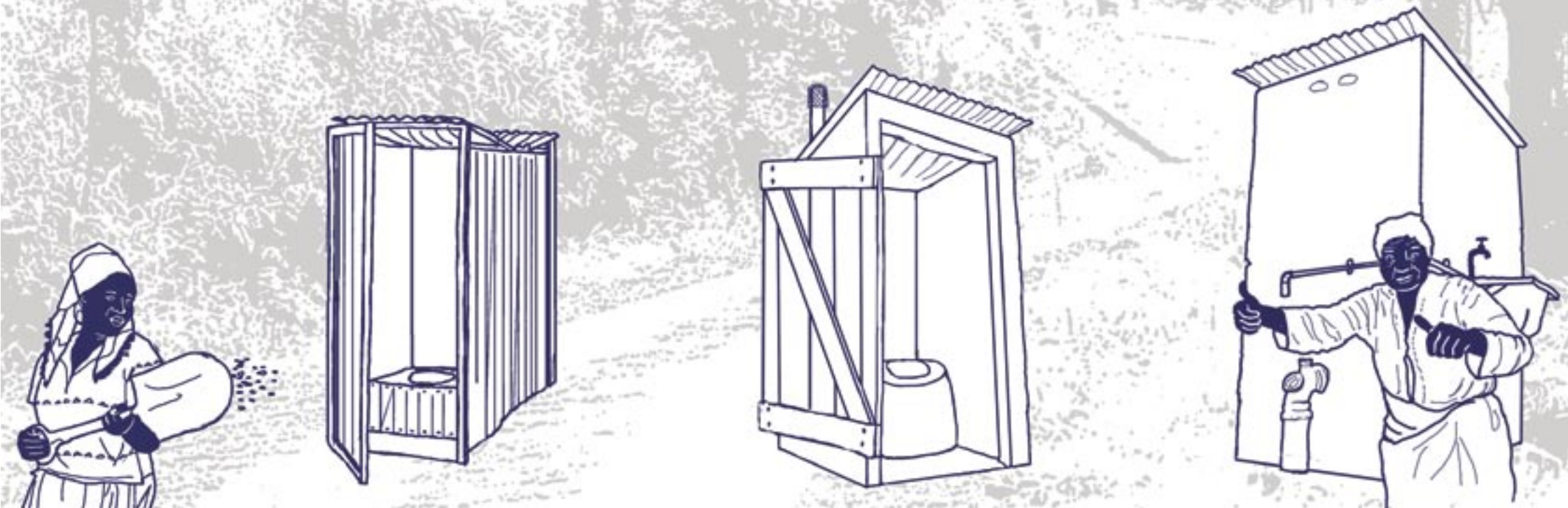


PART D: ANNUAL FINANCIAL STATEMENTS



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MANAGEMENT REPORT FOR THE YEAR ENDED 31 MARCH 2004

Report by the Accounting Officer to the Executive Authority and Parliament of the Republic of South Africa.

I. General review of the state of financial affairs

• Important policy decisions and strategic issues facing the department

The Department of Water Affairs and Forestry continues to work towards building a better life for all. It seeks to ensure that the country has reliable supplies of water, for sustainable social and economic development. It encourages water conservation and manages demand. It also manages and expands the national water resource infrastructure where necessary. To address poverty, the Department continues to promote the provision of municipalities of the infrastructure required to reduce the backlog in access to basic water supply and sanitation. It also regulates and promotes the provision of efficient and sustainable water services at municipal level and still runs substantial water services operations which are to be transferred to local government. In forestry, the Department continues to manage some plantation and indigenous forests but the emphasis is on transferring direct management responsibilities to more appropriate organizations in both public and private sector. A key area is the restructuring of plantations run by the Department, with an emphasis on ensuring black economic empowerment and economic benefits to the communities that rely on the forests. After 1994 the Department's agenda was dominated by the development of new policies, legislation and implementation programmes for its three functional areas: water resources management, water services and forestry. By the end of 1998, the Department had put in place three new policies and four new laws, which introduced fundamental changes and created the framework for the Department to give effect to the Constitution.

Water resources management

The National Water Act (36 of 1998) replaced previous legislation with an equitable system of administrative authorisations to use water, and Government became the public trustee of the nation's water resources. The Department is responsible for administering all aspects of the new Act, and for the development and implementation of related policies, strategies and regulatory instruments. It is also responsible for planning, developing, operating and maintaining the water resources management infrastructure

owned by the state, and for overseeing the activities of all water management institutions. This role will change over time, as 19 new regional water management institutions – catchment management agencies – are established. The creation of a national water utility is also being considered, to manage national infrastructure and to develop new infrastructure.

Water services

The 1994 water and sanitation White Paper determined that the role of the Department was a direct delivery function on behalf of Government: to rapidly provide basic water and sanitation services to people living primarily in rural areas. This function came to an end at the end of the 2003/04 financial year and in future local government will assume responsibility for delivery, operation and maintenance of water and sanitation services as provided for in the Constitution. The role of the Department will change from direct provider to sector leader, supporter and regulator. Important new government policies have been developed and implemented since the 1994 White Paper and these have been reflected in the Water Services Strategic Framework, approved by Cabinet in September 2003. The new approach may lead to some amendments to the Water Services Act (108 of 1997).

