

Notes to the Consolidated Annual Financial Statements

For the year ended 30 June 2010

1. ACCOUNTING POLICIES

GENERAL INFORMATION

Umgeni Water is a water board established in terms of Section 28 of the Water Services Act, 108 of 1997 and a national government business entity as per Schedule 3B of the Public Finance Management Act No. 1 of 1999, as amended, domiciled in South Africa. The address of its registered office, principal place of business and the principal activities of the organisation are described in the Director's Report on page 106. The following principal accounting policies were applied by Umgeni Water for the year ended 30 June 2010.

STATEMENT OF COMPLIANCE

The consolidated annual financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations of those standards, as issued by the International Accounting Standards Board (IASB) and the Public Finance Management Act No. 1 of 1999, as amended.

ADOPTION OF NEW AND REVISED STANDARDS

During the current year the following accounting standards, interpretations and amendments to accounting standards which are relevant to Umgeni Water were adopted:

IFRS 3 Business Combinations (Revised) effective 1 July 2009

The changes affect the valuation of non-controlling interest, the accounting for transaction costs as an expense, the initial recognition and subsequent measurement of a contingent consideration at fair value at acquisition date and for business combinations achieved in stages any gain or loss on the difference between the fair value and the carrying amount of the previously held equity interest in the acquiree to be recognised in profit or loss. The change in accounting policy was applied prospectively from its effective date and had no material impact on profit for the year.

IAS 27 Consolidated and Separate Financial Statements (Amended) Effective 1 January 2009

IAS 27 (Amended) requires that a change in the ownership interest of a subsidiary (without loss of control) is accounted for as a transaction with owners in their capacity as owners. Therefore, such transactions will no longer give rise to goodwill, nor will it give rise to a gain or loss. When control of an investee is lost, the resulting gain/loss is recognised in profit/loss. Losses have to be allocated to the non-controlling interest even if it results in a deficit position. The change in accounting policy was applied prospectively and had no material impact on profit for the year.

IFRS 7 Financial Instruments: Disclosures Effective 1 January 2009

The amended standard requires additional disclosures about fair value measurement and liquidity risk. The fair value measurement disclosures had no material impact on disclosures. The liquidity risk disclosures are not significantly impacted by the amendments and are presented in Note 28.2.2.

IFRS 8 Operating Segments Effective 1 January 2009

IFRS 8 replaced IAS 14 *Segment Reporting* upon its effective date. The Group concluded that the operating segments determined in accordance with IFRS 8 are the same as the business segments previously identified under IAS 14. IFRS 8 disclosures are shown in the Segmental Report on page 116.

IAS 1 Presentation of Financial Statements Effective 1 January 2009

The revised standard separates owner and non-owner changes in equity. The statement of changes in equity includes only details of transactions with owners, with non-owner changes in equity presented in a reconciliation of each component of equity. In addition, the standard introduces the statement of comprehensive income: it presents all items of recognised income and expense, either in one single statement, or in two linked statements. The Group has elected to present one statement.

IAS 23 Borrowing Costs Effective 1 January 2009

The revised IAS 23 requires capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. This was previously the policy of the group and as a result IAS 23 was early adopted in June 2009.

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

1. ACCOUNTING POLICIES continued

ADOPTION OF NEW AND REVISED STANDARDS continued

IFRIC 18 Transfers of Assets from customers Effective 1 July 2009

IFRIC 18 provides guidance on accounting for transactions in which an entity receives property, plant, or equipment from a customer and uses the asset to connect the customer to a network or to provide the customer with an ongoing access to a supply of goods or services (or both). IFRIC 18 also applies to transactions in which the entity receives cash from the customer and uses the cash to construct or acquire an item of plant, property, or equipment for such an arrangement. IFRIC 18 is applicable prospectively for transfers of assets received on or after 1 July 2009. The adoption of this interpretation did not have any impact on the financial position or performance of the group during the current year, but may have an impact going forward.

Improvements to IFRSs

In May 2008 and April 2009 the IASB issued an omnibus of amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. There are separate transitional provisions for each standard. The adoption of the amendments resulted in changes to accounting policies but did not have any impact on the financial position or performance of the group.

PRINCIPAL ACCOUNTING POLICIES

BASIS OF PREPARATION OF FINANCIAL RESULTS

The consolidated financial statements are prepared using the historic cost basis except for certain items such as financial instruments and biological assets which are stated at fair value as set out in the accounting policies below.

