



AUDITOR - GENERAL

REPORT OF THE AUDITOR-GENERAL TO PARLIAMENT ON THE FINANCIAL STATEMENTS OF THE WATER TRADING ACCOUNT FOR THE YEAR ENDED 31 MARCH 2005

1 AUDIT ASSIGNMENT

The financial statements as set out on pages 198 to 207 for the year ended 31 March 2005, have been audited in terms of section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996), read with sections 4 and 20 of the Public Audit Act, 2004 (Act No. 25 of 2004). These financial statements, the maintenance of effective control measures and compliance with relevant laws and regulations are the responsibility of the accounting officer. My responsibility is to express an opinion on these financial statements, based on the audit.

2 NATURE AND SCOPE

The audit was conducted in accordance with Statements of South African Auditing Standards. Those standards require that I plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement.

An audit includes:

- examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements,
- assessing the accounting principles used and significant estimates made by management, and
- evaluating the overall financial statement presentation.

Furthermore, an audit includes an examination, on a test basis, of evidence supporting compliance in all material respects with the relevant laws and regulations which came to my attention and are applicable to financial matters.

The audit was completed in accordance with Auditor-General Directive No. 1 of 2005.

I believe that the audit provides a reasonable basis for my opinion.

3 QUALIFICATION

3.1 Financial statements

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.

The lack of an appropriate, documented and approved policy and procedure framework lead to control weaknesses as reported below.

As at 31 March 2005 revenue, expenses, account's payable and account's receivable are not correctly stated.

This is as 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.

Furthermore, -

- Accruals are overstated by R13 353 566.

- Revenue interest of R23 925 462 that were raised on debtor's accounts is not included in the income statement. Credit adjustments of R32 304 296 were also not processed in the income statement. The debit net effect is R8 378 834.
- The income statement does not reflect transactions of R268 794 557 processed in the SAP debtors module.
- Water Research levies due to the Water Research Commission and other amounts due to the equipment trading account are understated by R24 648 746. This is due to a lack of reconciliations.
- Included in the R1 266 666 373 disclosed in Note 4.1 to the financial statements is an amount of R11 774 075 written off in respect of debts of various entities for which no approval to write-off could be furnished.
- The restated closing balances in respect of water services' assets differ by R41 078 000 in relation to the opening balances on the financial statements of the 2004-05 financial year.

3.2 Property, plant and equipment

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.

Due to the lack of a control framework to perform independent reconciliations and checks, it was noted that the fixed asset register contains invalid bar code numbers. Fixed assets of R14 198 000 included in Note 4 to the financial statements could not be verified.

The replacement value instead of the fair value less any subsequent accumulated depreciation was disclosed on the balance sheet. This resulted in fixed assets being overstated by an unknown amount.

4 DISCLAIMER OF AUDIT OPINION

Because of the significance of the matters referred to in paragraph 3, I do not express an opinion on the financial statements.

5 EMPHASIS OF MATTER

Without further qualifying the audit opinion expressed above, attention is drawn to the following matter:

5.1 Re-submission of financial statements

Financial statements submitted on 31st May 2005, have officially been withdrawn and re-submitted on 29th July 2005 due to material misstatements. The misstatements result from a cash accounting system and employees not trained to prepare financial statements in accordance with the required accounting standards.

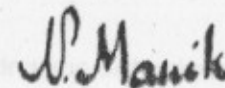
6 INFORMATION SYSTEMS AUDIT OF THE GENERAL CONTROLS SURROUNDING THE WARMS SYSTEM

An information systems audit of the general controls of the information technology environment was completed in July 2005 and the findings were brought to the attention of the accounting officer.

Due to a lack of properly defined procedures, access controls were not effectively maintained.

7 APPRECIATION

The assistance rendered by the staff of the Water Trading Account during the audit is sincerely appreciated.



**N Manik for Auditor-General
Pretoria
14/9/2005**

MANAGEMENT REPORT OF WATER TRADING ACCOUNT FOR THE YEAR ENDING 31 MARCH 2005. REPORT BY THE ACCOUNTING OFFICER TO THE EXECUTIVE AUTHORITY AND PARLIAMENT OF THE REPUBLIC OF SOUTH AFRICA

Operation Review

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.

The water trading account is divided into four components. These are designed to reflect the type of service provided and also the probable future institutional homes of the activity concerned. The four sub-accounts are:

- Integrated Catchment Management,
- Integrated Systems,
- Bulk water Supply and
- Water Services

Integrated Catchment Management

The provision of water resource management services, including but not limited to water allocation and control of use, water resource protection and pollution control, clearing of waterweeds and alien vegetation that impact on the water resources and other functions that in terms of the National Water Act will eventually be delegated to statutory Catchment Management agencies.

