



30 September 2008

Preparatory Document: Report of the Auditor-General to Parliament on the Financial Statements and Performance Information of the Department of Water Affairs and Forestry (DWAF), 2004/05 – 2007/08

1. Introduction

The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Statements of Generally Accepted Accounting Practice (SA Statements of GAAP), and in the manner required by the Public Finance Management Act, 1999 (Act No 1 of 1999) (PFMA). This responsibility includes:

- Designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.
- Selecting and applying appropriate accounting policies.
- Making accounting estimates that are reasonable in the circumstances.

As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No 25 of 2004) (PAA), the responsibility of the Auditor-General to express an opinion on these financial statements. The auditor-general conducted the audit in accordance with the International Standards on Auditing and General Notice 616 of 2008, issued in Government Gazette No 31057 of 15 May 2008.

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 entity'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 entity's internal control. An audit also includes evaluating the:

- Appropriateness of accounting policies used.
- Reasonableness of accounting estimates made by management.
- Overall presentation of the financial statements.

In terms of audit reports, a poor audit outcome is an audit opinion that is qualified, adverse or disclaimed and includes matters of emphasis noted in the audit report. Irrespective of the audit outcome, the accounting officer must (in writing) explain specific serious transgressions, which may include the incurring of overspending, unauthorised, irregular and fruitless and wasteful expenditure. The following questions are crucial in examining the audit outcomes of respective departments:

- What is the outcome of the department's audit? Apart from overspending, does the audit identify any other unauthorised expenditure? Are any serious matters raised by the Auditor-



General under Emphasis of Matter and/or in the management letter sent to the accounting officer?

- At what point did the accounting officer become aware of the risk of overspending or under-spending? What remedial steps did the accounting officer take at that stage to prevent or deal with the problem?
- If monthly reports reflected under-spending, what steps were taken to improve spending capacity?

2. Tracking the auditor-general's report between the 2004/05 – 2007/08 financial years

In 2004/05, 2005/06 and 2007/08, the report of the auditor-general focused on the financial statements for the water trading account and the equipment trading account (2005 and 2006). The following was highlighted in 2005 and 2006:

2.1 Water trading account

The purpose of the Water Trading Account of the Department of Water Affairs and Forestry is to ensure the availability of water to key water users in South Africa in an efficient, cost-effective and sustainable way. This is done by managing infrastructure, which has been planned and built using the Departmental and other resources to meet evolving water use requirements in terms of national policy.¹

2.1.1 Financial statements

2005 Qualification Financial Statements	2006 Qualification Financial Statements
<p>The trading account's financial statements need to be prepared in accordance with Statements of Generally Accepted Accounting Practice, but the recording of the transactions are done on the Basic Accounting System, which is a cash recording system. This system does not provide for any accrual accounting and the relevant journal entries and as a result, information from manual and various computer systems are used to compile the financial statements.</p> <p>The lack of an appropriate documented and approved policy and procedure framework lead to control weaknesses. As at 31 March 2005, revenue, expenses, account's payable and account's receivable are not correctly stated. This is the validity and accuracy of accounts receivable and the related debtor interest amounts could not be determined as it includes unidentified deposits and a material number of transactions included without supporting documentation. Completeness and accuracy of accounts payable could not be determined as the audit at three out of nine regional offices revealed the omission of material accruals.</p>	<p>The trading account's financial statements need to be prepared in accordance with Statements of Generally Accepted Accounting Practice, but the recording of the transactions are done on the Basic Accounting System, which is a cash recording system. This system does not provide for any accrual accounting and the relevant journal entries and as a result, information from manual and various computer systems are used to compile the financial statements.</p> <p>The lack of an appropriate documented and approved policy and procedure framework lead to control weaknesses. The following transactions could not be supported with documentation:</p> <ul style="list-style-type: none"> • R324 million for revenue generated from rendering of services. • R13 million for other exchange revenue. • R12 million for provision against revenue.



2.1.2 Property, plant and equipment

In terms of **Property, Plant and Equipment** within the Water Trading Account, the following was reflected for the 2005 and 2006 Financial Year:

2005 Qualification	2006 Qualification
In terms of section 38(1) (d) of the Public Finance Management Act, 1999 (Act 1 of 1999), the accounting officer is responsible for the management, including the safeguarding and the maintenance of assets for the trading accounts.	The amount of R45, 1 billion disclosed as property, plant and equipment – Water Resources in the financial statements could not be substantiated with an asset register. Journal entries of R6, 7 million could not be validated with supporting documentation. The following matters were noted regarding assets: <ul style="list-style-type: none"> • Additions for the year could not be traced to the asset register. • Asset register does not indicate the location or barcode of some of the assets, the verification of assets from the asset to the register and vice versa could not be performed, and as a result, the physical verification of assets could not be done.