The financial framework for water and sanitation services has changed significantly. In the past the Department has been an important financier of water investments, but this responsibility came to an end at the end of March 2003. As from the beginning of the 2004/05 financial year financing of basic water supply and sanitation will be through the Municipal Infrastructure Grant, under the auspices of the DPLG. Operating funds and functions will be transferred to local government over a multi-year period.

Forestry

The Department promotes the sustainable management of South Africa's indigenous and commercial forest resources.

It aims to ensure that commercial plantations are regulated and managed in a sustainable manner to promote investment, employment, competition and black empowerment, as well as rural development. It seeks to ensure that there is an effective system to monitor, regulate and manage the protection and use of South Africa's indigenous state forests. The 1996 White Paper on Sustainable Forest Development focused on the transformation of the forest sector to serve the needs of South Africa and its people. The National Forests Act (84 of 1998) and the National Veld and Forest Fires Act (101 of

1998), which followed, impact on the Department's work, and on all players in the sector. A great deal of attention has been focused on the restructuring of the forests and plantations run by the Department. The process of disposing of the category A or large and economically viable plantations is largely complete. The emphasis has been on ensuring black empowerment, and that the communities that rely on the forests benefit economically. The Department's efforts have ensured that private companies and communities engage in innovative partnerships to their mutual benefit.

- Significant events that have taken place during the year
In 1994 the Department became the owner and operator of water services infrastructure transferred from the former homeland administrations. In addition, the Department has continued to operate some basic water services capital projects implemented through the Community Water Supply and Sanitation Capital Programme. In order to give effect to the constitutional and other legal frameworks regulating water services provision, the Department

Comment on major projects undertaken or completed during the year

Water Services Projects completed during 2003/04

Project Code	Region	Project Name	Project Type	End of Construction	FMS 02/03	BAS 03/04
EC513	Eastern Cape	Mdina SAN	S	30-05-03	446 644	981 064
KN046	KwaZulu Natal	Sidinsi	W	01-10-03	36 742	210 424
KN082	KwaZulu Natal	Mbonambi	W	30-05-03	1 507 659	504 300
KN123	KwaZulu Natal	Kholweni	W	25-09-03	0	6 669 116
KN124	KwaZulu Natal	Bhekumthetho	W	15-07-03	2 094 945	905 498
KN232	KwaZulu Natal	Vutshini	W	30-04-03	2 462 525	300 741
KN236	KwaZulu Natal	Mthimude	W	12-04-03	-1 213 000	13 037
KN261	KwaZulu Natal	Shemula San	S	30-07-03	1 356 864	44 049
KN325	KwaZulu Natal	Ophuzane San	S	30-10-03	580 288	104 394
KN355	KwaZulu Natal	Ufasimba	W	30-09-03	1 271 289	1 333 944
KN404	KwaZulu Natal	Nkonjeni	W	14-04-03	856 242	1 882
KN463	KwaZulu Natal	Kransdraai San	S	31-10-03	284 621	78 332
KN544	KwaZulu Natal	Mvazane	W	28-10-03	191 972	1 522 084
KN548	KwaZulu Natal	Nteneshana	W	28-10-03	702 487	2 289 442
KN549	KwaZulu Natal	Ndlovu	W	22-08-03	1 061 061	1 717 542
NW032	North West	Ga-Mopedi, Ntsweng and Sedibeng Water Supply	W	01-09-03	3 175 736	579 544
NW037	North West	Bulk Water Supply to Oskraal and Environs	W	04-07-03	3 527 846	1 976 989
		Totals (Values)			18 343 921	19 232 380

is implementing a comprehensive programme to transfer the water services works that it currently owns and/ or operates to the relevant water services authorities/institutions over three years.

In terms of the programme which is included in the Division of Revenue Act, all transfers should be effected by June 2005 with all conditional grants (subsidies) phased out by June 2011 at which stage the conditional grants will be incorporated into the equitable share allocations to local government. By the close of financial year transfers had been made to Mangaung Local Municipality, Bloem Water, Ethekweni Metro, Umhlatuze District Municipality, Amajuba District Municipality, Zululand District Municipality, Ugu District Municipality, Ilembe District Municipality, Umkanyakude District Municipality, Newcastle Local Municipality, Utukela District Municipality, Lephalale Local Municipality. The present day value of the assets transferred to these institutions is R 610 million.