Integrated Systems

The supply of bulk raw water from integrated systems which together comprise the National Water Infrastructure at agreed of reliability to bulk water users and the funding, in terms of agreements, of the construction of major water resources projects such as the Lesotho Highlands Water Project Phase I, the Komati Basin Water Development Project, the Berg River Water Project, the Olifants River Development Project and others.

Bulk Water Supply

The provision of bulk raw water from independent systems which do not form part of the National Water infrastructure to major water users, at agreed levels of reliability to bulk water users; and the provision of raw water to the individual water users on Government water Schemes which will in future be managed by statutory Water Users Association or related autonomous agencies.

Water Services

The provision of basic water services in predominantly rural areas where municipalities have not yet taken over this function and the provision of bulk potable water supplies to certain municipalities.

Water services tariffs for users are determined and approved by the Municipality which is the Water Service Authority (WSA) for the area concerned in terms of regulations promulgated under section 10(I) of the Water Service Act 108 of 1997. They are not normally paid to the Department. The water services function is being transferred to local authorities in terms of legislation. The operations and maintenance of these schemes has, since 2001, been funded by a "grant in kind" under the provisions of the Division of Revenue Act. In the current year, 27 schemes with value of R1 207 million have been transferred. It is estimated that this transfer process will be completed by the end of March 2006 and that the subsidy will be consolidated into the equitable share by 2012. As part of the process the Department refurbishes the schemes before the transfer so that the transferred schemes are sustainable.

Working for Water

The Working for Water Programme which is undertaken under the Integrated Water Resources Management sub-account undertakes a number of functions in addition to removing alien vegetation that impacts on water resources. These include the promotion of bio-diversity and nature conservation and the provision of certain welfare services, as well as research and policy formulation.

Major projects undertaken during the year

The Berg Water Project (BWP) is being built to augment the water supplies from the Western Cape Water System by 81 million m³ to 523 million m³ per year by 2007. It will be integrated with the Riviersondereinde-Berg River Government Water Scheme.

The Minister of Water Affairs and Forestry directed TCTA in terms of section 103(2) of the National Water Act, 1998 to fund and implement the BWP as agent for DWAF.

TCTA has entered into an Implementation Agreement with DWAF, which has a Raw Water Supply Agreement with the City of Cape Town. These two agreements will govern the funding, implementation and raw water supply and payment of the BWP. The Project will be operated and maintained by DWAF on completion of construction, as part of the Western Cape Water System.

The Olifants River Water Resources Development Project is being implemented by the Department of Water Affairs. On 09 June 2004 this project was approved by Cabinet with the vision of providing water to unlock the vast mineral wealth in a region (mostly in the vicinity of Sekhukhune and Mogalakwena areas) spanning both Limpopo and Mpumalanga Provinces, and thereby stimulating much needed economic growth in one of the poorest parts of the country. The Project will also create significant employment opportunities as well as enable the supply of safe potable water to thousands of poor rural households. The capital cost of the water resource infrastructure has been estimated at R4 000 million, which will be spent over a period of about 10 years or longer, as different components of the project are phased in to meet the growth in

water requirements. The first water from the Project is planned to be available in 2010.

The detail planning of the Project as well as the environmental impact assessment has been completed, whilst the design of the dam is at advanced stage. It is expected that environmental authorisation for the implementation of the Project will be obtained by September 2005. Construction of the first elements can commence early in 2006, provided that funding of the project is secured. Various funding options are currently being investigated. A preliminary phase of the project, the raising of the Flag Boshelo dam, is already under construction.

Revenue Generation and Collection

The Department is continuing to manage outstanding revenue and has reached settlement agreements in a number of cases. Local authority debt to the value of R1 266 666 000 has been written off because it cannot be recovered due to change in demarcation of local boundaries in 1997.

Revenue collected by the sub-account Integrated Catchment Management was supplemented by an earmarked allocation to fund for the Working for Water programme's activities which are carried out under this sub-programme since it is the intention of government that water users should contribute to the cost of controlling alien vegetation that impact on water resources.

Revenue in the Bulk Water Supply sub-account, which comes principally from agricultural water users, is limited by the National Water Pricing Policy which, has set along-term goal of achieving full coverage of operating costs by revenue, although there is a ceiling on annual price increases.

Spending and Augmentation on the trading account

Currently, only the integrated systems sub-account generates a surplus. The Water Service sub-account was primarily funding by a conditional Local Government grant in terms of the Division

of Revenue Act which is accounted for as an augmentation of the trading account.

