

Annexure “C”

Audited Financial Statements

Annexure “C1”

Report on the Consolidated Financial Statements

**NELSON MANDELA BAY METROPOLITAN
MUNICIPALITY**

**REPORT ON THE CONSOLIDATED FINANCIAL
STATEMENTS FOR THE FINANCIAL YEAR**

1 JULY 2009 TO 30 JUNE 2010

1. INTRODUCTION

It is my privilege to present the report on the consolidated financial results of the Nelson Mandela Bay Metropolitan Municipality for the financial year ended 30 June 2010.

The Municipality, being classified as high capacity, was required to fully implement Generally Recognised Accounting Practice (GRAP) with effect from the 2008/09 financial year. Accordingly, the consolidated financial statements for the year ended 30 June 2010 have also been prepared in the applicable GRAP format.

The report firstly deals with Key Financial Ratios, Capital Expenditure, the overall Operating Results and the Statement of Financial Position. It concludes with a brief summary of the overall results.

1.1 Performance Review

Below is a brief performance overview comparing the financial results with the financial targets:

	2009/10	2008/09	
Operational Performance	Actual	Actual	Target
<input type="checkbox"/> Actual operating expenditure to budget	108,67%	97,3%	95%
<input type="checkbox"/> Actual operating income to budget	115,51%	100,2%	95%
<input type="checkbox"/> Capital spending to budget	80,14%	99,6%	95%
<input type="checkbox"/> Personnel Costs to income	26,79%	29,5%	34%
<input type="checkbox"/> Repairs and Maintenance as % of total Operating Expenditure	7,21%	8,9%	9%
<input type="checkbox"/> Debt servicing costs to Annual Operating Income	2,38%	1,6%	12%
<input type="checkbox"/> Net Debtors to Annual Operating Income	9,54%	16,3%	15%
<input type="checkbox"/> Loan Debt to Income Ratio	23,85%	7,4%	25%
Liquidity			
<input type="checkbox"/> Debtors collection period (days)	150	176	55
<input type="checkbox"/> Debtors Collection Rate	93,75%	91,7%	98%
<input type="checkbox"/> Creditors Turnover (days)	25	29	30

1.2 Key Financial Ratios

This section highlights certain significant ratios relevant to the statement of financial performance and the statement of financial position.

1.3 Statement of Financial Performance

	2009/10	2008/09
1.3.1 <u>Personnel Costs to Income</u>	26,79%	29,5%

Personnel costs to income express this category of expenditure as a percentage of total income. It indicates whether the control exercised over this expenditure category is reflected in the final results. It is to be noted that the actual 2009/10 personnel costs amounted to 26,79%, compared to the target of 34%. This ratio reflects an improvement over the 2008/09 financial year.

1.4 Statement of Financial Position

The ratios in this section indicate the Municipality's financial position.

	2009/10	2008/09
1.4.1 <u>Turnover Rate of Consumer Debtors (days)</u>	150	176

This ratio measures the efficiency with which the municipality collects its outstanding debt and converts it back into cash. This ratio reflects an improvement.

	2009/10	2008/09
1.4.2 <u>Consumer Deposits in relation to Consumer Debtors (in days)</u>	21,7	20,5

Consumer deposits are kept as a security against non-payment by debtors. This ratio reflects how many days of outstanding consumer debtors are covered by cash held as deposits.

The 2009/10 position reflects that 21,7 days of outstanding debtors are covered by security deposits, compared to 20,5 days for 2008/09.

2. CAPITAL EXPENDITURE AND CAPITAL FINANCING

2.1 Capital Expenditure¹

¹ Capital expenditure is regarded as any expenditure incurred or incidental to the acquisition or improvement of land, buildings, engineering structures and machinery and

Capital expenditure incurred during the 2009/10 financial year, compared with the adjustments budget, is as follows:

