

South Africa

Public Audit Act, 2004

## Auditing of Local Government in terms of the Municipal Finance Management Act 56 of 2003

General Notice 1512 of 2006

Legislation as at 27 October 2006

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# Auditing of Local Government in terms of the Municipal Finance Management Act 56 of 2003

## Contents

1. Audit opinion .....	1
2. Compliance with applicable legislation and reporting relating to performance against predetermined objectives .....	2
3. Disclosure of budget information .....	2
4. Period of application .....	2
5. Glossary of terms .....	3
Annexure A .....	4
Annexure B .....	7
Annexure C .....	9



## South Africa

### Public Audit Act, 2004

# Auditing of Local Government in terms of the Municipal Finance Management Act 56 of 2003

## General Notice 1512 of 2006

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**Commenced on 27 October 2006**

*[This is the version of this document from 27 October 2006.]*

Under the powers vested in me by section 3 of the Public Audit Act, 2004 ([Act No. 25 of 2004](#)) (hereinafter referred to as the PAA), I, Shauket Allie Fakie, Auditor-General of the Republic of South Africa, hereby determine the following:

### 1. Audit opinion

The objective of an audit of financial statements is to enable the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework.

In terms of section 13(3) of the PAA I hereby advise that, for the 2005-06 audits, I have determined that the approach set out in annexure A to this notice be followed in the formulation of my audit reports on the financial statements of municipalities and municipal entities. This is in response to the financial reporting frameworks prescribed by the National Treasury in terms of the MFMA for application by municipalities and municipal entities.

#### a. GRAP & GAAP and GRAP & GAMAP

The National Treasury has determined the GRAP & GAAP basis of accounting to be as follows:

“The financial statements have been prepared in accordance with the South African Statements of Generally Accepted Accounting Practice (GAAP) including any interpretations of such Statements issued by the Accounting Practices Board, with the prescribed Standards of Generally Recognised Accounting Practice (GRAP) issued by the Accounting Standards Board replacing the equivalent GAAP Statement...” (This is more fully set out in annexure B to this notice.)

The National Treasury has determined the GRAP & GAMAP basis of accounting to be as follows:

“The financial statements have been prepared in accordance with the Standards of Generally Recognised Accounting Practice (GRAP) and the Standards of Generally Accepted Municipal Accounting Practice (GAMAP) prescribed by the Minister of Finance in terms of:

- [General Notice 991 of 2005](#), issued in *Government Gazette* no 28095 of 15 December 2005; and
- [General Notice 992 of 2005](#), issued in *Government Gazette* no 28095 of 7 December 2005;

Accounting policies for material transactions, events or conditions not covered by the above GRAP and GAMAP Standards ... have been based on the South African Statements of Generally Accepted Accounting Practice (GAAP) including any interpretations of such

Statements issued by the Accounting Practices Board. ..." (This is more fully set out in annexure C to this notice.)

I have recognised the GRAP & GAAP and GRAP & GAMAP bases of accounting set out above as comprehensive bases of accounting and my audit report will therefore be issued in terms of ISA 800.

**b. IMFO**

The IMFO basis of accounting constitutes the standards determined by the Institute of Municipal Treasurers and Accountants (now the Institute of Municipal Finance Officers) in its Code of Accounting Practice (1997) and Report on Published Annual Financial Statements (second edition - January 1996).

I have recognised the IMFO basis of accounting as an entity-specific basis of accounting and I will therefore issue a "prepared in accordance with..." audit opinion in accordance with SAAPS 2.

## **2. Compliance with applicable legislation and reporting relating to performance against predetermined objectives**

In terms of section 20(2)(b) and (c) of the PAA, an audit report must reflect an opinion or conclusion on (b) the auditee's compliance with any applicable legislation relating to financial matters, financial management and other related matters, and (c) the reported information relating to the performance of the auditee against predetermined objectives.

**a. Municipal entities**

I have determined that, until further information is published in this respect, no separate opinion or conclusion on compliance with legislation or performance against predetermined objectives should be included in the audit reports. Conclusions in this regard will be reached as part of the financial auditing process. Reporting will be in respect of material non-compliance with applicable legislation relating to financial matters or material shortcomings in the process of reporting against predetermined objectives that may come to the attention of the auditor during the audit.

**b. Municipalities**

I have determined that, until further information is published in this respect, no separate opinion or conclusion on compliance with legislation should be included in the audit reports. Conclusions in this regard will be reached as part of the financial auditing process. Reporting will be in respect of material non-compliance with applicable legislation relating to financial matters that may come to the attention of the auditor during the audit. Reporting on the performance measurement system in terms of section 46 of the Municipal Systems Act, 2000 ([Act No 32 of 2000](#)) will be undertaken in a separate report in accordance with ISRS 4400.