Projects started during 2003/04

Project Code	Region	Project Name	Project Type	Start of Construction	FMS 02/03	BAS 03/04
EC601	Eastern Cape	Qoqodala Sanitation	S	06-01-04	0	1 450 000
EC707	Eastern Cape	Klipplaat Bulk Water Supply	W	01-10-03	0	300 000
KN424	KwaZulu Natal	Springvale	W	25-08-03	0	2 984 039
KN528	KwaZulu Natal	Ndelu	W	23-01-04	0	125 939
KN546	KwaZulu Natal	Ompentsheni	W	04-08-03	0	357 651
KN547	KwaZulu Natal	Hlabathini	W	18-08-03	0	687 585
KN550	KwaZulu Natal	Zigagayi	W	14-08-03	0	562 284
KN556	KwaZulu Natal	Vukuzithatha San	S	05-01-04	0	34 721
MP203	Mpumalanga	Water provision to rural areas	W	28-02-04	0	1 000 000
MP207	Mpumalanga	Water Reticulation for Sisulu/Isipingo -430 stands	W	03-02-04	0	1 330 000
MP211	Mpumalanga	Water to 3060 stands in Govan Mbeki Municipality	W	30-09-03	0	2 000 000
MP212	Mpumalanga	Stand connections in Govan Mbeki Municipality	W	20-10-03	0	1 000 000
MP215	Mpumalanga	Phasing out buckets with VIP toilets	S	13-10-03	0	3 000 000
MP220	Mpumalanga	Bulk WWS upgrade to Magonong incl Reticulation	W	23-11-03	0	2 000 000
MP233	Mpumalanga	Witbank: Internal water network (1500 x stands)	W	16-02-04	0	1 950 000
MP267	Mpumalanga	Ericsville Network	W	12-02-04	0	850 000
MP287	Mpumalanga	eMjindini: Reservoir	W	02-12-03	0	1 400 000
NW035	North West	Lower Mayeakgoro Water Supply	W	15-05-03	0	3 904 685
NW132	North West	Central Rural Water Supply Programme	W	26-05-03	0	13 461 494
NW134	North West	Southern DM RWSP	W	01-07-03	0	2 588 535
NW135	North West	Kgalagadi Rural Water Supply Programme	W	01-04-03	0	7 772 183
NW136	North West	Bojanala DM Rural Water Supply	W	01-10-03	0	4 940 916
WC042	Western Cape	Weltevrede RWS	W	12-05-03	0	2 061 000
		Totals (Values)			0	55 761 033

Spending trends

- Reasons for under/(over) spending:
Please see notes to the Appropriation Statement.

Programme 1:Administration: Underspending R23,162 million.

Impact on programmes and service delivery:

There should be no impact on service delivery.

Actions taken to prevent recurrence:

Actions have been taken to improve the reporting of expenditure through BAS, e.g., training the personnel responsible to capture information timeously.

In relation to transfer expenditures, a multi disciplinary Joint Response Facility (JRF) has been established to give support to municipalities in respect of both transfers and section 78 assessments. The JRF will identify capacity gaps and recommend interventions to ensure that we are able to achieve the target dates for the programme. Unions have now committed to the establishment of a Water Sector Transformation and Restructuring Committee which should facilitate negotiations on staff transfers.

Programme 2:Water Resource Management: Underspending: R77,372 million.

Impact on programmes and service delivery:

The impact of the underspending has been slight since it resulted largely from an increase in available funds. Most of the activities for which the funds were allocated (drought relief) have commenced and the funds are already committed.

Actions taken to prevent recurrence:

In the event of severe and unforeseeable natural events, such as floods and droughts, the planned work of the Department is always likely to be affected. None the less, certain actions have been taken to prevent a recurrence of the underspending for 2003/04, e.g. a request has been made to the Minister of Finance to enhance the systems for provision of emergency funds to avoid the delays which resulted in the late release of funds to the Department.

A plan is in place to ensure the effective spending of any increase in revenue in the current financial year.

Programme 3:Water Services: Underspending: R341,405 million.

Impact on programmes and service delivery:

If the request for roll-overs are successful, the impact of the underspending would be negligible. However, if it is not granted, the Department will be faced with major problems of claims for not honouring contractual commitments which could lead to fruitless expenditure of legal actions and paying of interest. In the case of transfer of payments for drought relief which could not be done to Local Authorities, a similar situation will arise.

There should be no impact on service delivery due to the delay in transfers as the Department retains the responsibility for management, operation and maintenance of the functions up to the point that transfer agreements have been concluded and migration of the function takes place.

The fact that the Trading Account was not augmented by a similar amount than budgeted for will have no impact on the 03/04 budget no on 04/05 budget. It must be emphasised that this was a once off situation caused by the drought which will not provide a sustainable trend.

Actions taken or planned to avoid recurrence:

Actions have been taken to improve the reporting of expenditure through BAS, e.g., training the personnel responsible to capture information timeously. Systems will also be put in place to prevent the pile-up of transaction during the last month of the financial year.

A multi disciplinary Joint Response Facility (JRF) has been established to give support to municipalities in respect of both transfers and section 78 assessments. The JRF will identify capacity gaps and recommend interventions to ensure that we are able to achieve the target dates for the programme. Unions have now committed to the establishment of a Water Sector Transformation and Restructuring Committee which should facilitate negotiations on staff transfers.

National Treasury has been asked not to transfer funds at the end of the financial year in future.

Programme 4: Forestry: Underspending R15,154 million.

Impact on programmes and service delivery:

The Treasury has already been requested to roll-over the unspent funds to the 2004/05 financial year. If this request is approved it will have no impact on the budget or service delivery.

Actions taken or planned to avoid recurrence:

The Department is currently undertaking negotiations to SAFCOL and if successful there might not be any future payments to SAFCOL.

2. Services rendered by the Department

2.1 The following services are rendered by the Department:

The main services rendered by the Department are to ensure that water is provided to all South Africans in an efficient and cost-effective and sustainable way and to manage and sustain our forests, using the best scientific practice in a participatory and sustainable manner. Details of these services are covered under the different Key Performance Areas within the programmes.