Directorate	Adjustment s Budget	Actual Expenditure	Variance with Adjustments Budget {over/(under) }
	R'000	R'000	R'000
Infrastructure & Engineering	1 824	1 376 574	(447 291)
Housing & Land	78 504	79 531	1 027
Economic Development & Recreational Services	241 654	214 808	(26 846)
Safety & Security	93 285	88 930	(4 355)
Corporate Services	58 746	53 802	(4 944)
Budget & Treasury	50 628	51 396	768
Public Health	114 028	81 242	(32 786)
Electricity & Energy	238 482	218 250	(20 232)
Chief Operating Officer	6 000	6 198	198
2010 FIFA World Cup Stadium	152 765	141 600	(11 165)
Strategic Programmes Directorate	53 436	21 119	(32 317)
	2 911 819	2 333 450	(578 369)
Entity: Mandela Bay Development Agency (MBDA)	270	246	(24)
	2 912 089	2 333 696	(578 393)

It should be noted that, compared to the 2009/10 Adjustments Capital Budget, the actual expenditure constituted 80,14% of the Adjustments Budget.

In relation to the under spending of R578 million in the 2009/10 financial year, R408 million was carried over to the 2010/11 financial year as it related to committed expenditure for contracts already awarded.

2.2 Capital Financing

equipment. This expenditure normally confers a lasting benefit and results in the acquisition of, or extends the life of a fixed asset or long-term work. It includes vehicles, office furniture and equipment but would exclude minor items that are generally regarded as being expendable even though in some instances their useful lives may extend beyond one year.

The 2009/10 Capital Expenditure was financed as follows:

R'000

Capital Replacement Reserve (CRR)	274 208
Levies Replacement Grant	186 021
External Finance Fund	747 990
European Union Funding	9
Equitable Share	747 987
Grants and Subsidies – National Government	14 837
Grants and Subsidies – Provincial Government	13 320
Provincial Housing Board Subsidies	789
Housing Revolving Fund	68 675
Public Contributions	32 214
Municipal Infrastructure Grant	240 482
Department of Minerals and Energy	6 918
TOTAL	<u>R 2 333 450</u>

MBDA - Levies Replacement Grant	246
TOTAL	<u>R 2 333 450</u>

3. OPERATING RESULTS

The summarised operating results as at 30 June 2010 are as follows:

	2010		
	Actual R'000	Budget R'000	Variance R'000
REVENUE			
Property rates	756,499	774,525	(18,025)
Service Charges	2,510,971	2,566,236	(55,265)
Interest earned - external investments	65,323	185,926	(120,603)
Interest earned - outstanding debtors	105,783	114,120	(8,337)
Fines	23,415	50,384	(26,969)
Licences and Permits	8,242	7,828	414
Government Grants and Subsidies	2,395,859	1,398,577	997,282
Rental of facilities and equipment	15,545	18,417	(2,872)
Income for agency services	1,219	1,107	113

Other Income			56,872
	242,987	186,115	
Gains on the disposal of property, plant and equipment		7	7
	0		
Total Revenue	6,125,846	5,303,241	822,605

	2010		
	Actual R'000	Budget R'000	Variance R'000
EXPENDITURE			
Employee related costs	1,641,282	1,485,352	155,930
Remuneration of Councillors	44,885	46,311	(1,425)
Bad debts	419,469	44,839	374,630
Collection costs	2,757	3,448	(690)
Contracted services	147,764	86,213	61,551
Depreciation / Amortisation	537,372	452,141	85,231
Impairment	26,686	-	26,686
Repairs and Maintenance	408,118	449,655	(41,536)
Finance charges Paid	146,030	162,370	(16,340)
Bulk purchases	1,237,381	1,234,407	2,973

	2010		
	Actual R'000	Budget R'000	Variance R'000
EXPENDITURE			
Grants and subsidies paid	283,059	102,072	180,987
General Expenses	757,119	1,141,197	(384,078)
Loss on Foreign Exchange Transaction	3,973	-	3,973
Loss on disposal of Property Plant and Equipment	2,933	-	2,933
Share of loss in associate	725	-	725
Total Expenditure	5,659,559	5,208,008	451,550
Surplus for the year	466,287	95,233	371,054