The consolidated financial statements are prepared on the going concern basis using the accrual basis of accounting except for cash flow information.

Except as otherwise disclosed, these accounting policies are consistent with those applied in all periods presented in these consolidated financial statements.

BASIS OF CONSOLIDATION OF FINANCIAL RESULTS

Business combinations are accounted for using the acquisition method. On acquisition date, fair values are attributed to the identifiable assets, liabilities and contingent liabilities. Fair value of all identifiable assets and liabilities included in the business combination are determined by reference to market values of those similar items, where available, or by discounting expected future cash flows using the discount rate to present values. The consideration transferred is the fair value of the group's contribution to the business combination in the form of assets transferred, liabilities assumed or contingent consideration at the acquisition date. Transaction costs directly attributable to the acquisition are charged to the statement of comprehensive income.

A non-controlling interest at acquisition date is determined as the non-controlling shareholders' proportionate share of the fair value of the net identifiable assets of the entity acquired.

On acquisition date goodwill is recognised when the consideration transferred and the recognised amount of the non-controlling interests exceeds the fair value of the net identifiable assets of the entity acquired. Goodwill is tested at each reporting date for impairment. To the extent that the fair value of the net identifiable assets of the entity acquired exceeds the consideration transferred and the recognised amount of non-controlling interests, the excess is recognised in the statement of comprehensive income on acquisition date.

When an acquisition is achieved in stages (step acquisition), the identifiable assets and liabilities are recognised at their full fair value when control is obtained, and any adjustment to fair values related to these assets and liabilities previously held as an equity interest is recognised in the statement of comprehensive income.

When there is a change in the interest in a subsidiary after control is obtained, that does not result in a loss in control, the difference between the fair value of the consideration transferred and the amount by which the non-controlling interest is adjusted is recognised directly in the statement of changes in equity.

The profit or loss realised on disposal or termination of an entity is calculated after taking into account the carrying value of any related goodwill.

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

1. ACCOUNTING POLICIES continued

BASIS OF CONSOLIDATION OF FINANCIAL RESULTS continued

Subsidiaries

The assets, liabilities, income, expenses and cash flows of subsidiaries are consolidated from the date of acquisition, being the date on which the group obtains control, and continue to be consolidated until the date that such control ceases. Control is achieved where Umgeni Water has the power to govern the financial and operating policies of the acquired entity so as to obtain benefits from its activities.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used in line with those used by the group. All material inter-company balances and transactions are eliminated.

Associates

An associate is an entity over which the group has significant influence and that is neither a subsidiary nor a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

The financial results of associates are included in the group's results according to the equity method from acquisition date until disposal date. Under this method, subsequent to the acquisition date, the group's share of profits or losses is charged to the statement of comprehensive income as equity accounted earnings and its share of movements in reserves is recognised as other comprehensive income, except where the movement in equity reserves relates to the group in its capacity as owner where it is recognised in the statement of changes in equity. All cumulative post-acquisition movements in equity of associates are adjusted against the cost of the investment. When the group's share of losses in associate equals or exceeds its interest in those associates, the group does not recognize further losses, unless the group has incurred a legal or constructive obligation or made payments on behalf of those associates.

Goodwill relating to associates forms part of the carrying value of those associates.

The total carrying value of each associate is evaluated annually, as a single asset, for impairment or when conditions indicate that a decline in fair value below the carrying amount is other than temporary. If impaired, the carrying value of the group's share of the underlying assets of associates is written down to its estimated recoverable amount in accordance with the accounting policy on impairment and charged to the statement of comprehensive income as part of equity accounted earnings of that associate.

Where the reporting date of an associate differs from that of the group, adjustment are made to the associate's most recent audited financial results for material transactions and events that occur since then to the reporting date of the group.

Where a group entity transacts with an associate of the group, unrealised profits and losses are eliminated to the extent of the group's interest in the relevant associate.

PROPERTY, PLANT & EQUIPMENT

Property, plant and equipment is stated at cost less accumulated depreciation and impairment. Land is not depreciated. The gain or loss arising on the disposal or retirement of an item of property, plant and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the statement of comprehensive income.

Works under construction are stated at cost which includes cost of materials, direct labour, allocated portion of direct project overheads and any costs incurred in bringing it to its present location and condition. Work in progress is commissioned on date of significant completion.

Servitudes are considered an integral part of the asset and are essential to the operation of the asset and therefore form part of the cost of relevant tangible asset.

Borrowing costs are capitalised on qualifying assets in accordance with the relevant accounting policy on finance costs.