2.2 Tariff policy

Water Services:

Water Service tariffs should in all cases be set/approved by the WSA.

In determining tariffs the following items are taken into account (as per regulations in terms of section 10(1) of the WSA Act 108 of 1997):

- a) the cost of water purchases;
- b) overhead, operational and maintenance costs;
- c) cost of capital not financed through any grant, subsidy or donation;
- d) replacement, refurbishment and extension of water services works; and
- e) ensuring that all households have access to basic water supply and basic sanitation.

Where this Department still providing water to end users, (i.e. retail water), it acts as Water Service Provider for the Water Service Agencies and needs to submit tariffs to the Water Service Agencies for approval. These tariffs are either:

actual costs of supply, or

where actual costs cannot be determined, then the latest "WS tariffs in the absence of scheme specific tariffs," as approved by our Minister, are applied.

(Note that if Water Service Authorities do not enter into an agreement with the Department, no tariff can be levied and in a number of cases tariffs do not fully reflect cost of supply and tariff increases are necessary, but that in line with government policy, tariff increases are kept as low as possible and gradually phased in).

Water Resources:

The policy framework for water resources is stipulated in chapter 5 of National Water Act, 1998. The raw water pricing strategy was established on 12 November 1999 by a notice in the Government Gazette.

Contents of pricing strategy

The Pricing Strategy contains the objectives, methodology and implementation strategy for setting water use charges for purposes of:

funding water resource management by water management institutions

funding water resource development and use of waterworks by:

- the Department
- Water management institutions

achieving the equitable and efficient allocation of water (economic charge)

Water uses subject to pricing

Section 56 of the National Water Act, 1998 empowers the Minister of Water Affairs and Forestry to establish a pricing strategy for charges for any water use described in section 21:

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 contains waste from any

industrial or power generation process;
altering the bed, banks, course or characteristics of a watercourse;
removing, discharging or disposing of water found underground; and
using water for recreational purposes.

Water uses to be priced in terms of published strategy

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

taking water from a water resource (underground or surface water);
storing water. Abstraction from dam or recharged aquifer will constitute the use. The annual refilling of dams constructed to enhance property values or for recreation, and which are located in important water-courses, will constitute the use and will be based on an estimation of evaporation losses; and
engaging in a stream flow reduction activity, such as afforestation.

The proposed pricing strategy for waste discharges and return flows will be the subject of a separate publication. Only authorised, licensed or registered water uses can be priced.

Allowable water uses not subject to pricing

Schedule 1 of the National Water Act states the following uses need no authorisation and are thus not subject to pricing:

water for reasonable domestic use;
water for small gardening not for commercial purposes;
the watering of animals within the grazing capacity of the land;
storage and use of run-off water from a roof;
water use in emergency situations;
non-consumptive use of water for recreational purposes, under certain conditions; and
discharging of water containing waste into a communal conduct controlled by another authorised person.

2.3 Free services

Free basic water:

The Department renders support to the provision of Free Basic Water through Provincial Support Units. According to the Free Basic Water implementation reports, Water Services Authorities benefited tremendously from this service

and it is the intention to extend this into a One-Stop-Shop service which will also assist with the implementation of Free Basic Sanitation. This service will also provide Water Sector related information to all on request.

Implementation of Free Basic Water by Water Services Authorities is on track with 65,6% of the South African population and 51,4% of the Poor enjoying Free Basic Water. Even though the Department is aware of some Water Service Authorities who have provided Free Basic Sanitation to those in their supply-zone, no official implementation figures on Free Basic Sanitation are available at this stage.

Other services:

Various technical support services were provided to water institutions particularly, in poor rural communities. Water services were provided free in the absence of any financial cost recovery or local government subsidisation system.



Inventories:

Inventories on hand at year end

	“Costing method used”	2002/03	2003/04
		R'000	R'000
Stores on hand	Average price	35 223	35 409
Equipment on hand (A-class accountable items)	per item type	<u>183 355</u>	<u>85 017</u>
Total		<u>218 577</u>	<u>120 426</u>

3. Capacity constraints

The department has seen a flight of skills from the department to other institutions due to financial incentives, uncertainty arising from restructuring, and other factors.

Where the Department has been unable to recruit the necessary skills, secondment or employment of professional service providers has been undertaken.

There remain significant challenges in filling posts in scarce occupational classes, such as engineering, hydrology, water resources planning. Meeting employment equity targets in these scarce occupational classes is particularly difficult.

It is important to note that the entire department is engaged in ‘triple tasks’, i.e.

- maintenance of old functions
- restructuring to move to the future
- operating some future functions

This places a heavy work load on functions such as Human Resources which have not been able to undertake all tasks due to lack of systems and skilled people and have resorted to the use of professional service providers as a result.

4. Utilisation of donor funds

During the 2003/04 financial year an amount of R229,157 million was spent on projects funded through donor funds.

Donor funds were received from the following countries.

	R'000
European Union	249 997
Ireland	31 017
Netherlands	13 969
Norway	12 700
DFID	<u>19 025</u>
Total	<u>326 708</u>

5. Trading entities / public entities

5.1 Trading entities

The department operates the following trading entities:

Water trading account.

Equipment trading account.