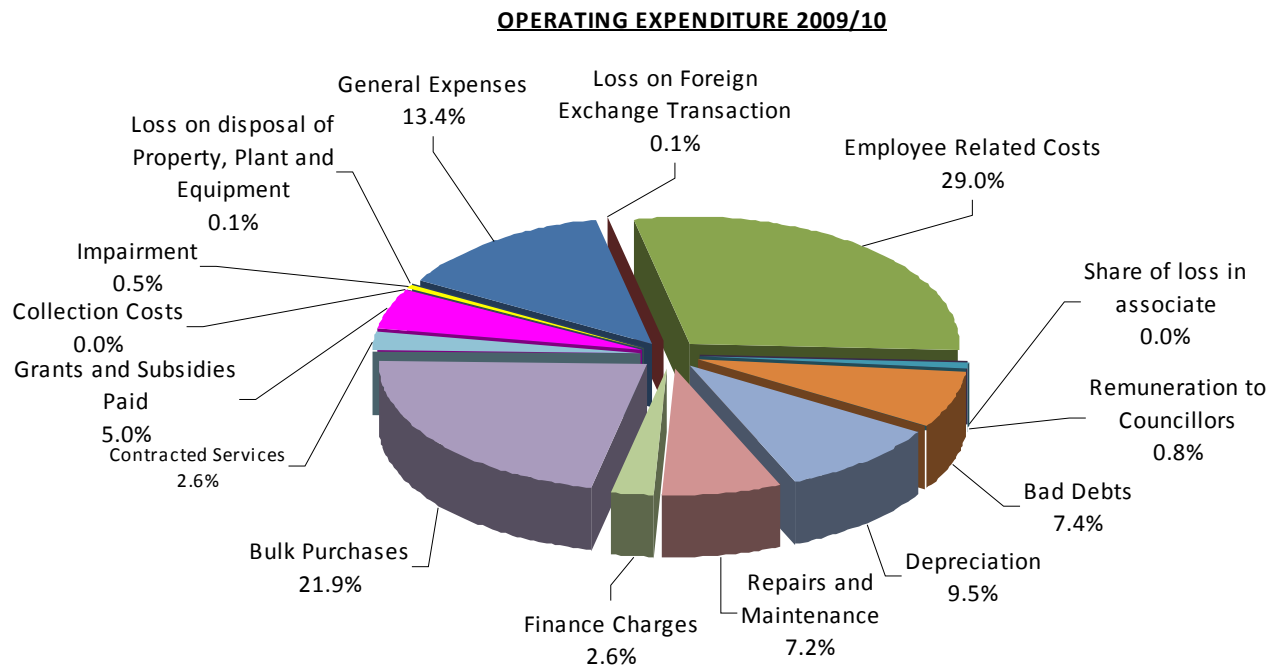
The reasons for the expenditure and revenue variances compared to the budget, are discussed in Section 3.3 of the report.

3.1 Operating Expenditure

The analysis of Council's operating expenditure is as follows:

	<u>R'000</u>	<u>% of Total Expenditure</u>
Employee related costs	1,641,282	29%
Remuneration of Councillors	44,885	0.79%
Bad debts	419,469	7.41%
Collection costs	2,757	0.05%
Contracted services	147,764	2.61%
Depreciation/Amortisation	537,372	9.49%
Impairment	26,686	0.47%
Repairs and Maintenance	408,118	7.21%
Finance charges paid	146,030	2.58%
Bulk purchases	1,237,381	21.86%
	<u>R'000</u>	<u>% of Total Expenditure</u>
Grants and subsidies paid	283,059	5%
General Expenses	757,119	13.38%
Loss on Foreign Exchange Transaction	3,973	0.07 %
Loss on disposal of Property, Plant and Equipment	2,933	0.05%
Share of loss in associate	725	0.01%
Total Expenditure	5,659,559	100%

The expenditure analysis is reflected in the following graph:



Expenditure such as personnel costs, remuneration of councillors, bulk purchases of electricity and water, general expenses and repairs and maintenance in respect of which Council has limited capacity to adjust in the short term, account for approximately 72,3% of operating expenditure. This leaves limited scope for variation of other expenditure categories.

