

**CITY OF EKURHULENI METROPOLITAN MUNICIPALITY (CoE)  
ORDINARY COUNCIL MEETING**

**2018.01.25**

**A-F (03-2018)**

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**EKURHULENI HOUSING COMPANY (EHC): SUBMISSION OF ANNUAL REPORT INCLUSIVE OF ANNUAL FINANCIAL STATEMENTS AND REPORT OF THE AUDITOR GENERAL FOR THE 2016/2017 FINANCIAL YEAR**

**PURPOSE:**

To submit to Council the Ekurhuleni Housing Company (EHC) Annual Report inclusive of the Annual Financial Statements and the Report of the Auditor General for the 2016/2017 financial year.

**STRATEGIC OBJECTIVE**

Promoting good governance

**WARDS AFFECTED**

All wards

**IDP LINKAGE**

Service Delivery Improvement, Enhanced Oversight / Achievement of Clean Audit Report.

**EXECUTIVE SUMMARY**

The Annual Financial Statements for the 2016/2017 financial year have been prepared and submitted in accordance with Section 126 of the Municipal Finance Management Act 56 of 2003 (MFMA).

The Annual Report for the 2016/2017 financial year is hereby submitted in terms of Section 127 of the MFMA, which requires that the Accounting officer of a municipal entity must, within six months after the end of the financial year, submit the entity's annual report for that financial year to the municipal manager of the entity's parent municipality.

The purpose of the Annual Report as set out in Circular 63 is:

- To provide a record of the activities of the municipality or entity during the financial year to which the report relates;
- To provide a report on performance in service delivery and budget implementation for the financial year;
- To promote accountability to the local community for the decisions made throughout the year by the municipality or municipal entity; and
- To reduce the additional reporting requirements that will otherwise arise from Government Departments, monitoring agencies and financial institutions.

**CITY OF EKURHULENI METROPOLITAN MUNICIPALITY (CoE)  
ORDINARY COUNCIL MEETING**

**2018.01.25**

**A-F (03-2018)**

---

The external audit was completed by 30 November 2017. The Auditor General has issued his report on the annual financial statements and Ekurhuleni Housing Company has achieved an Unqualified Audit.

The annual financial statements disclosed irregular, fruitless and wasteful expenditure that was incurred during the 2016/2017 financial year and as such section 32 of the MFMA must be followed. The council committee referred to in section 32 (2) (b) of the MFMA that will investigate the irregular, fruitless and wasteful expenditure is the MPAC committee. The committee must in their report back to Council, include recommendations regarding whether the expenditure must be:

- Recovered from the employees / service providers where it is found that the irregular, fruitless and wasteful expenditure was incurred deliberately and negligently
- Certified as irrecoverable and written off by Council

This item is giving an overview of the financial results, the report of the Auditor General and the entity's performance results.

**The following Annexures are attached to this submission:**

**Annexure A** Annual Report

**Annexure B** Audited Financial Statements

**Annexure C** Auditor General's Report on the Financial Statements

## **DISCUSSION**

Section 122 of the MFMA 56 of 2003 provides the requirements for the preparation of annual financial statements. Section 126 stipulates that the annual financial statements must be completed within two months after the end of the financial year and their submission for auditing by the Auditor General. The Annual Financial Statements for the 2016/2017 financial year have been prepared in accordance with Section 126 of the Municipal Finance Management Act.

The EHC has completed the financial statements within the legislative deadlines.

Circular 63 received from National Treasury provides detailed explanation of the Annual Report process. EHC has complied with the requirements of the MFMA Circular 63. The unaudited Annual Report, including the Annual Financial Statements, were submitted to the Office of the Auditor General South Africa (AGSA) on 31 August 2017.

The audited Annual Report and Annual Financial Statements must now be noted in Council. The Annual Report must be referred to the oversight committee in terms of section 129 of the MFMA 56 of 2003.

### **A. SUMMARY OF THE FINANCIAL RESULTS FOR THE YEAR ENDED 30 JUNE 2017**

- The **total Revenue** increased by 38% to R134 million from R96, 9 million.

**CITY OF EKURHULENI METROPOLITAN MUNICIPALITY (CoE)  
ORDINARY COUNCIL MEETING**

**2018.01.25**

**A-F (03-2018)**

---

- The **total Expenditure** decreased by 10% to R64, 6 million from R71, 4 million.
- The **Tax Expense** increased by 675% to R73.4 million from R12, 8 million (income).
- The net surplus for the year decreased by 112% to -R4.4 million (loss) from R38, 2 million (income).
- **Capital expenditure** increased by 422%or R87, 4 million from R16, 8 million.