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

1. ACCOUNTING POLICIES continued

PROPERTY, PLANT & EQUIPMENT continued

When property, plant and equipment comprise major components with different useful lives, these components are accounted for as separate items. Expenditure incurred to replace or modify a significant component of plant is capitalised and any remaining book value of the component replaced is written off in the statement of comprehensive income. All other expenditure is charged to the statement of comprehensive income.

Property, plant and equipment is depreciated to its estimated residual value on a straight line basis over its expected useful life. The depreciation methods, estimated remaining useful lives and residual values are reviewed at least annually.

Asset category	Estimated useful life (years)
Buildings and Infrastructure	
Buildings	40
Dams and weirs	45
Pipelines	30-45
Pump stations	10-30
Reservoirs and intake works	45
Tunnels	45
Water treatment works	10-45
Wastewater treatment works	10-45
Equipment and vehicles	
Plant & equipment, furniture & fittings	5
Vehicles	5
Computers	3-5

LEASES

Classification

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

In the capacity of a lessor

Amounts due from lessees under finance leases are recorded as receivables at the amount of the group's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the group's net investment outstanding in respect of the leases.

Rental income from operating leases with fixed escalation clauses is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised on a straight line basis over the lease term.

In the capacity of a lessee

Assets held under finance leases are recognised as assets of the group at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability to the lessor is included in the statement of financial position as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income.

Rentals payable under operating leases with fixed escalation clauses are charged to income on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight-line basis over the lease term.

INVESTMENT PROPERTY

Investment property, which is held to earn rentals and for capital appreciation is shown at cost, less subsequent depreciation and impairment.

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

1. ACCOUNTING POLICIES continued

INTANGIBLE ASSETS (Other than goodwill)

Research and development

Research expenditure is charged to the statement of comprehensive income when incurred. Development expenditure is recognised as an expense, unless it is probable that it will give rise to a product that will generate future benefits for the organisation, in which case it is capitalised.

Development costs are only recognised as assets if all the following conditions are met:

- an asset is created that can be identified;
- it is probable that the asset created will generate future economic benefits; and
- the development costs of the asset can be measured reliably.

Software

Software is carried at cost less accumulated amortisation and impairment. Internally developed and packaged software and the direct costs associated with the development and installation thereof are capitalised and recognised as intangible assets.

Software is amortised in full on a straight-line basis as follows:

- customised software 5 years;
- shelf software 2 years.

Costs associated with research and development of computer software programs are recognised as an expense as they are incurred. Development costs are capitalised if it meets the criteria for capitalising development expenditure.

Costs relating to the acquisition of licences are treated as an expense in the period in which the licence is acquired.

Other intangible assets

Intangible assets are initially recognised at cost if acquired separately or internally generated, or at fair value if acquired as part of a business combination. If assessed as having an indefinite useful life, it is not amortised but tested for impairment annually and impaired if necessary. If assessed as having a finite useful life, it is amortised over its useful life using a straight-line basis, and tested for impairment if there is an indication that it may be impaired.

NON-CURRENT ASSETS OR DISPOSAL GROUPS HELD FOR SALE

Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Where a disposal group held for sale will result in the loss of control of a subsidiary, all the assets and liabilities of that subsidiary are classified as held for sale, regardless of whether a non-controlling interest in the former subsidiary is to be retained after the sale.

Upon classification of a non-current asset or disposal group as held for sale it is reviewed for impairment. The impairment charged to the statement of comprehensive income is the excess of the carrying value of the non-current asset or disposal group over its expected fair value less costs to sell.

Non-current assets (and disposal groups) classified as held for sale are measured at the lower of the assets' previous carrying amount and fair value less costs to sell. No depreciation or amortisation is provided on non-current assets from the date they are classified as held for sale.

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

1. ACCOUNTING POLICIES continued

NON-CURRENT ASSETS OR DISPOSAL GROUPS HELD FOR SALE continued

If a non-current asset or disposal group is classified as held for sale, but the criteria for classification as held for sale is no longer met, the disclosure of such non-current asset as held for sale is ceased. On ceasing classification, the non-current assets are reflected at the lower of:

- The carrying amount before classification as held for sale adjusted for any depreciation or amortisation that would have been recognised had the asset not been classified as held for sale;
- The recoverable amount at the date the classification as held for sale ceases. The recoverable amount is the amount at which the asset would have been recognised after the allocation of any impairment loss arising on the cash generating unit as determined in accordance with the group's policy on the impairment of non-financial assets.