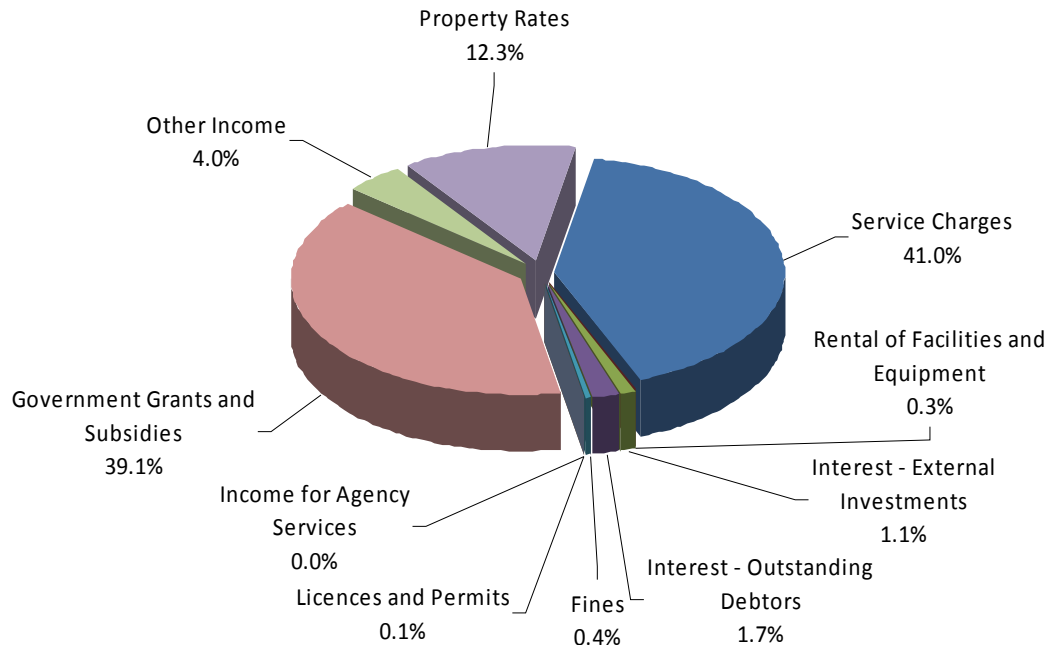
3.2 Operating Revenue

The following is a breakdown of Council's operating revenue represented by the respective revenue categories:

	<u>R'000</u>	<u>% of Total Revenue</u>
REVENUE		
Property rates	756,499	12.35%
Service Charges	2,510,971	40.99%
Interest earned - external investments	65,323	1.07%
Interest earned - outstanding debtors	105,783	1.73%
Fines	23,415	0.38%
Licenses and Permits	8,242	0.13%
Government Grants and Subsidies	2,395,859	39.11%
Rental of facilities and equipment	15,545	0.25%
Income for agency services	1,219	0.02%
Other Income	242,987	3.97%
Total Revenue	6,125,846	100.00%

The above breakdown is displayed in the following graph:

OPERATING REVENUE 2009/10



Service charges, property rates and grants and subsidies are the major sources of income, constituting 92,4% of the income base.

The net operating results are normally reflected in the statement of financial position, which will now be discussed.

3.3 Operating Results - Variances

Total accrued operating expenditure² amounted to R5 659 559, whilst the total accrued income amounted to R6 125 846. This resulted in an excess of accrued operating income over accrued operating expenditure of R466 287 for the year.

After comparing actual accrued expenditure and accrued income with the original budget, the results are attributable to the following:

	R'000	Variance %	R
Expenditure less than budget:			
Councillors' Remuneration	1 425	3,1	
Collection Costs	690	20,0	

² Expenditure incurred in the daily operations of the organisation, such as remunerating personnel, transport, repairs and maintenance of equipment, etc

Finance Charges Paid	16 340	10,1	
General Expenses	384 078	33,7	
Repairs and Maintenance	<u>41 536</u>	9,2	444 069

	R'000	Variance %	R
Expenditure greater than budget:			
Employee related costs	(155 930)	(10,5)	
Grants and subsidies paid	(180 987)	(177,3)	
Bad Debts	(374 630)	(835,5)	
Contracted Services	(61 551)	(71,4)	
Depreciation/Amortisation	(85 231)	(18,9)	
Bulk Purchases	(2 973)	(0,2)	
Loss on Foreign Exchange Transaction	(3 973)		
Loss on Disposal of Assets	(2 933)		
Impairment	(26 686)		
Share of loss in associate	<u>(725)</u>		
			(895 619)