## **3. Disclosure of budget information**

GRAP 1 paragraph 11 et seq. requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is still in the process of being developed, I have determined that my audit of any disclosures made by the entities in this respect will be limited to reporting on non-compliance with this disclosure requirement.

## **4. Period of application**

The guidance provided in this document comes into immediate effect, but will not influence any audit reports already issued.

Regardless of any changes to international auditing standards regarding the audit report that may come into effect after the date of this directive, the reporting requirements outlined above will apply to all audit reports dated on or before 31 May 2007, issued in respect of audits conducted on entities subject to the MFMA.

## 5. Glossary of terms

GAAP: South African Statements of Generally Accepted Accounting Practice

GAMAP: Generally Accepted Municipal Accounting Practice

GRAP: Generally Recognised Accounting Practice

MFMA: Municipal Finance Management Act. 2003 ([Act No. 56 of 2003](#))

PAA: Public Audit Act, 2004 ([Act No. 25 of 2004](#))

ISA: International Standards on Auditing

ISRS: International Standards on Related Services

## Annexure A

Type of entity	Separate financial statements			Consolidated financial statements		
	Mandatory basis of accounting	Audit report	Voluntary alternative basis of accounting	Mandatory basis of accounting	Audit report	Voluntary alternative basis of accounting
High-capacity municipalities	GRAP & GAMAP	<ul style="list-style-type: none"> <li>ISA 800: "Comprehensive basis of accounting"</li> <li>Audit opinion: "Present fairly" in accordance with the basis of accounting in annexure B, i.e. GRAP, GAMAP &amp; GAAP<sup>a</sup></li> </ul>		GRAP & GAMAP	<ul style="list-style-type: none"> <li>If a proper GRAP &amp; GAMAP compliant consolidation was attempted: <ul style="list-style-type: none"> <li>ISA 800: "Comprehensive basis of accounting"</li> <li>Audit opinion: "Present fairly" in accordance with the basis of accounting in annexure B, i.e. GRAP, GAMAP</li> </ul> </li> </ul>	

a

In accordance with correspondence from the National Treasury it is assumed that the correct application of the principles in paragraphs 7, 11 and 12 of GRAP 3 on the development of accounting policies and disclosures for transactions, events or conditions not covered by the three GRAP and eight GAMAP standards will result in municipalities only applying SA Statements of GAAP for such transactions, events or conditions.



					<ul style="list-style-type: none"> <li>If a proper GRAP &amp; GAMAP compliant consolidation was not attempted: <ul style="list-style-type: none"> <li>ISRS 4400: "Agreed-upon procedures"</li> <li>No audit opinion: "Report of agreed-upon procedures"</li> </ul> </li> </ul>	& GAAP <sup>a</sup>
Medium-capacity municipalities	IMFO	<ul style="list-style-type: none"> <li>SAAPS 2 "Entity-specific basis of accounting"</li> <li>Audit opinion: "Prepared in accordance with ..."</li> </ul>	GRAP & GAMAP	IMFO	No audit opinion will be expressed on the consolidated financial statements <sup>b</sup>	GRAP & GAMAP

a

In accordance with correspondence from the National Treasury it is assumed that the correct application of the principles in paragraphs 7, 11 and 12 of GRAP 3 on the development of accounting policies and disclosures for transactions, events or conditions not covered by the three GRAP and eight GAMAP standards will result in municipalities only applying SA Statements of GAAP for such transactions, events or conditions.

b

Medium-capacity municipalities are required to prepare consolidated financial statements for the 30 June 2006 financial year-end. In the absence of an IMFO consolidation specimen, this is interpreted by the National Treasury as requiring medium-capacity municipalities to only include an audited set of financial statements for each of its municipal entities, together with the municipality's own audited financial statements, in the municipality's annual report. As an audit opinion will be expressed on each individual set of financial statements, no audit opinion will be expressed on the "consolidated" financial statements.