These trading entities were established in terms of the old Exchequer Act, 1975 (Act 66 of 1975) and the Director-General is the Accounting Officer of both entities.

5.1.1 Water trading account

The aim of this trading account is to develop and implement catchment management plans and manage, operate and maintain government water schemes, regional bulk water supply and water services infrastructure.

5.1.2 Equipment trading account

Functions

The equipment trading account provides equipment for construction and maintenance of government water schemes.

5.2 Public entities

The following public entities report to the department.

5.2.1 Trans-Caledon Tunnel Authority (PFMA Schedule 2 Major Public Entity)

The Trans-Caledon Tunnel Authority (TCTA) was established in 1986 to undertake certain tasks emanating from the treaty on the Lesotho Highlands Water Project on behalf of the South African government. The project aims to augment water supply to the Vaal system and to generate hydroelectric power in Lesotho. The Authority was directed by the Department to fund all costs incurred in the water delivery component of the Lesotho Highlands Water Project, and to undertake financial risk management on behalf of South Africa.

Following revisions to the protocol for the implementation of the project, new governance arrangements have been introduced to improve operational efficiency. In terms of its revised establishment agreement, the Authority may be required to perform additional responsibilities in other areas. These need not be related to the Lesotho Highlands Water Project – the Department of Water Affairs and Forestry may require specific expertise on other projects as well. In accordance with this provision, the Authority has been tasked to assist Umgeni Water Board with the management of its treasury function. It has also been tasked with the construction and raising of funds for the Berg River Project.

No grants are made to the Authority, as it is funded from income on tariffs levied on the sale of water and other loans. Where other parties benefit from services provided, the TCTA is empowered to recover the costs of such services.

5.2.2 Water Research Commission (PFMA National Public Entity Schedule 3 – Part A)

The Water Research Commission was established in terms of the Water Research Act, 1971 (Act 34 of 1971). Its terms of reference are to promote co-ordination, communication and co-operation in the field of water research, to establish water research needs and priorities from a national perspective, to fund research on a priority basis, and to promote the effective transfer, dissemination and application of research findings. The Commission plays an important role in developing high-level human resources in the sector.

No grants are made to the Commission as its work is funded by a levy on water users.

Accountability arrangements

In terms of the Public Financial Management Act, the Minister of Water Affairs

and Forestry is responsible for the approval of the Commission's budget.

5.2.3 Water Boards (PFMA National Government Business Enterprises Schedule 3 – Part B)

Functions

The water boards were established as water service providers that report to the Minister of Water Affairs and Forestry. The primary function of these boards is bulk water service provision within their supply areas. They also manage other water services, and supply potable water at cost-effective prices and have been used by the Department as implementing agents for water services projects.

The Water Boards

Albany Coast Water	Ikangala Water	Overberg Water
Amatola Water	Lepelle Northern Water	Pelladrift Water
Bloem Water	Magalies Water	Rand Water
Botshelo Water	Mhlathuze Water	Sedibeng Water
Bushbuckridge Water	Namakwa Water	Umgeni Water

Accountability arrangements

The water boards were established in terms of the Water Act, 1956 (Act 54 of 1956) and the Water Services Act, 1997 (Act 108 of 1997).

These boards are currently administered by the Water Services Act, 1997 (Act 108 of 1997). The Water Services Act requires water boards to submit Policy Statements, Business Plans and Annual Reports to the Minister of Water Affairs and Forestry, in terms of sections 39, 40 and 43 respectively.

In terms of this Act the Minister may direct a water board to amend its business plan or policy statement if aspects are not consistent with the Act or are deemed not to be in the best interests of the general population. The review of business plans takes place annually during which time each water board has to respond to issues raised in the Department's appraisal of their business plan.

In furtherance of the regulatory requirements, the Department monitors governance of water boards. The Act requires the Minister to consider the need for representation of Water Services Authorities, other interest groups and expertise required on the Board when appointing members to the Board. The primary purpose of the Board is to ensure the water board's compliance with

the Act, and to promote and ensure that the water board's business plan and policy statement are implemented (section 38(1)).

In terms of section 32(b) water boards are required to enter into service provision agreements when performing its primary or other activities. These agreements are also intended to serve as regulatory mechanism, to regulate the relationship between the institutions.

In terms of the Public Finance Management Act, (PFMA) 1999, (Act 1 of 1999), Water Boards, as Schedule 3, Public Entities, must submit audited financial statements to National Treasury for each financial year in accordance with the generally accepted accounting practice. Further, in terms of the PFMA the accounting authority is the Board and its fiduciary responsibilities are spelt out in section 50 and 51 of the PFMA.

Water Boards have been set up to be financially independent institutions. In terms of section 34(1) of the Water Services Act water boards must strive, amongst others, to be financially viable. In this respect, they are required to repay and service their debts; recover their capital, operational and maintenance costs; make reasonable provision for depreciation of assets; recover the costs associated with the repayment of capital from revenues over time; and make reasonable provision for future capital requirements and expansions.

The impact of their financial performance on the Department has therefore been limited. Apart from providing seed funding for some of the newly formed water boards and operating subsidies, where they have undertaken specific functions on behalf of the Department, the Department has only in exceptional circumstances had to provide financial assistance to some of the water boards.