2.1.3 Non-adherence to accounting framework

In terms of **non-adherence to accounting framework** for the Water Trading Account for the year ending 31 March 2006, the following was noted:

Non-adherence to the requirements of the South African Statements of Generally Accepted Accounting Practice (GAAP) resulted in the following misstatements: <ul style="list-style-type: none"> • Accounts receivable had been understated with R540 million and Revenue had been understated with R329 million. These amounts include unexplained differences of R249 million between the regional accrual listings and the amounts disclosed in the financial statements. • The impairment of debtors amounting to R161 million had not been done in terms of IAS 39 and an additional provision of R216 million had been made that was not disclosed.

In terms of the disclaimer of audit opinion, emphasis of matter, the following aspects were noted in the 2005 and 2006 Auditor-General's reports:

2005	2006
Disclaimer of Audit Opinion Because of the significance of the matters referred to trading account's financial statements, the auditor-general's report did not express an opinion on the financial statements.	Disclaimer of Audit Opinion Because of the significance of the matters referred to in terms of non-adherence to the accounting framework, the auditor-general's report did not express an opinion on the financial statements.
Emphasis of Matter The following was emphasised: <ul style="list-style-type: none"> • Re-submission of financial statements – Financial statements submitted on 31 May 2005, have officially, withdrawn, and re-submitted on 29 July 2005 due to material misstatements. This is due to 	Emphasis of Matter The following was emphasised: <ul style="list-style-type: none"> • Lack of a policy framework – the inadequate policies and procedures also resulted in the following failures to adhere to the requirements of the PFMA and the Treasury Regulations.



<p>the lack of an appropriate documented and approved policy and procedure framework.</p>	<ul style="list-style-type: none"> • The framework for Supply Chain Management had not been adhered to. • The general ledger bank account was in overdraft in contravention of Treasury Regulation 19.3.2. • The requirements of section 16 of the Division of Revenue Act 2003 were not adhered to by the municipalities that receive grants and WTA had not monitored the adherence to the requirements. • Performance Information – in terms of section 20(2) (c) of the Public Audit Act, the performance of the department against the predetermined objectives is subject to auditing by the Auditor-General. The required information was not submitted for audit purposes. • Inadequate monitoring – material non-compliance in respect of the PFMA and Treasury Regulations was identified due to the lack of monitoring. Treasury Regulations section 19.2.3 determines that while a trading entity is allowed to open a bank account, the entity may not run an overdraft. The Annual Financial Statements for 2005/06 discloses the bank balance as being in overdraft of R1, 3 million.
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2.2 Equipment trading account

The business of the Equipment Trading Account is to provide equipment for the construction and maintenance of government water schemes. The tariffs on rental equipment are based on recovery of a usage charge and the maintenance of the equipment. No profit margin is built into the rental tariff.

This operation supports Departmental activities and revenue collection, and does not present any problems as the hire of equipment is mainly done within the operations of the Department. Revenue increased by 15.5% because of an increase in demand for equipment rental created by an increase in construction and maintenance projects.

