ensure that the payments due to SARS were made within the period ending on the 25th day of the first month commencing after the end of the tax period, in contravention of section 28(1) of the Value Added Tax Act 89 of 1991 (VAT Act). The municipality has incurred interest and penalties amounting to R1,48 million for the 2019-20 financial year. The non-compliance has resulted in a material financial loss for the Newcastle Municipality of R1,48 million and this has been disclosed as fruitless and wasteful expenditure in note 52 of the 2019-20 annual financial statements.

The accounting officer was notified of this material irregularity on 26 February 2021 and was invited to make a written submission on the actions taken and that will be taken to address the matter. The accounting officer planned to strengthen controls over creditors and to prioritize third party payments and to reconcile monthly by 30 June 2021.

46. The accounting officer has prioritised the SARS account and has ensured submission is made by the 25th day as per the VAT Act and has prevented any further material financial loss by 30 June 2021.
47. Third party payments are now made within the required timeframes, with zero interest and penalties charged by SARS by 30 June 2021.
48. On 25 August 2021, the accounting officer presented to council the section 52(d) of the MFMA report for 30 June 2021, file reference T6/1/1-2020/2021, confirming that the municipality has been experiencing cash flow challenges and that no official could be held liable for the financial loss.
49. The material irregularity is resolved.

Interest and penalties incurred on SARS Account: Payroll Taxes

50. The municipality failed to ensure that the payments due to SARS were made within seven days after the end of the month during which the amount was deducted or withheld from employees for the period June 2019 to June 2020, in contravention with paragraph 2(1) of the Fourth Schedule of the Income Tax Act 58 of 1962. The non-compliance has resulted in a material financial loss for the Newcastle Municipality of R8,26 million and this has been disclosed as fruitless and wasteful expenditure in note 52 of the 2019-20 annual financial statements.
51. The accounting officer was notified of the material irregularity on 26 February 2021 and was invited to make a written submission on the actions taken and that will be taken to address the matter. The accounting officer planned to ensure that the payments to SARS are made with the required timeframes, with zero interest and penalties charged by SARS and to strengthen controls over creditors and to prioritize third party payments and reconcile monthly.
52. On 25 August 2021, the accounting officer presented to council the section 52(d) of the MFMA report for 30 June 2021, file reference T6/1/1-2020/2021, confirming that the municipality has been experiencing cash flow challenges and that no official could be held liable for the financial loss.
53. I will follow up on the implementation of the planned actions during my next audit.

Salary payments to terminated employees

54. The municipality failed to ensure that terminated employees were exited timeously by the human resources department, thus resulting in the employees being paid months after they had left the municipality for the financial years 2015-16 to 2019-20, in contravention with section 65(2)(a) of the MFMA. The likely financial loss related to the non-compliance amount to R1,22 million as the municipality is in the process of investigating the issues and possibly recovering the debts from the terminated employees. The salary overpayments are disclosed as fruitless and wasteful expenditure in note 52 of the 2019-20 annual financial statements.
55. The accounting officer was notified of the material irregularity on 14 April 2021 and was invited to make a written submission on the actions taken and that will be taken to address the nhhhsalary overpayments on termination and to investigate and report the findings and recommendations to council for possible recovery, write-off or condonation.

56. On 16 April 2021, the accounting officer issued circular 6/2021, a memorandum to all strategic executive directors relating to the communication of all employee exits. On 09 August 2021, the accounting officer, engaged the internal audit unit to investigate unauthorised, irregular and fruitless and wasteful expenditure for 2017-18 to 2020-21 as per council resolution taken on 3 March 2021. The internal audit reported the outcomes of the investigation on 13 September 2021. The accounting officer plans to take the necessary actions based on the outcomes of the report and the council resolutions.
57. I will follow up on the implementation of the planned actions during my next audit.

Other reports

58. In addition to the investigations relating to material irregularities, I draw attention to the following engagements conducted which 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 compliance with legislation.
59. An investigation into allegations of fraud around the payroll system was undertaken by the Hawks covering the period July 2014 to June 2020. The investigation was in progress at the date of this auditor's report.
60. In terms of Presidential Proclamation No. R. 23 of 2020 as published in Government Gazette No. 43546 dated 23 July 2020, Special Investigating Unit is investigation matters relating to procurement of goods and services by the Newcastle Municipality under the national state of disaster. The investigation was still in progress at the date of this auditor's report.

Auditor-General

Pietermaritzburg

15 December 2021



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 the basic services key performance area 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 relating to events or conditions that may cast significant doubt on the ability of the Newcastle Municipality 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 my 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 operating as a going concern
 - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and determine 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.
4. I also provide the accounting officer with a statement that I have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on my independence and, where applicable, actions taken to eliminate threats or safeguards applied.