Any adjustments required to be made on reclassification are recognised in the statement of comprehensive income on reclassification, and included in income from continuing operations.

Where the disposal group was also classified as a discontinuing operation, the subsequent classification as held for sale also requires that the discontinued operation be included in continuing operations. Comparative information relating to the classification as a discontinued operation is restated accordingly.

BIOLOGICAL ASSETS

Game stock and plantations are measured at their fair value less estimated point-of-sale costs. The fair value of biological assets are determined annually based on market prices of similar age, genes, and genetic merit. All changes in fair values are recognised in the statement of comprehensive income in the period in which they arise.

IMPAIRMENT OF NON-FINANCIAL ASSETS

At each reporting date, the group reviews the carrying amounts of its non-financial assets other than inventories and deferred tax to determine whether there is any indication that the carrying value may not be recoverable and whether those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any. Where the asset does not generate cash flows that are independent from other assets, the group estimates the recoverable amount of the cash-generating unit to which the asset belongs. An intangible asset with an indefinite useful life is tested for impairment annually and whenever there is an indication that the asset may be impaired.

Recoverable amount is the higher of fair value less costs to sell and value-in-use. In assessing value-in-use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted. If the recoverable amount of an asset, or cash-generating unit, is estimated to be less than its carrying amount, the carrying amount of the asset or cash-generating unit, is reduced to its recoverable amount.

An impairment loss is recognised as an expense immediately, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss, other than goodwill, subsequently reverses, the carrying amount of the asset or cash-generating unit is increased to the revised estimate of its recoverable amount, in order that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset or cash generating unit, in prior years.

A reversal of an impairment loss is recognised as income immediately, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

1. ACCOUNTING POLICIES continued

INVENTORIES

Inventories are stated at the lower of the weighted average cost and net realisable value. Obsolete, redundant and slow-moving inventories are identified and written down to the estimated net realisable value.

Net realisable value is the estimate of the selling price in the ordinary course of business, less the estimated costs of completion, selling and distribution expenses.

TRADE AND OTHER RECEIVABLES

Short duration receivables with no stated interest rate are measured at original invoice amount less allowance for doubtful debts.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise cash on hand. Cash and cash equivalents are measured at carrying value which is deemed to be fair value.

UMGENI WATER CAPITAL AND GRANT FUNDING

Capital grants for infrastructure received by Umgeni Water after 1 July 2000 are reflected against property, plant and equipment. These are amortised against income over the remaining useful life of the assets to which the grants relate.

Capital grants received prior to 1 July 2000 are shown on the statement of financial position as Umgeni Water capital and are included under capital.

Government grants towards staff re-training are recognised as income over the periods necessary to match them with the related costs and are deducted in reporting the related expense.

EMPLOYEE BENEFITS

Retirement benefit costs - Provident fund

Contributions to the defined contribution retirement benefit plan for the provident fund are recognised as an expense when employees have rendered service entitling them to the contributions.

Retirement benefit costs – Pension fund

For the defined benefit retirement benefit plans, the cost of providing benefits is determined using the projected unit credit method, with actuarial valuations being carried out every three years. Actuarial gains and losses that exceed ten percent of the greater of the present value of the group's defined benefit obligation and the fair value of plan assets as at the end of the prior year are amortised over the expected average remaining working lives of the participating employees. Past service cost is recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight line basis over the average period until the benefit becomes vested.

The retirement benefit obligation recognised in the statement of financial position represents the present value of the defined benefit obligation as adjusted for unrecognised actuarial gains and losses and unrecognised past service cost, and as reduced by the fair value of plan assets. Any asset resulting from this calculation is limited to unrecognised actuarial losses and past service cost, plus the present value of available funds and reductions in future contributions to the plan.

Other retirement benefits

Post-retirement healthcare benefits are provided to certain of the entity's retirees. The cost of providing benefits is determined using the projected unit credit method with actuarial valuations being carried out every year. Actuarial gains and losses are recognised immediately in the year in which they arise.

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

1. ACCOUNTING POLICIES continued

EMPLOYEE BENEFITS continued

Short-term employee benefits

Short-term employee benefits are those that are due to be settled within twelve months after the end of the period in which the services have been rendered. Remuneration of employees is charged to the statement of comprehensive income. The group recognises a liability for leave and performance bonuses which is included in provisions and accrues for other short-term employee benefits.

TRADE AND OTHER PAYABLES

Trade payables are not interest bearing and are stated at their nominal value.