Income in excess of budget:

Income for agency services			10,2
	113		
Government Grants and Subsidies	997 283	71,3	
Other Income	56 872	30,6	
Licences and Permits	<u>414</u>	5,3	1 054 682

Income less than budget:

Property Rates	(18 025)	(2,3)	
Fines	(26 969)	(53,35)	
Interest Earned - External Investments	(120 603)	(64,9)	

Interest Earned – Outstanding Debtors	(8 337)	(7,3)	
Service Charges	(55 265)	(2,1)	
Gain on disposal (PPE)	(7)	100	
Rental of facilities and equipment	<u>(2 872)</u>	(15,6)	<u>(82 349)</u>
			371 054
Budgeted Surplus			<u>R95 233</u>
Net accrued surplus for the year			<u>R466 287</u>

Detailed below are the reasons for the more significant variations:

3.3.1 Underspending against budget:

3.3.1.1 General Expenses – R384 078

The underspending is mainly due to Housing Top Structures spending being less than budgeted.

3.3.2 Expenditure greater than budget:

3.3.2.1 Bad Debts – R374 630

Bad debts increased due to escalating outstanding debtors.

3.3.2.2 Depreciation – R85 231

Depreciation was R85,2 million more than budgeted due to the higher than anticipated final capital expenditure for 2009/10, resulting in more assets being commissioned. This was also influenced by the review of the respective useful lives of assets, in accordance with the applicable accounting standards.

3.3.2.3 Grants and Subsidies paid – R180 987

The increased spending of R180,9 million is mainly due to a change in accounting practices, with the ATTP subsidies now being classified as grants.

3.3.2.4 Employee related costs – R155 930

The increased spending of R155,9 million is mainly as a result of an increase in the past service liability in respect of post retirement benefits relating to ill health and medical aid contributions.

3.3.2.5 Contracted services – R61 551

The increased spending of R61,6 million is mainly as a result of the 2010 World Cup and increased utilisation of contract security services.

3.3.3 Income in excess of budget:

3.3.3.1 Government Grants and Subsidies – R997 283

The Government grants and subsidies are in excess of the budget largely due to a change in accounting practices, as the original budget did not include the capital expenditure funded from government grants.

3.3.4 Income less than budget:

3.3.4.1 Fines – R26 969

In relation to fines, only 46% of the budgeted income was realised due to various challenges experienced by the Safety and Security Directorate, impacting on its ability to collect fines income.

3.3.4.2 Interest Earned - External Investments – R120 603

The interest earned on external investments was less than budget, due to a significant decline in the investment portfolio.

4. STATEMENT OF FINANCIAL POSITION

The statement of financial position reflects the financial results and policies of Council at a particular point in time. It is a snapshot at the year-end to determine the asset worth of the organisation and to what extent that worth is encumbered.

4.1 Financial Policies

No significant financial policy reviews were undertaken during the year.

4.2 Housing Development Fund

The fund increased by R871 683 (0,8%) from R100,5 million in 2008/09 to R109,4 million in 2009/10.

4.3 Capital Replacement Reserve

The reserve decreased by R66,6 million (23,1%) from R287,7 million in 2008/09 to R221,1 million in 2009/10.

4.4 Donations and Public Contribution Reserve

The fund increased by R134,8 million (65,4%) from R206,1 million in 2008/09 to R340,9 million in 2009/10.

4.5 Government Grant Reserve

The fund increased by R700 million (25,7%) from R2,8 billion in 2008/09 to R3,5 billion in 2009/10.

4.6 Non-current Liabilities

4.6.1 Long Term liabilities³

Long term liabilities amounted to R1,4 billion in 2009/10 compared to R394,9 million in 2008/09 and are made up as follows:

	2009/10	2008/09
	R'000	R'000
External loans	1 449 914	384 186
Brookes Bequest	9 873	9 285
Contract Retention Creditors	1 228	1 517
	<u>R1 461 015</u>	<u>R394 988</u>

The increase is mainly attributable to the raising of new loans in the amount of R1, 165 billion.