5.3 Other entities

5.3.1 Komati River Basin Water Authority:

The Komati River Basin Development Project is a joint development between South Africa and Swaziland in terms of the treaty on the development and utilisation of the water resources of the Komati River basin, ratified in 1992. The purpose of the project is to promote rural development and alleviate poverty in the lower Komati Valley by increasing the productivity of the land through irrigated agriculture. In terms of the treaty, the Komati River Basin Water Authority (KOBWA) was established as a special purpose vehicle charged with managing and financing the project. The main focus of the project was the construction of the Driekoppies Dam in South Africa and

the Maguga Dam in Swaziland. Both have been completed.

In terms of the treaty, funding of project costs is guaranteed by the South African government and the Department is responsible for payment of these costs.

5.3.2 National Forest Recreation and Access Trust:

The object of the National Forest Recreation and Access Trust is to promote access to and the use of forests for recreation, education, culture or spiritual fulfillment. In terms of section 41(2) of the National Forests Act (84 of 1998), the Minister is the sole trustee of the Trust. The only source of revenue for the Trust is interest earnings.

6. Organisations to which transfer payments have been made

	R'000
<hr/>	
Conditional grant transfers to Municipalities	
Alfred Nzo	20 182
Amatole	39 460
Cacadu	10 393
Chris Hani	24 263
O.R.Tambo	54 573
Provincial	11 156
Ukhahlamba	21 890
Lejweleputswa	7 758
Motheo	18 773
Northern Free State	1 225
Thabo Mofutsanyane	23 918
Xhariep	2 880
West Rand	3 000
Bohlabela	29 000
Capricorn	28 637
Mopani	16 973
Sekhukhune	18 224
Vhembe	11 441
Waterberg	17 997
Ehlanzeni	48 054
Gert Sibande	29 320
Nkangala	26 467
Provincial	217

	R'000
Frances Baard	5 031
Karoo	2 378
Kgalagadi	13 086
Namakwa	1 919
Siyanda	5 417
Bojanala	4 400
Bophirima	13 990
Central	6 100
Kgalagadi	1 614
Southern	6 100
Boland	600
Central Karoo	1 572
City of Cape Town	2 837
Eden	4 901
Overberg	1 512
Provincial	100
West Coast	3 561
Water User Associations	
Lower Blyde River WUA	50 561
Impala WUA	55 970
Great Fish River WUA	13 561
Water Boards	
Umgeni	60 000
Bushbuckridge Water Board	1 500
Ikangala Water Board	2 000
Sedibeng Water Board	15 870
Other Transfers	
Equipment Trading Account	2 500
Water Trading Account	1 360 927
SAFCOL	15 960
Grand Total	<u>2 119 768</u>

Reasons for Transfer Payments

Grants to Municipalities:

Transfer payments are made to municipalities in accordance with the exit strategy of the Community Water and Sanitation Programme (CWSS-P) from the department to Local Government (LG) as detailed in the Division of Revenue Act, i.e. the framework for conditional grants to local authorities for the department capital projects. Transfer payments are made to ensure that LG have funds to implement those projects identified in Water Service Development Plans (WSDPs).

The ultimate endeavour of transfer payments is to ensure that sustainable water and sanitation infrastructure is delivered to rural communities.

Accountability Arrangements

Funds are transferred on the basis of a "Transfer Agreement" contract between the department and the receiving institution. The transfer agreement process is lengthy and time consuming, but the final outcome ensures the effective and sustainable delivery of infrastructure in accordance with the required accountability aspects of the Public Finance Management Act. This process includes (and not limited to) the following accountability aspects of project implementation:

- An approved feasibility and Business Plan;
- Council resolution that the infrastructure and/or monies will be transferred for sustainable water and sanitation development in rural communities;
- An effective workplan that constitutes:
 - a feasible implementation plan; and
 - a feasible operations plan;
- A clear time schedule detailing when funds will be spent and infrastructure will be delivered; and
- Sustainability, revenue and longevity processes.

Water User Associations:

Lower Blyde River Water User Association (WUA)

Payments of interest on the portion of the Land Bank loan allocated to Blyde 800 project which will provide opportunities for high value irrigation farming

for historically disadvantaged farmers. Included also is an amount of R48 million that was paid to Rand Merchant Bank to acquire the future ownership (in 20 years) of the pipeline in order to reduce the interest burden on water users.

Impala Water User Association (WUA)

Payments represent the additional subsidy on the increased subsidisable cost of the Bivane Dam and DWAF's payment of R36.7 million to Land Bank to cover the portion of Impala's Land Bank loan not covered by the government guarantee transferred to Rand Merchant Bank and which supports the establishment of historically disadvantaged farmers.

Kalahari East Water User Association (WUA)

Payments represents DWAF's portion of the Land Bank loan for the Kalahari East WUA in terms of a MOU between DWAF and Kalahari East WUA.

Great Fish River Water User Association (WUA)

Payments in terms of a government guarantee to Land Bank after the Great Fish River WUA defaulted on its debt and legal advice indicated that the amount would not be recoverable.

Water Boards:

Bushbuckridge Water Board

Provision of bridging funds as municipalities were unable to pay debts owing to the water board.

Inkangala Water Board

Provision of seed funding to the newly established water board.