***Detailed analysis is provided in the next two pages:***

**CITY OF EKURHULENI METROPOLITAN MUNICIPALITY (CoE)  
ORDINARY COUNCIL MEETING**

**2018.01.25**

**A-F (03-2018)**

<b>STATEMENT OF FINANCIAL PERFORMANCE</b>						
<b>Figures in Rand</b>	<b>2017</b>	<b>2016</b>	<b>R value</b>	<b>Variance</b>	<b>% Variance</b>	
	(PHll consolidated)	(EDC, PP, PHll, LHI)				
<b>Income</b>						
Rental of facilities	28,222,722	27,250,232	972,490	4%	Increase mainly due to Chris Hani extra rentals.	
Retail rental	54,799	-	54,799	100%	Retail rental now seperately disclosed.	
Transfers recognised	99,358,484	40,815,312	58,543,172	143%	Increase mainly due to Chris Hani building received as a grant in kind.	
Recoveries	4,034,127	4,283,928	-249,801	-6%	Due to legal fees on tenants overdue accounts not recovered from 2016/2017 onw ards.	
Interest earned - external	1,057,342	1,577,766	-520,424	-33%	Due to low er cash balances in banks during the year.	
Interest earned - outstanding debtors	465,680	331,608	134,072	40%	Due to higher gross debtor balances during the year.	
Internal charges	-	20,839,000	-20,839,000	-100%	No more intercompany charges due to consolidation of entities.	
Other revenue	352,363	1,757,669	-1,405,306	-80%		
<b>Gross income</b>	<b>133,545,517</b>	<b>96,855,515</b>	<b>36,690,002</b>	<b>38%</b>		
<b>Expenses</b>						
Employee related cost	-19,311,334	-12,917,032	-6,394,302	50%	Due to staff salary increases, new staff appointments, job grading implementation.	
Remuneration of Directors	-1,529,000	-1,200,000	-329,000	27%	Retention fee implemented.	
Impairment of Consumer Debtors	-2,872,457	-4,617,131	1,744,674	-38%	Due to overall better collection management.	
Impairment on loans	-4,907,393	-	-4,907,393	-100%	Due to LHI loan impaired (LHI liquidated).	
Depreciation & asset	-2,160,278	-1,196,727	-963,551	81%	Due to increased depreciation on new assets, especially Chris Hani building.	
Finance costs, SARS interest and penalties	-5,200,957	-85,888	-5,115,069	5956%	Increase mainly due to interest and penalties payable to SARS on Chris Hani building taxes.	
Lease rentals	-403,140	-	-403,140	-100%	Due to straight lining of leases in terms of GRAP.	
Municipal charges	-6,039,867	-6,427,514	387,647	-6%	Mainly due to LHI municipal charges (excluded due to liquidation and EMM takeover of properties).	
Repairs & Maintenance	-6,741,089	-5,925,020	-816,069	14%	Mainly due to higher tiling expenses.	
Internal charges-management fees	-	-23,756,460	23,756,460	-100%	No more intercompany charges due to consolidation of entities.	
Loss on disposal of assets	-30,213	-	-30,213	-100%	Assets disposed.	
Other expenditure	-15,404,709	-15,274,198	-130,511	1%	2017 in line w ith 2016.	
<b>Gross Expenses</b>	<b>-64,600,437</b>	<b>-71,399,970</b>	<b>6,799,533</b>	<b>-10%</b>		
<b>Surplus before taxation</b>	<b>69,389,636</b>	<b>25,455,545</b>	<b>43,934,091</b>	<b>173%</b>		
Taxation	-73,361,789	12,759,015	-86,120,804	-675%	Increase mainly due to taxes provided on Chris Hani building grant, also reversal of deferred tax asset due to Chris Hani building tax effect and SARS refund of 2016 taxes.	
<b>Net (Loss) / Profit after tax</b>	<b>-4,416,709</b>	<b>38,214,560</b>	<b>-42,631,269</b>	<b>-112%</b>		