Tariff policy for Water Resources

Water Resources:

The pricing policy for water resources is established in terms of Chapter 5 of the National Water Act, 1998. The raw water pricing strategy provided for by the Act was established on 12 December 1999 by a notice in the Government Gazette.

Water uses subject to pricing:

- Taking water from a water resource;
- Storing water;
- Impeding or diverting the flow in a watercourse;
- Engaging in a stream flow reduction activity;
- Engaging in a controlled activity;
- Discharging waste or water containing waste into a water resource by means of a conduit;
- Disposing of waste in a manner which may detrimentally impact on a water resource;
- Disposing of water which is heated by and/or contained waste from any industrial or power generation process;
- Altering the bed, banks, course or characteristics of a watercourse;
- Removing, discharging of water found underground; and
- Using water for recreational purposes.

The pricing strategy currently covers the following three consumptive water uses:

- Taking water from the water resource (underground or surface water);

- Storing water: while obstruction from dam or recharged aquifer will normally constitute the use, the annual refilling of dams constructed to enhance property value or for recreation, and which are located in important water-courses, constitute the use. Charges are based on an estimation of evaporation losses; and
- Engaging in a stream flow reduction activity, such as a forestation.

A revised pricing strategy has been developed and is currently under statutory consultation. It includes new changes for waste discharge.

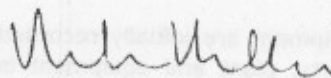
Progress with Financial Management Improvement

A consolidated fixed assets register was established and the asset management policy developed.

The Department implemented a SAP Billing Module system in April 2002 in order to manage revenue from the water resource trading sub-account. This system is being extended to the financial management of the entire Water Trading account and will go live on 1 April 2006. This will enable the department to operate accrual accounting on an integrated basis.

Approval

The annual financial statement has been approved by the Accounting Officer.



A.M. Muller
DIRECTOR-GENERAL

Accounting Policies

1 Basis for preparation

The financial statements have been prepared in accordance with South African Statement of General Accepted Accounting Practice using historical cost as modified by the revaluation of property, plant and equipment. The financial statements are prepared on a going concern basis.

1.1 Revenue

Sales which exclude value added taxes are recorded when service has been rendered and invoice issued. Commission from Water Research Levy collection is recognised when the department collects cash on behalf of Water Research Commission.

Interest income is recognised on a time proportion basis taking account of the principal outstanding and the effective rate over the period to maturity when it is determined that such income will accrue to the department.

1.2 Government grants

Government grants are recorded as deferred income when they become receivable and are then recognised as income on a systematic basis over the period necessary to match the grants with the related costs that they are intended to compensate.

1.3 Property, plant and equipment

All items of property plant and equipment are initially recorded at cost or replacement cost. Property, plant and equipment is carried at cost or replacement value less accumulated depreciation. Depreciation is calculated on a straight-line basis over the expected useful lives of the assets. The estimated useful lives of the assets are as follows:

Infrastructure assets: Roads	15 - 25 years
Infrastructure assets: Water	45 years
Dwellings: Mobile homes	4 - 5 years
Buildings:	25 - 30 years
Computer equipment:	3 years
Office equipment and furniture	5 years
Appliances	5 years
Machinery and equipment	5 years
Tools	2 years
Protective clothing	1 year

Replacement cost is based on valuation that is done every ten years. Increases in carrying value arising on revaluation are credited directly to a revaluation reserve. On disposal of the previous revalued property any amount relating to that asset remaining in the revaluation reserve is transferred to profit or loss for the period.

Repairs and maintenance are generally charged to expenses during the financial period in which they are incurred. However, major renovations are capitalised and included in the carrying amount of the asset when it is probable that future economic benefits in excess of the originally assessed standard of performance of the existing asset will flow to the trading entity. Major renovations are depreciated over the remaining useful life of the related asset.

1.4 Financial Instruments

Receivables are carried at the original invoice amount less provision made for impairment of these receivables. Such provision for impairment of receivables is established if there is objective evidence that the department will not be able to collect all amounts due according to the original terms of receivables. Receivables for services delivered are recognised in the balance sheet as a current asset and as revenue in the income statement since the financial statements are prepared on an accrual basis of accounting and supported by a separate disclosure in the notes to enhance the usefulness of the financial statements.

Payables are carried at the fair value of the consideration to be paid in future for goods or services that have been received or supplied and invoiced or formally agreed with the supplier. Payables for services delivered are recognised in the balance sheet as current liabilities and as expenditure in the income statement as the financial statements are prepared on an accrual basis of accounting and supported by a separate disclosure in the notes to enhance the usefulness of the financial statements.