2.2.1 Financial statements

<p>2005 Qualification Financial Statements</p> <p>The trading account's financial statements need to be prepared in accordance with Statements of Generally Accepted Accounting Practices (GAAP), but the recordings of the transactions are done on the Basic Accounting System (BAS), which is a cash recording system. The Annual Financial Statements fundamentally depart from the reporting requirements of GAAP.</p> <p>Material misstatements are present on the financial statement and impacts on the fair presentation of:</p> <ul style="list-style-type: none"> • Property, plant and equipment and related depreciation in that: <ul style="list-style-type: none"> • R944 000 disclosed as thefts and losses in the income statement are not included in disclosure note 4. • R8 978 000 of rebuilding costs disclosed as expenses and not fixed assets. • Sale of equipment to the amount of R9 087 000 was not included in note 4. 	<p>2006 Qualifications Financial Statements</p> <p>The trading account's financial statements need to be prepared in accordance with Statements of Generally Accepted Accounting Practices (GAAP), but the recordings of the transactions are done on the Basic Accounting System (BAS), which is a cash recording system. The Annual Financial Statements fundamentally depart from the reporting requirements of GAAP.</p> <p>Due to inadequate monitoring of the document management process, documentation supporting transactions in ETA to the value of R335 million could not be present for audit purposes.</p> <p>Inadequate Monitoring</p> <p>Material non compliance in respect of the PFMA and Treasury Regulations was identified as irregular expenditure amounting to R31 million, and has been incurred as the ETA was entered into finance leases without the approval of the Minister of Finance as required by section 66 of the PFMA</p>
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<ul style="list-style-type: none"> Assets with a book value of R106 101 000 relating to the 2003 – 04 financial year have been restated and decreased to one Rand. This is not consistent with the accounting policy and results in the contravention of Statements of Generally Accepted Accounting Practice. Retained earning – R1 522 000 of revenue relating to prior periods was included in the year under review, but sufficient documentation could not be furnished to support the amounts. 	<p>and TR 13.2.5. The irregular expenditure had not been disclosed as required by sections 40(3) (b) and 55(2) (b).</p> <p>Fixed Assets</p> <p>The asset register that was used to support the Annual Financial Statements did not meet the requirements of the fixed assets policy as:</p> <ul style="list-style-type: none"> Assets disclosed in the register with no acquisition cost. Acquisition for the year could not be traced to invoices. Incorrect treatment of additions resulted in assets being overstated with R31, 4 million.
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In terms of the disclaimer of audit opinion, emphasis of matter, the following aspects were noted in the 2005 and 2006 Auditor-General's reports:

2005	2006
<p>Adverse Audit Opinion</p> <p>Due to the effect on the financial statements of the matters referred to in Qualifications, the financial statements do not fairly present, in all material respects, the financial position of the Equipment Trading Account at 31 March 2005 and the results of its operations and cash flows for the year then ended, in accordance with GAAP, and in the manner required by the PFMA.</p>	<p>Disclaimer of Audit Opinion</p> <p>Because of the significance of the matters in the Financial Statements above, no opinion could be expressed on the financial statements.</p>
<p>Emphasis of Matter</p> <p>The following was emphasised:</p> <ul style="list-style-type: none"> Re-submission of financial statements – financial statements submitted on 31 May 2005, were officially withdrawn, and re-submitted on 29 July 2005 due to material misstatements. 	<p>Emphasis of Matter</p> <p>The following was emphasised:</p> <ul style="list-style-type: none"> Follow-up information systems audit of the audit of the greater computer controls for the Construction Equipment Management System – due to inadequate policies and procedure in respect of access, the programme had access to the production programmes and documented and approved change control management policies and procedures also did not exist. Furthermore, programme version control was not automated. Unauthorised changes to programmes could therefore occur that could compromise the integrity of the data. The above weaknesses may impact on the integrity of the data within the Construction Equipment Management System. The department is in the process of implementing SAP to address the problem. Performance information – In terms of section 20(2) (c) of the Public Audit Act, the performance of the department against the predetermined objectives is subject to auditing by the Auditor-General. The required information was not submitted for audit purposes. Inadequate Monitoring – material non-compliance in respect of the PFMA and Treasury Regulations was identified due to the lack of monitoring. TR section 19.2.3 determines that while a trading entity is allowed to open a bank account, the entity may not run an overdraft. The Annual Financial Statements for 2005/06 discloses the bank balance as being in overdraft of R1, 3 million.



3. Recent report of the auditor-general on the financial statements and performance information of vote 34 and the water trading entity for the year ended 31 March 2008

3.1 Budget Vote 34

Basis for qualified opinion

Tangible capital assets

- No assurance could be obtained regarding the completeness, existence and valuation of the closing balance of assets disclosed in note 30 to the annual financial statements due to the following:
 - Additions amounting to R44 475 000 as reflected in note 30, which relate to the purchase of machinery and equipment were not substantiated in the fixed asset register. Additional reconciliations and supporting schedules were submitted on 23 July 2008, and the auditor general was unable to conduct and complete this exercise and report by 31 July 2008.
 - An adjustment to the opening balance of fixed assets amounting to R98 708 000 for machinery and equipment was unsubstantiated.
 - An adjustment to the opening balance for biological and cultivated assets amounting to R297 214 000 was not audited due to the initial omission of this amount in the financial statements submitted on 30 May 2008 and late submission of supporting schedules. Alternative audit procedures could not be performed.