Low-capacity municipalities	IMFO	<ul style="list-style-type: none"> <li>SAAPS 2: "Entity-specific basis of accounting"</li> <li>Audit opinion: "Prepared in accordance with..."</li> </ul>	GRAP & GAMAP	c		
Municipal entities that:	GRAP & GAAP	<ul style="list-style-type: none"> <li>ISA 800: "Comprehensive basis of accounting"</li> <li>Audit opinion: "Present fairly" in accordance with the basis of accounting in annexure A, i.e. GRAP &amp; GAAP</li> </ul>				
Municipal entities that:	GRAP & GAAP	<ul style="list-style-type: none"> <li>ISA 800: "Comprehensive basis of accounting"</li> <li>Audit opinion: "Present fairly"</li> </ul>				

c

Low-capacity municipalities are not required to prepare consolidated financial statements for the 30 June 2006 financial year-end.

financial year		in accordance with the basis of accounting in annexure A, i.e. GRAP & GAAP		
Municipal entities that: <ul style="list-style-type: none"> <li>are not subject to the Companies Act; and</li> <li>did not adopt SA Statements of GAAP in the previous financial year</li> </ul>	GRAP & GAMAP	<ul style="list-style-type: none"> <li>ISA 800: “Comprehensive basis of accounting”</li> <li>Audit opinion: “Present fairly” in accordance with the basis of accounting in annexure B, i.e. GRAP, GAMAP &amp; GAAP<sup>d</sup></li> </ul>	GRAP & GAAP	

## Annexure B

### “GRAP & GAAP basis of preparation

The financial statements have been prepared in accordance with the South African Statements of Generally Accepted Accounting Practice (GAAP) including any interpretations of such Statements issued by the Accounting Practices Board, with the prescribed Standards of Generally Recognised Accounting Practice (GRAP) issued by the Accounting Standards Board replacing the equivalent GAAP Statement as follows:

d

(content missing)

Standard of GRAP	Replaced Statement of GAAP
GRAP 1: Presentation of financial statements	AC101: Presentation of financial statements
GRAP 2: Cash flow statements	AC118: Cash flow statements
GRAP 3: Accounting policies, changes in accounting estimates and errors	AC103: Accounting policies, changes in accounting estimates and errors

The recognition and measurement principles in the above GRAP and GAAP Statements do not differ or result in material differences in items presented and disclosed in the financial statements. The implementation of GRAP 1, 2 & 3 has resulted in the following significant changes in the presentation of the financial statements:

1 **Terminology differences:**

Standard of GRAP	Replaced Statement of GAAP
Statement of financial performance	Income statement
Statement of financial position	Balance sheet
Statement of changes in net assets	Statement of changes in equity
Net assets	Equity
Surplus/deficit for the period	Profit/loss for the period
Accumulated surplus/deficit	Retained earnings
Contributions from owners	Share capital
Distributions to owners	Dividends
Reporting date	Balance sheet date

2. The cash flow statement can only be prepared in accordance with the direct method.
3. Specific information such as:
  - (a) receivables from non-exchange transactions, including taxes and transfers;
  - (b) taxes and transfers payable;

- (c) trade and other payables from non-exchange transactions;

must be presented separately on the statement of financial position

4. The amount and nature of any restrictions on cash balances is required to be disclosed.

*Paragraph 11 - 15 of GRAP 1 has not been implemented as the budget reporting standard is in the process of being developed by the international and local standard setters. Although the inclusion of budget information would enhance the usefulness of the financial statements, non-disclosure will not affect fair presentation."*

## Annexure C

### "GRAP & GAMAP basis of preparation

The financial statements have been prepared in accordance with the Standards of Generally Recognised Accounting Practice (GRAP) and the Standards of Generally Accepted Municipal Accounting Practice (GAMAP) prescribed by the Minister of Finance in terms of:

- [General Notice 991 of 2005](#), issued in *Government Gazette* no. 28095 of 15 December 2005; and
- [General Notice 992 of 2005](#), issued in *Government Gazette* no. 28095 of 7 December 2005;

The Standards comprise the following:

GRAP 1	Presentation of financial statements
GRAP 2	Cash flow statements
GRAP 3	Accounting policies, changes in accounting estimates and errors
GAMAP 4	The effects of changes in foreign exchange rates
GAMAP 6	Consolidated financial statements and accounting for controlled entities
GAMAP 7	Accounting for investments in associates
GAMAP 8	Financial reporting of interests in joint ventures
GAMAP 9	Revenue
GAMAP 12	Inventories
GAMAP 17	Property, plant and equipment
GAMAP 19	Provisions, contingent liabilities and contingent assets

Accounting policies for material transactions, events or conditions not covered by the above GRAP and GAMAP Standards have been developed in accordance with paragraphs 7, 11 and 12 of GRAP 3. These accounting policies and the applicable disclosures have been based on the South African Statements of Generally Accepted Accounting Practice (GAAP) including any interpretations of such Statements issued by the Accounting Practices Board. A summary of the significant accounting policies is disclosed below.”