

Directors' Report

In terms of the Public Finance Management Act No. 1 of 1999, as amended, the Board of Umgeni Water is the accounting authority and the directors have pleasure in presenting their report for the year ended 30 June 2010.

Nature of business

Umgeni Water is a state owned business enterprise, established in 1974 to supply potable water in bulk to municipalities within its operational area. Umgeni Water defines its activities in line with the Water Services Act No. 108 of 1997. The primary activities in terms of section 29 of the Act are:

- (a) to treat raw water and distribute the treated water via its infrastructure and
- (b) the treatment and disposal of bulk wastewater.

In terms of section 30 of the Act, Umgeni Water also engages in other services that complement bulk water service provision such as laboratory services, water quality monitoring and environmental management and acts as an implementing agent for any sphere of government for projects related to water service delivery.

Compliance with legislation

The annual financial statements are prepared in accordance with International Financial Reporting Standards and the following relevant statutes:

- Water Services Act No. 108 of 1997;
- Public Finance Management Act No. 1 of 1999, as amended (PFMA); and
- Public Audit Act No. 25 of 2004.

These acts require preparation of the financial information to be in compliance with the Companies Act No. 61 of 1973, as amended.

Corporate governance and risk management

The Board supports the principles of the Code of Corporate Practices and Conduct as set out in the King II Report and substantially complies therewith. The Codes as per King III which will be adopted in the new financial year are now called the Code of Governance Principles. The Board is responsible for monitoring the risk management process.

For further details on corporate governance and risk management refer to the section on corporate governance detailed on page 18.

Share capital and directors' interests

The entity has no share capital and therefore no director has any equity interest in the organisation.

Directorate

The Board as it is currently constituted is set out on pages 18 to 26 of the annual report.

Members of the Board and Executive Committee's emoluments are disclosed in the Remuneration Report on pages 110 to 111 in terms of regulation 28.1 of the PFMA.

Company secretary and registered address

The company secretary is Ms Marlene Hilton and her registered address and that of the registered office are as follows:

Business address	Postal address
310 Burger street Pietermaritzburg 3201	PO Box 9 Pietermaritzburg 3200

Auditors

Deloitte and Touche continued in office as auditors of Umgeni Water and its subsidiaries. The auditor General has been appointed as the external auditor for the 2011 financial year.

Directors' Report continued

Tariff policy

Umgeni Water's tariff policy is to set the lowest possible constant tariff in real terms. The underlying principles of this policy are:

- the promotion of the efficient and sustainable use of water;
- the equitable access to water supply services, whereby the basic water service should be affordable; and
- the solvency and sound financial management of Umgeni Water.

Umgeni Water's tariff model uses the cash flow methodology and is based on a constant tariff in real terms. This implies that tariff increases be linked to CPI annually. The trade-off is a changing debt level. Debt will first increase as net cash flows are negative, and then decrease as net cash flows become positive. The higher annual tariffs and controlled expenditure will result in a growing net surplus, which will be directed towards debt repayment.

The annual tariff process encompasses the principle of consultation and transparency and aims to assist Umgeni Water's stakeholders with their long term planning. The tariff process adheres fully to Section 42 of the Municipal Finance Management Act and Circular 23 issued by National Treasury.

After full analysis of its projected cash flows, the directors were of the opinion that the tariff for 2010/2011 is appropriate and will not adversely affect Umgeni Water's gearing levels and financial sustainability. The tariff increase for 2010/2011 effective 1 July 2010 has been agreed at 6.2% for all Water Service Authorities.

	2009	2010	2011
<u>Price per kilolitre</u>			
<u>Bulk tariff 1</u>			
Base tariff	R2.960	R3.078	R3.279
Tariff increase	R0.118	R0.201	R0.203
New tariff	R3.078	R3.279	R3.482
% increase	4.0%	6.5%	6.2%
<u>Bulk tariff 2-eThekweni Metropolitan Municipality</u>			
Base tariff	R2.960	R3.019	R3.215
Tariff increase	R0.059	R0.196	R0.199
New tariff	R3.019	R3.215	R3.414
% increase	2.0%	6.5%	6.2%

Financial performance

The positive operating performance and cash flows have enabled the group to strengthen its financial position and further reduce its gearing levels during the current year.

Profit for the year of R541m was 3% higher than the R527m in the previous year and was mostly due to the 31% reduction in finance costs.

Cash generated from operating activities increased by 13.6% to R847m (2009: R745m). The amount spent on capital projects (PPE & intangible assets) totalled R334m (2009: R237m). Cash generated as a result of the issuance of the UG21 bond amounted to R600m whilst R1,086m was used to repay debt, R41m placed in financial investments and R32m net interest paid.