**CITY OF EKURHULENI METROPOLITAN MUNICIPALITY (CoE)  
ORDINARY COUNCIL MEETING**

**2018.01.25**

**A-F (03-2018)**

<b>Statement of Financial Position as at 30 June 2017</b>					
<b>Figures in Rand</b>	<b>2017</b>	<b>2016</b>	<b>R value</b>	<b>Variance</b>	<b>% Variance</b>
	(PHII consolidated)	(EDC, PP, PHII, LHI)			
<b>Assets</b>					
<b>Current Assets</b>					
Inventories	-	115,175	-115,175	-100%	Inventories now reclassified (capitalised to form part of Investment properties).
Loans to related entities	420,000	5,035,811	-4,615,811	-92%	LHI Loan Impairment (LHI now liquidated).
Current tax receivable	-	1,053,942	-1,053,942	-100%	Net tax creditor at year end.
Receivables from exchange transactions	1,887,515	452,721	1,434,794	317%	Increase from rental deposit due on leased offices, increase in prepayments (GRAP adjustment).
VAT receivable	532,269	-	532,269	100%	Net VAT debtor at year end (Awaiting SARS VAT refunds on net inputs).
Consumer debtors	793,110	1,089,484	-296,374	-27%	Decrease due to better collections management around year end.
Cash and cash equivalents	20,468,752	19,027,246	1,441,506	8%	Net increase due to grants received in cash.
	<b>24,101,646</b>	<b>26,774,379</b>	<b>-2,672,733</b>	<b>-10%</b>	
<b>Non-Current Assets</b>					
Investment property	131,622,028	47,858,107	83,763,921	175%	Increase mainly due to Chris Hani addition and Block E project capitalised.
Property, plant and equipment	2,499,252	1,149,010	1,350,242	118%	Increase mainly due to access control system bought
Intangible assets	238,603	151,033	87,570	58%	Increase mainly due to higher software license fees and additional users fees.
Deferred tax	-	27,088,609	-27,088,609	-100%	Net deferred tax liability at year end (Chris Hani building and SARS refund result).
	<b>134,359,883</b>	<b>76,246,759</b>	<b>58,113,124</b>	<b>76%</b>	
<b>Total Assets</b>	<b>158,461,529</b>	<b>103,021,138</b>	<b>55,440,391</b>	<b>54%</b>	
<b>Liabilities</b>					
<b>Current Liabilities</b>					
Current tax payable	19,019,772	-	19,019,772	100%	Increase mainly due to EMM Capital Grants now fully taxable (Chris Hani building).
Finance lease obligation	-	46,581	-46,581	-100%	Finance lease settled.
Deferred operating lease	58,620	-	58,620	100%	Due to operating lease straight lining in terms of GRAP.
Trade and other payables from exchange transa	4,975,155	2,645,495	2,329,660	88%	Increase mainly due to EMM water error passed on to EHC to pay (R1million).
Provisions	3,046,943	1,741,909	1,305,034	75%	Due to leave and performance bonus provision increases.
Tenants Deposits	4,258,192	3,441,115	817,077	24%	Increase mainly due to Chris Hani new tenants.
VAT Payable	-	330,168	-330,168	-100%	Decrease due to VAT inputs exceeding outputs.
	<b>31,358,682</b>	<b>8,205,268</b>	<b>23,153,414</b>	<b>282%</b>	
<b>Non-Current Liabilities</b>					
Unspent conditional grants and receipts	12,683,355	7,248,863	5,434,492	75%	Increase mainly due to SHRA grant received (Chris Hani building).
Deferred tax	31,269,194	-	31,269,194	100%	Net deferred tax liability mainly due to Chris Hani building related taxes.
	<b>43,952,549</b>	<b>7,248,863</b>	<b>36,703,686</b>	<b>506%</b>	
<b>Total Liabilities</b>	<b>75,311,231</b>	<b>15,454,131</b>	<b>59,857,100</b>	<b>387%</b>	
<b>Net Assets</b>	<b>83,150,298</b>	<b>87,567,007</b>	<b>-4,416,709</b>	<b>-5%</b>	
Contributions from owners	100	100	-	0%	
Accumulated surplus	83,150,198	87,566,907	-4,416,709	-5%	
<b>Total Net Assets</b>	<b>83,150,298</b>	<b>87,567,007</b>	<b>-4,416,709</b>	<b>-5%</b>	

**CITY OF EKURHULENI METROPOLITAN MUNICIPALITY (CoE)  
ORDINARY COUNCIL MEETING**

**2018.01.25**

**A-F (03-2018)**

---

**INFORMATION TO BE NOTED BY THE COUNCIL IN REVIEWING THE DRAFT ANNUAL FINANCIAL STATEMENTS.**

No adjustment to comparative figures were necessary

**a. REPORT OF THE AUDITOR GENERAL**

The Auditor General (AG) report contained in the annexures to this report is the signed report. The page numbers (which refer to the pages in the annual report) will be included in the published version of the annual report.

The MFMA, Section 126 (3) require The Auditor-General must—

- a) audit those financial statements; and
- b) submit an audit report on those financial statements to the accounting officer of the municipality or entity within three months of receipt of the statements.

The report of the Auditor General will include audit work performed on the following activities of the entity:

- a) Financial Statements, whether the financial statement fairly present in all material aspects the financial results and financial position of the entity and its cash flow
- b) Annual performance, to report: material findings on the reported performance information against predetermined objectives presented in the annual performance report, the usefulness and reliability of the reported performance information.
- c) Compliance with legislation, whether the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters.
- d) Other information.