Umgeni Water Board

Umgeni provided water supplies to rural and peri-urban communities around Pietermaritzburg through projects partially supported by the Department using RDP funds. The Umgeni contribution to the project was funded by way of long-term loans and the capital expenditure incurred by Umgeni was R457 million.

Due to socio economic problems in the area where these schemes have been constructed, as well as governments tariff policies, Umgeni could not generate sufficient revenue from these rural schemes to repay the loans. This placed Umgeni in serious financial difficulties. They therefore approached the department for assistance in contributing to the costs of the project which qualified for 100% capital support in terms of Departmental policy. The department contributed R60 million during 2002/03 and R60 million during the current financial year with the remainder of the obligations met by the relevant municipalities.

Sedibeng Water Board

Sedibeng water invested their own financial resources into basic water and sanitation services in their region to speed up reduction of the backlog.

The Department paid Sedibeng for these services. The transfer payment to Sedibeng in terms of national policy in 2003/04 amounted to R15.87 million.

Other transfers:

Trading Accounts

Both trading accounts, namely, the Water Trading Account and the Equipment Trading Account are operating within the department and any losses must be made good from the Exchequer.

SAFCOL

The department entered into an agreement to pay SAFCOL an annual subsidy for the period 2002/03 until 2005/06. The payments were made to cover costs associated with conversion of plantations to other land use in the Southern and Western Cape as well as phasing out of loss making operations.

SAFCOL is in the process to finalise the transfer of ownership of the plantations in the Southern and Western Cape to private entities. Funding associated with land conversion has also been resolved between the department and the receiving agencies.

7. Public / private partnerships (PPP)

An evaluation has been made of a Public Private Partnership to extend the clearing of invasive alien plants in certain coastal areas to incorporate secondary industries to process the cleared biomass to commercial products, principally high-grade charcoal. The expectation is that more job opportunities will be created through this partnership without increasing the expenditure. Procurement documents were prepared and Treasury approval was obtained. Since there is a requirement for a twelve-year financial commitment from Government, consultation is underway with other Departments to determine whether such a commitment would be appropriate in view of the fact that similar activities are undertaken without subsidy in other areas.

8. Corporate governance arrangements

- Risk management approach

The risk assessment process has been concluded and risk facing the department have been identified. This was achieved by holding discussions with the Branches Managers within the department. Risk database profiles which were developed were also updated. The respective Branch Managers have the responsibility to manage the risk areas relevant to their areas of work. The regular updating of the risk assessment process is facilitated by the Directorate: Internal Audit.

- Fraud prevention policies

The fraud prevention policy which is a key element of effective and efficient internal control systems has been developed and is being implemented in the Department.

- Effectiveness of internal audit and audit committee

The Directorate: Internal Audit conducts its activities in accordance with the standards as laid down by the Institute of Internal Auditors. It provides assurance to management that internal controls are effective and that the identified risks are properly managed. The Audit Committee is functioning effectively. Members of the Audit Committee were appointed in terms of the Public Finance Management Act and are discharging their duties in accordance with the prescribed policies.

- Other governance structures, including management processes to

minimise conflict of interest

Other committees such as the Management Committee (MANCO), Executive Committee (EXCO), Departmental Control Committee (DCC), etc are functioning effectively and are achieving their objectives.

The Department has sound management structures in place to deal with flow of information and issues of conflict of interest.

- Implementation of the code of conduct:

The code of conduct has been developed and procedures are in place to deal with cases where irregularities occur.

- Safety, health and environment issues facing the organisation.

Issues of Health and Safety in the Department are being co-ordinated by a formally established structure and reports quarterly.

9. Discontinued activities / activities to be discontinued

The Department has been engaged in funding and operating community water supply and sanitation since 1994 in the Re-construction and Development Programme and Community Water Supply and Sanitation programmes. The responsibility for direct funding and operation is being transferred to local government and the Department will in future focus on monitoring, support in technical assistance and capacity building, regulation and policy.

The Department will continue over the next two years to complete those contractually committed projects which the department or its agents, other than local government are implementing using Medium Term Expenditure Framework and donor funds. The major portion of the department's Medium Term Expenditure Framework allocation for the Community Water Supply and Sanitation programmes has been reallocated to the MIG programme, which is managed by Department of Provincial and Local Government with effect from 1 April 2004. The Department of Provincial and Local Government and MIG have undertaken to honour contractually committed projects that were under the Community Water Supply and Sanitation programmes, with the balance of funds going into an "uncommitted" amount which will be dealt with by Department of Provincial and Local Government. The Department will start focussing on its role as sector leader and monitor the performance of municipalities in meeting the backlog eradication targets.

10. New / proposed activities

Since, in terms of policy, the management and development of the national water infrastructure for economic purposes should be self-funding and the funding and planning of such activities occurs over longer periods than are covered by the Medium Term Expenditure Framework, proposals are being developed for the establishment of a National Water Infrastructure Agency which would be equipped to undertake these responsibilities under the supervision of the Department.

11. Events after the reporting date

None.

12. Progress with financial management improvement

Since 1 April 2003 the Financial Management System (FMS) was replaced by the Basic Accounting System (BAS). The BAS has been fully implemented in the Department and training has been offered to officials on the use of the new system. As reported elsewhere the Department is currently busy with the implementation of new software in respect of the Management of the Financial Affairs of the Trading Accounts to enable it's reporting in accordance with GAAP.