Directors' Report continued

The total interest bearing debt has reduced by R462m to R1 517m (2009: R1,979m) resulting in a reduction of the gearing level to 0.73 (2009: 1.28).

Refer to the annual financial statements for full details of financial performance and the financial review on page 90.

Capital expenditure and commitments

Capital expenditure for the year amounted to R330m (2009: R234m) for property, plant and equipment and R5m (2009: R3m) for intangible assets (software). The group's capital commitments are set out in note 8 of the annual financial statements and the funding thereof is discussed in the financial review on page 96.

Changes to subsidiary and associate companies

There were no changes to subsidiary and associate companies during the year. Further details are set out in note 11 of the annual financial statements.

Post balance sheet events

No material events have taken place in the affairs of the group between the end of the financial year and the date of this report.

Going concern

The directors, having considered all the relevant information, have satisfied themselves that the group is in a sound financial position and that it has adequate access to sufficient borrowing facilities to meet its foreseeable cash requirements. There are adequate resources to continue operating for the foreseeable future and it is therefore appropriate to adopt the going concern basis in preparing the financial statements.

INFORMATION REQUIRED BY THE PUBLIC FINANCE MANAGEMENT ACT NO. 1 OF 1999, AS AMENDED

Materiality framework

In terms of Section 28.3.1 of the regulations of the PFMA, for the purposes of materiality and significance, the accounting authority has developed and agreed a framework of acceptable levels of materiality and significance established at 0.5% of gross revenue which equates to R8.2m (2009: R7.5m). Management also apply a qualitative aspect to all errors found.

Fruitless and wasteful expenditure

Based on the materiality framework, no significant fruitless and wasteful expenditure was incurred during the current financial year.

Irregular expenditure

Based on the materiality framework, no significant irregular expenditure was incurred during the current financial year.

Financial misconduct

There were instances of procurement misconduct in the current financial year which are still subject of a forensic audit.

Disciplinary proceedings will be instituted, employees charged, and criminal proceedings instituted where applicable. Internal controls continue to be reviewed and improved.

Directors' Report continued

Performance against financial targets (Parent only)

The performance of Umgeni Water against the key financial indicators as agreed in the shareholders compact is illustrated in the table that follows.

Indicator	Unit	2010 Target	Jun-10	Jun-09
Average potable water tariff	R/kl	3.23 ✓	3.23	3.03
Average tariff increases	%	CPI ✓	6.5	3
CPI	%	n/a	4.2	6.9
Capital investment in PPE & intangible assets	R'000	655,215 ✗ ¹	332,115	236,145
Return on assets <i>Profit from operations/total assets [excl. fin assets]</i>	%	18.58 ✓	20.00	22.63
Interest cover ratio <i>Profit from operations/net finance costs</i>	No.	3.92 ✓	7.74	5.51
Debt to equity <i>Total interest-bearing debt/capital & reserves</i>	No.	0.62 ✗ ²	0.73	1.28
Current ratio <i>Current assets / current liabilities</i>	No.	0.81 ✓	2.43	0.99
Debtors collection period <i>Accounts receivable(excl Vat) / revenue x 365 days</i>	Days	33 ✗ ³	51	39
Credit rating – Long-term	(ZAF)	AA+ ✓	AA+	AA+
- Short-term	(ZAF)	F1+ ✓	F1+	F1+

✓ Achieved
 ✗ Not achieved

Reasons for not meeting the financial targets as per the shareholder's compact are as follows:

- (1) The under spend was primarily due to project scope changes arising from customer requirements.
- (2) The issue of the UG21 bond for R600m had not been budgeted in 2010.
- (3) The approved target was not met by 18 days as a result of the following overdue debtors: Bulk water debtors R26m primarily Msunduzi Local Municipality, commercial debtors R48m primarily DWA for dam operating and maintenance costs. Overdue bulk water debtor amounts were subsequently received in July 2010.

Disclosures required in terms of directives received

Directive issued by National Treasury on 16 July 2010

Soccer World Cup clothing and tickets

Umgeni Water has not incurred any expenditure on soccer world cup clothing and tickets during the year ended 30 June 2010.

Directive issued by The Minister of Water and Environmental Affairs on 2 February 2010

Request for increased involvement in OR Tambo District Municipality water services

Umgeni Water incurred R0.5m expenditure for the year ended 30 June 2010 in terms of the directive for the scoping of the turnaround strategy and monitoring exercise at OR Tambo District Municipality.