**The report of the Auditor General is summarized as follows:**

Paragraph 2: Audit Opinion on the financial statements - Unqualified

Paragraph 5: Indicate that sufficient and appropriate audit evidence was obtained to express the audit opinion.

**Emphasis of Matters.**

Emphasis of Matter is intended to draw attention to the matters but it does not change the audit opinion, the audit opinion remains unqualified.

1. Report on the audit of the financial statements.

1.1 Material losses/Impairment – This relates to the irrecoverable bad debt written-off for consumer debtors. The amount of R3, 890, 807 was written off.

1.2 Fruitless and wasteful expenditure was incurred for interest and penalties relating to second provisional tax payment. This is mainly due to transfer of Chris Hani building to EHC. The associated grant amounted to R 79,143,200. Interest and penalties to the amount of R5 093 785 was incurred. The decision to recognise the transfer of Chris Hani in the EHC books took place at year end.

**CITY OF EKURHULENI METROPOLITAN MUNICIPALITY (CoE)  
ORDINARY COUNCIL MEETING**

**2018.01.25**

**A-F (03-2018)**

---

2. Report on the audit of annual performance report.

2.1 No material findings on the usefulness and reliability of the reported performance information for the selected objectives.

3. Report on the audit of compliance with legislation

Material findings.

3.1 Procurement and contract management - Goods and services of a transactional value above R200 000 were procured without inviting competitive bids. The deviation was identified in the procurement processes and approved by the Accounting Officer and the board. The total amount of R1, 936,571.00 was disclosed as a deviation in the AFS.

3.2 Expenditure Management – Irregular expenditure was incurred for the tilling of rental units. The amount of R1 879 177 was incurred.

4. Other information

4.1 No audit opinion expressed on other information. Other information includes the director's report, the audit committee's report, and the company secretary's certificate.

5. Internal Controls

5.1 Financial and performance management.

Review and monitor compliance with applicable laws and regulations. Internal controls with regard to SCM practices be improved to ensure compliance. Internal controls with respect to financial statement be reviewed by management to ensure accurate and reliable reports.

## **B. FINANCIAL PERFORMANCE AGAINST BUDGET**

The comparison between the budget and actual results is reported on page 13 to 15 of the annual financial statements and was previously reported to council in the 4<sup>th</sup> quarter SDBIP report presented to council during the month of July 2017, Refer to Annexure B:

## **C. SDBIP PERFORMANCE/ NON FINANCIAL INFORMATIONS SDBIP**

The full analysis of the 2016/17 Annual Report is contained in the Annual Report submitted or attached (**Annexure A**).

## **ORGANISATIONAL AND HUMAN RESOURCE IMPLICATIONS**

None

## **FINANCIAL IMPLICATIONS**

None

**CITY OF EKURHULENI METROPOLITAN MUNICIPALITY (CoE)  
ORDINARY COUNCIL MEETING**

**2018.01.25**

**A-F (03-2018)**

---

**LEGAL IMPLICATIONS**

The legal section has not been approached for comments.

**COMMUNICATION IMPLICATION**

None.

**OTHER DEPARTMENTS/ BODIES CONSULTED**

The Audit Committee and Internal Auditor reviewed the draft annual financial statements and Annual Reports during the preparation processes and their recommendations were taken into account before the draft annual financial statements and Annual Reports were submitted to the Auditor General for auditing.

**RECOMMENDATION**

1. **That** the Annual Report, inclusive of the Annual Financial Statements and the Report of the Auditor-General for the 2016/2017 financial year, **BE NOTED**.
2. **That** the report, inclusive of the reports of the Municipal Entities, **BE REFERRED** to the Municipal Public Accounts Committee (MPAC) for the oversight process as contemplated in section 129 of the Municipal Finance Management Act.
3. **That** all instances of Irregular, Fruitless and Wasteful Expenditure as reported in the Annual Financial Statements, inclusive of the reports of the Municipal Entities, **BE REFERRED** to the Municipal Public Accounts Committee (MPAC) for investigation as contemplated in section 32 of the Municipal Finance Management Act.
4. **That** the Municipal Public Accounts Committee **REPORT BACK** to Council by no later than end March 2017 as required by sections 32 and 129 of the Municipal Finance Management Act.
5. **That** the final year end transactions for the compilation of the financial statements as described in the report, **BE APPROVED**.
6. **That** the municipality and municipalities entities Annual Reports, inclusive of the Annual Financial Statements and the Report of the Auditor-General for the 2016/2017 financial year, **BE APPROVED**.



**CITY OF EKURHULENI METROPOLITAN MUNICIPALITY (CoE)  
ORDINARY COUNCIL MEETING**

**2018.01.25**

**A-F (03-2018)**

---