1.5 Inventory

Inventory is stated at the lower of cost and net realisable value. Cost is determined using the weighted average cost method. Net realisable value is the estimated selling price in the ordinary course of business less the costs of completion and selling expenses. Water that is sold is classified as a service rendered instead of being classified as inventory since there is no value that can be attached to water.

At each balance sheet date the department reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets may be impaired. If any such indication exists the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount for an individual asset the recoverable amount is determined for the cash-generating unit to which the asset belongs.

1.6 Provisions

A provision is a liability of uncertain timing or amount which is recognised when trading entity has a present legal or constructive obligation as a result of past events when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and when a reliable estimate of the amount of the obligation can be made.

1.7 Leases

Leases where a significant portion of the risks and rewards of ownership are transferred to the lessee are classified as finance leases.

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

When operating lease is terminated before the end of the lease term, any payments required to be made by the lessor by way of penalties are recognised as an expense in the period in which termination takes place.

1.8 Contingent liabilities

The amount of contingent liabilities represents all outstanding litigation against the trading entity at the end of the financial year. Where the trading entity expects part of the provision to be reimbursed under the insurance contract the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

1.9 Employee benefits

Short-term employee benefits

The cost of short-term employee benefits is accrued for and recorded in the income statement in the reporting period in which it occurs.

Termination benefits

Termination benefits are payable whenever an employee's employment is terminated before the normal retirement date or whenever an employee accepts voluntary redundancy for these benefits or resigns. The department recognises termination benefits when it is demonstrably committed either to terminate the employment of current employee(s) according to a detailed formal plan without possibility of withdrawal or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Benefits falling due more than twelve months after the balance sheet date are discounted to present value.

Retirement benefits

The department provides retirement benefits for its employees through a defined benefit plan for government employees. These benefits are funded by both employer and employee contributions. Once the department has paid the contributions, the department has no further payment obligations.

Medical benefits

The department provides medical benefits for its employees through defined benefit plans. These benefits are funded by employer and/or employee contributions. No provision is made for medical benefits in the financial statements of the department. Post-retirement medical benefits for retired civil servants are recognised in the financial statements during the period the period in which they occur.

1.10 Intangible assets

Intangible assets are measured initially at cost. Intangible assets are recognised if it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise and the cost of the asset can be measured reliably.

1.11 Cash and cash equivalents

Cash and cash equivalents are carried at cost in the balance sheet. For the purposes of the cash flow statement, cash and cash equivalents comprise cash on hand, deposits held at call with banks, other short-term highly liquid investments with maturities of three months or less, and bank overdrafts. Bank overdrafts are included within borrowings in current liabilities in the balance sheet.

1.12 Comparative figures

Where necessary, comparative figures have been adjusted to conform to changes in presentation in the current year.

BALANCE SHEET AT 31 MARCH 2005

	Note	2005 R'000	2004 R'000
ASSETS			
Non-current assets			
Intangible assets	9	28	19
Property, plant and equipment	10/10.1/10.2	50 081 878	52 031 181
Current assets			
Inventory		17 932	26 988
Accounts receivable	8	813 029	2 014 969
TOTAL ASSETS		50 912 867	54 073 157
LIABILITIES			
Non-current liabilities			
Current liabilities			
Bank overdraft	7	349 282	218 603
Provisions	11	249 015	244 804
Accounts payable	12	360 374	346 179
Prepayments	13	-	605
EQUITY			
Capitalisation reserve	19	51 886 946	52 642 505
Accumulated deficit/surplus		(1 932 750)	620 461
TOTAL EQUITY AND LIABILITIES		50 912 867	54 073 157

**INCOME STATEMENT FOR THE YEAR ENDED
31 MARCH 2005**

	Note	2005 R'000	2004 R'000
Revenue	3	3 820 336	3 731 066
Direct operating expenditure		(1 618 224)	(2 009 895)
Operating expenses		(5 399 660)	(2 702 543)
Administrative expenditure		(323 914)	(271 671)
Deficit from trading activities	4	(3 521 462)	(1 253 043)
Net investment income	5	4 664	2 561
Net deficit for the period		(3 516 798)	(1 250 482)