The Department regularly reports and monitors it's financial position through the Early Warning Reports and the Quarterly Reports. The Executive Authority is also monthly informed about the financial position.

13. Performance information

The performance information is outlined in paragraph 4.4 of the annual report.

Approval

The annual financial statements have been approved by the Accounting Officer.

A.M. Muller

REPORT OF THE AUDITOR-GENERAL TO PARLIAMENT ON THE FINANCIAL STATEMENTS OF VOTE 34 — DEPARTMENT OF WATER AFFAIRS AND FORESTRY FOR THE YEAR ENDED 31 MARCH 2004

1. AUDIT ASSIGNMENT

The financial statements as set out on pages 81 to 135, for the year ended 31 March 2004, 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 3 and 5 of the Auditor-General Act, 1995 (Act No. 12 of 1995). 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.

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

3. QUALIFICATION

3.1 Misallocation of transactions amongst the Vote and Trading entities

The Basic Accounting System (BAS) of the Department contains the chart of accounts of the Vote, the Water Trading account and the Equipment trading account.

Due to internal control weaknesses regarding the allocation of transactions

amongst these three entities, material, expenditure transactions that should have been allocated to the entities, were detected in the accounts of the Department.

Due to the volume of transactions, I was unable to determine the extent of the potential misstatements.

3.2 Insufficient supporting documentation

Certain transactions selected for testing lacked sufficient or complete documentation to substantiate the validity, accuracy, completeness and accounting treatment of the relevant items. The nature of most of these transactions also limited the application of alternative procedures to provide the required audit assurance. Of the amounts initially investigated and resolved by management, certain transactions were not cleared to my satisfaction, at the reporting cut-off date of 24 July 2004.

Payments for goods and services

Tender contracts could not be provided for 22 payments to the amount of R31 million because sufficient references were not available to trace the payment transaction to the tender contracts.

This is a result of a poorly designed accounting system.

4. QUALIFIED AUDIT OPINION

In my opinion, except for the effect on the financial statements of the matters referred to in paragraph 3, the financial statements fairly present, in all material respects, the financial position of the Department of Water Affairs and Forestry at 31 March 2004 and the results of its operations and cash flows for the year then ended, in accordance with prescribed accounting practice and in the manner required by the Public Finance Management Act, 1999 (Act No. 1 of 1999) (PFMA).

5. EMPHASIS OF MATTER

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

5.1 Audit of financial statements

The accuracy of the comparative figures on the appropriation statement could not be determined due to the change in programmes as well as the conversion to the Basic Accounting System (BAS).

5.2 Recovery of loans from water boards, irrigation boards, municipalities and the Land and Agricultural Development Bank

As previously reported the department administers state loans to various entities. The total outstanding capital and interest of R200 million as at 31 March 2004



includes potentially irrecoverable loans of R20 million disclosed as such in note 19.1 to the financial statements. The department requested approval from the National Treasury to write off these loans in applying the 2003-04 roll over funds.

5.3 Internal audit

An internal audit function had been established but it was not functioning as envisaged by section 38(1)(a)(i) and (ii) of the PFMA and section 3.2 of the Treasury Regulations. My review indicated non-compliance with section 3.2.6 of the Treasury Regulations which requires that an internal audit must be conducted in accordance with the standards set by the Institute of Internal Auditors.

Only one internal audit was completed compared to the total of thirteen audits planned and approved in the annual operational plan.

5.4 Movable assets

In terms of section 38(1)(d) of the PFMA the accounting officer is responsible for the safeguarding of assets. An asset management policy including an updated register of movable assets was not in place for the year under review. Control over the physical existence of movable assets was not efficient.

6. PROGRESS WITH PREVIOUSLY REPORTED MATTERS AND SCOPA RESOLUTIONS

The department reacted favourably to the SCOPA Resolutions. For more detail refer to Annexure A.

7. APPRECIATION

The assistance rendered by the staff of the Department of Water Affairs and Forestry during the audit is sincerely appreciated.

SA Fakie

Auditor-General

Pretoria

27 July 2004

ANNEXURE A

PROGRESS WITH PREVIOUSLY REPORTED MATTERS AND SCOPA RESOLUTIONS

Reference to previous audit report and SCOPA resolutions	Subject	Findings on progress
Audit report: Paragraph 5.1.5; page 107 SCOPA Recommendation	Risk management and internal control weaknesses	The accounting officer reports to the audit committee on the work done by the Financial Inspection Unit. No non-compliance with the PFMA was noted during the year under review.
Audit report: Paragraph 5.1.7; page 107 SCOPA resolution:	Late submission of financial statement due to supporting evidence not submitted	Resolved. Financial statements for 31 March 2004 was received on 31 May 2004.
Audit report: Paragraph 5.1.1; page 106 SCOPA resolution:	Clearing of suspense accounts	The suspense accounts were satisfactorily cleared.
Audit report: Paragraph 3.1, page 105, par 3.2, page 139, 143 and 147	Separation of accounts	The accounts were separated as from 1 April 2004 on the Basic Accounting System. However, challenges still exists in separating transactions between the Vote account and the Trading Accounts.