Emphasis of matter – significant uncertainties

Tangible capital assets: buildings and other fixed structures

- Based on a review that was conducted by a specialist, it can be concluded that the approach, methodology and procedures followed in the valuation process adopted in respect of buildings and other fixed structures amounting to R2 344 487 000, as reflected in note 30 to the annual financial statements, are scientifically sound. However, several refinements regarding the valuation of assets will only be completed by September 2008. As a result, it is uncertain at this point in time whether the valuation amount relating to 31 March 2008 will change significantly upon completion of the above exercise.

Highlighting critically important matters presented or disclosed in the financial statements

Local and foreign aid

- Expenditure amounting to R281 065 000 was incurred on the European Union water and sanitation service project during the year, while no donor funds had been received to defray the expenditure in the current year as the agreement was only signed and came into effect on



20 March 2008. As a result, there is an amount of R281 065 000 reflected as over-expenditure on this project.

Other matters

- Section 51(1) (a) (i) of the PFMA states that the accounting officer must ensure that the entity has and maintains effective, efficient and transparent systems of financial and risk management and internal control.
- With regard to the reporting item of tangible capital assets, 2 root causes (control environmentⁱⁱ and monitoringⁱⁱⁱ) gave rise to the inefficiencies in the system of internal control.

Non-compliance with applicable legislation

Division of revenue act

- Transfer payments budgeted for in terms of DoRA were not made in accordance with schedule 7 of DoRA. As a result, there were under- and overpayments to municipalities resulting in a net overpayment of R19 970 000.

Report on performance information

- The measurable objectives reported in the annual report of the Department are materially inconsistent when compared with the predetermined objectives as per the strategic plan and budget. Some measures/targets do not comply with the set criteria for determining the measures as required by the framework for managing programme performance information.

3.2 Water trading entity

The 2007/08 financial and performance information highlighted the following:

Basis for qualified opinion

Accounts receivable

- Included in accounts receivable is an amount of R82 615 244, which the trading entity has reflected as receivables. However, individual debtors disagree that some of these amounts are owed by them. The trading entity did not investigate all debtor balances for recoverability as required by the South African Statement of Generally Accepted Accounting Practice, IAS 39 (AC 133) *Financial instruments: Recognition and Measurement*. As a result, the above amount was not included in the provision for doubtful debts. Therefore, the value of receivables could be overstated by an unknown amount.



Emphasis of matters - Significant uncertainty

Property, plant and equipment: infrastructure assets

- Based on a review that was conducted by a specialist, it can be concluded that the approach, methodology and procedures followed in the valuation process adopted in respect of infrastructure assets amounting to R78 764 759 000, as reflected in note 5 to the annual financial statements, are scientifically sound. However, several refinements regarding the valuation of assets will only be completed by September 2008 and there is uncertainty regarding ownership or control of certain cross-border assets. A final policy decision needs to be taken regarding which off balance sheet assets will be included in the asset register. As a result, it is uncertain whether the valuation amount relating to 31 March 2008 will change significantly upon completion of the above exercise.

Restatement of corresponding figures

- As disclosed in note 19 to the financial statements, the corresponding figures for 31 March 2007 have been restated as a result of errors in the financial statements of the Water Trading Entity at, and for the year ended, 31 March 2007.

Other matters

Internal controls

- Section 51(1) (a) (i) of the PFMA states that the accounting officer must ensure that the entity has and maintains effective, efficient and transparent systems of financial and risk management and internal control.
- With regard to the reporting item of receivables, 2 root causes (control environment^{iv} and risk assessment^v) gave rise to the inefficiencies.

Non compliance with applicable legislation

Treasury regulations

- The trading entity had a bank account in overdraft at year end amounting to R99 600 654, in contravention of Treasury Regulation 19.2.3.

Report on performance information

Non-compliance with regulatory requirements

- The trading entity did not have a separate strategic plan indicating measurable objectives and targets for the year as required by Treasury Regulation 5.1.1. As a result, the achievements as disclosed in the annual report could not be measured against planned objectives.



Sources

Department of Water Affairs and Forestry (2007/2008), Annual Report

Department of Water Affairs and Forestry, *Strategic Plan, 2007/08 – 2009/10*

National Treasury, Estimates of National Expenditure 2008



ⁱ The information above was sourced from the Department of Water Affairs and Forestry, Annual Report 2005 and Annual Report 2006.

ⁱⁱ Control environment establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.

ⁱⁱⁱ Monitoring covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within a process.

^{iv} Control environment establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.

^v Risk assessment involves the identification and analysis by management of relevant financial reporting risks to achieve predetermined financial reporting objectives.