**STATEMENT OF CHANGES IN EQUITY FOR THE
YEAR ENDED 31 MARCH 2005**

	Note	2005 R'000	2004 R'000 Restated
Accumulated deficit			
Opening balance		620 461	-
Deficit for the period as previously stated		(3 516 798)	(1 250 482)
Impact of restatement of assets		-	55 156
Impact of restatement of accounts receivable balance		-	1 815 787
Revaluation reserve recognised		963 587	-
Closing balance		(1 932 750)	620 461
Revaluation reserve			
Opening balance as previously stated		52 642 505	54 280 577
Revaluation reserve on valuation of assets		208 028	-
Reserve realised on transfer of scheme assets		(963 587)	(820 852)
Revaluation reserve as previously stated	19	51 886 946	53 459 725
Impact of restatement of assets		-	(817 220)
Restated closing balance		51 886 946	52 642 505
TOTAL EQUITY AND RESERVES		49 954 196	53 262 966

**CASH FLOW STATEMENT FOR THE YEAR
ENDED 31 MARCH 2005**

	Note	2005 R'000	2004 R'000 Restated
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash receipts from customers		2 495 580	2 203 374
Government grant		1 356 017	1 360 928
Cash paid to suppliers and employees		(3 976 519)	(3 772 513)
Cash generated from operations	14	(124 922)	(208 211)
Interest received	5	4 664	2 561
Net cash flows from operating activities		(120 258)	(205 650)
CASH FLOWS FROM INVESTING ACTIVITIES			
Additions to property plant and equipment	9/10	(10 421)	(12 953)
Proceeds from sale of property plant and equipment		-	-
Net cash flows from investing activities		(10 421)	(12 953)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from loans		-	-
Net (decrease) in cash and cash equivalents		(130 679)	(218 603)
Cash and cash equivalents at beginning of period		(218 603)	-
Cash and cash equivalents at end of period	7	(349 282)	(218 603)

	2005 R'000	2004 R'000 Restated
3 Revenue		
Revenue comprises the following:		
Sale of water	2 454 837	2 349 302
Water research fund	393	1 506
Government grants	1 356 017	1 360 928
Other income	9 089	19 330
	<u>3 820 336</u>	<u>3 731 066</u>

Government grants were unconditionally granted to the department in order to cover operating expenditure. The department did not receive any other form of assistance from the state during the period under review.

4 (Deficit) from trading activities

The following were (added)/deducted in arriving at the deficit from operations:

Personnel expenditure	727 409	695 843
Professional and special services	420 131	440 106
Transfer payments	436 225	425 813
Repairs and maintenance	95 765	141 474
Consumable stock	85 603	101 840
Bad debts written off	-	2 071
Operating lease expenses	5 415	13 306

Depreciation and amortisation: 1 245 235 679 414

Vehicles	50	15
Tools	101	-
Scientific instruments	410	40
Furniture	438	518
Computer equipment	1 839	391
Office equipment	582	65
Appliances	438	79
Boreholes	131	20
Buildings	302	56
Depreciation on water resources assets	1 017 039	395 670
Depreciation on water services assets	220 713	282 079
Clothing and protective gear	1 106	-
Machinery and equipment	2 070	473
Amortisation	16	8

	Note	2005 R'000	2004 R'000
Loss on transfer of fixed assets		922 508	793 441
Audit fees		1 345	44
Current year audit fees		<u>1 345</u>	<u>44</u>
Impairment loss		1 267 676	64 364
Internal receivables		<u>1 010</u>	<u>1 070</u>
External receivables	4.1	1 266 666	63 294
Realised revaluation reserve		<u>(963 587)</u>	<u>(820 852)</u>
Unallocated deposits	4.2	<u>894 516</u>	<u>-</u>

4.1 Water service receivables written off

During the year an amount of R1 266 666 000 pertaining to water services receivables was written off. This was due to the fact that subsequent to the department having billed some water users, specific funds were made available in terms of DORA (Division of Revenue Act). These funds were specifically intended to fund the operations of these water services schemes. In order to avoid double charging it was necessary for the department to write off the amounts that had been billed to water services customers.

4.2 Unallocated Deposits

The Department has installed a SAP billing module to manage revenue on an accrual basis to replace the transversal BAS which only operates on a cash basis. Due to problems in the interface with the transversal systems, transaction identification information was lost. The resulting unallocated receipts of R894 516 000 are being reconciled manually.

5 Investment Income

Investment income comprises the following:

Interest received	(4 693)	(2 631)
Interest paid	<u>29</u>	<u>70</u>
	<u>(4 664)</u>	<u>(2 561)</u>

6 Operating Leases

The department's future minimum lease payments under non-cancellable operating leases are as follows:

Not later than 1 year	5 427	1 859
2 - 5 years	<u>8 486</u>	<u>2 831</u>
	<u>13 913</u>	<u>4 690</u>