4.6.2 Non-Current Provisions

4.6.2.1 Provision for Rehabilitation of Landfill Sites

Provision has been made for the costs relating to the rehabilitation of landfill sites situated at Arlington, Koedoeskloof and Ibhayi. The costs as determined were discounted to the present day costs of rehabilitating the tip sites by adjusting for inflation related increases and applying a discounting factor equivalent to the average cost of borrowing. The discounted rehabilitation costs of landfill sites amounted to R130,9 million as at 30 June 2010. The provision was accordingly determined at R130,9 million, compared to R97, 7 million in 2008/09.

³ Long term liabilities consist of mainly external loans repayable over a period of longer than one year after the balance sheet date.

4.6.3 Employee Benefits Provisions

4.6.3.1 Provision for Post Retirement Benefits

This Provision was determined at R843,7 million, based on an actuarially assessed valuation as at 30 June 2010, compared to R722,1 million in 2008/09. The provision fully covers the liability relating to post retirement benefits.

4.7. Property, Plant and Equipment

Property, plant and equipment include infrastructure, buildings, plant and equipment, and amounted to R10,8 billion at year-end, compared to R7,3 billion in 2008/09. The increase of R2,5 billion is mainly attributable to the carrying value of the 2010 Soccer Stadium in the amount of R1,8 billion being transferred from Investment property to Property, Plant and Equipment in terms of the relevant accounting practices.

4.8. Investment Property

Investment property includes land and buildings and amounted to R70,8 million at year-end, compared to R1,9 billion in 2008/09. The decrease is mainly attributable to the carrying value of the 2010 Soccer Stadium in the amount of R1,8 billion being transferred from Investment Property to Property, Plant and Equipment in terms of the relevant accounting practices.

4.9. Cash and Investments

Investments and short-term investment deposits amounted to R671,8 million at year-end, compared to R926,3 million in 2008/09.

The total amount invested, contains certain monies earmarked for specific purposes, over which Council has limited discretion.

4.10. Debtors

Debtors amounted to R1 344 394 841 before the deduction of the Provision for Doubtful Debts of R759 979 578.

The relatively high level of outstanding debtors is a source of concern for the following main reasons:

- ◇ it diminishes the ability to spend on infrastructure development required for anticipated economic growth and to address service backlogs in the underdeveloped areas;
- ◇ it influences Council's credit rating and ability to raise loans on competitive terms;
- ◇ it limits the ability to budget for growth;
- ◇ it affects tariffs negatively, requiring higher than inflation increases.
- ◇ it influences the level of expenditure on the maintenance of assets.

The inability to collect outstanding debts timeously is reflected in the debtors' collection period. The situation is as follows:

4.10.1 Average Debtors' Collection Period for Electricity, Water, Refuse, Sewerage and Property Rates

	<u>2009/10</u>	<u>2008/09</u>
Debtors (R'000)	1 344 394	1 367 932
Tariff Income and Rates (R'000)	3 267 470	2 829 206
Number of Days	150	176
Target	55	55

The following measures have been implemented to arrest the growth in arrear debtors:

- The Revenue Enhancement Strategy is being implemented to improve revenue collection.
- The Assistance to the Poor Policy (ATTP) has been reviewed, so that debts relating to ATTP account holders can be written off at the end of each month.

5. OVERALL RESULTS AND COMMENTS

The overall financial results are generally considered to be acceptable. In order to sustain this situation the maintenance of sound financial management practices is required as well as mitigating the risks that impact on financial sustainability by instituting appropriate measures to address such risks.

The present risks are essentially the following:

- Continued non-payment of accounts by debtors.
- The requirement to contain personnel costs.
- Non-compliance with sound financial management practices.

- Limited spending on the maintenance and renewal of infrastructure assets.
- Possible acceptance by the municipality of unfunded mandates, such as the provision of Housing, Health, Roads and Library Services.
- Financial implications associated with the establishment of REDS.
- Replenishment of the Capital Replacement Reserve.
- Insufficient cashbacking of the 2010/11 Budget and subsequent budgets.
- The need to enhance the Municipality's revenue base.