PROVISIONS

Provisions are recognised when the group has a present legal or constructive obligation as a result of a past event and it is probable that this will result in an outflow of economic benefits that can be reliably estimated.

Onerous contracts

Provision for onerous contracts is recognised when the expected benefits to be derived by the group from a contract are lower than the unavoidable cost of meeting the obligations under the contract.

FINANCIAL GUARANTEE CONTRACTS

Financial guarantee contracts are accounted for in terms of IFRS 4 insurance contracts and consequently are measured initially at cost and thereafter in accordance with IAS 37 - Provisions, contingent liabilities and contingent assets.

FINANCIAL ASSETS

The group classifies its financial assets into the following categories:

- Held-to-maturity financial assets;
- Loans and receivables;
- Available-for-sale financial assets.

The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition. Management re-evaluates such designation at least at each reporting date.

Financial assets are recognised on transaction date when the group becomes party to the contracts and thus obtains rights to receive economic benefits and are derecognised when those rights no longer exist.

Financial assets are stated initially on transaction date at fair value including transaction costs. Held-to-maturity financial assets and loans and receivables are subsequently stated at amortised cost using the effective interest rate method. Available-for-sale financial assets are subsequently stated at fair value at reporting date.

Unrealised gains and losses arising from revaluation of available-for-sale financial assets are recognised as other comprehensive income and included in the investment revaluation reserve. On disposal or impairment of available-for-sale financial assets, cumulative unrealised gains and losses previously recognised as other comprehensive income are included respectively in determining the profit or loss on disposal of, or impairment charge relating to, that financial asset, which is recognised in the statement of comprehensive income.

The fair values of financial assets are based on quoted prices in an active market at the close of business on the reporting date. If the market for a financial asset is not active, the entity establishes the fair value in accordance with the valuation technique which adopts a constant spread approach.

Premiums or discounts arising from the difference between the fair value of a financial asset and the amount receivable at maturity date are charged to the statement of comprehensive income based on the effective interest rate method.

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

1. ACCOUNTING POLICIES continued

FINANCIAL ASSETS continued

Impairment of financial assets

Financial assets are assessed for indicators of impairment at each reporting date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted. For financial assets carried at amortised cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables where the carrying amount is reduced through the use of a doubtful debts allowance account. When a trade receivable is uncollectable, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited to profit or loss. Changes in the carrying amount of the allowance account are recognised in profit or loss.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through profit and loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

Derecognition of financial assets

The entity derecognises a financial asset only when the contractual rights to the cash flows from the asset expire; or it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity.

FINANCIAL LIABILITIES

Financial liabilities are initially recognised at fair value, net of transaction costs incurred and are subsequently stated at amortised cost. Premiums or discounts arising from the difference between the fair value of financial liabilities raised and the amount repayable at maturity date are charged to the statement of comprehensive income as finance costs based on the effective interest rate method.

Derecognition of financial liabilities

The group derecognises financial liabilities when, and only when, the group's obligations are discharged, cancelled or they expire.

EFFECTIVE INTEREST METHOD

The effective interest method is a method of calculating the amortised cost of a financial asset/financial liability and of allocating interest income/expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts/cash payments (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial asset/financial liability, or, where appropriate, a shorter period.

OFFSET

Financial assets and financial liabilities are only offset if there is a legal right to offset and there is an intention either to settle on a net basis or to realise the asset and settle the liability simultaneously.

REVENUE

The group recognizes revenue when the amount of revenue can be reliably measured and it is probable that economic benefits will flow to the entity. Revenue is measured at the fair value of the consideration received or receivable net of discounts and value added taxation. Revenue is recognised as follows:

Sale of goods

Sale of goods is recognised when significant risks and rewards of ownership have passed and the collectability of the related receivable is reasonably assured. Sale of goods consists of potable bulk water sales to customers.

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

1. ACCOUNTING POLICIES continued

REVENUE continued

Sale of goods continued

Water revenue is recognised at the point of metering to the customer.

Sale of services

Sale of services is recognised in the period in which the services are rendered. Sale of services consist of other services that complement bulk water service provision such as laboratory services, water quality monitoring and acting as an implementing agent for any sphere of government for projects related to water service delivery.

Sale of services from acting as an implementing agent is recognised by reference to the stage of completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided (refer below construction contracts).

Other revenue

Other revenue is recognised when the significant risks and rewards of ownership are transferred to the purchaser and the amount of revenue can be measured reliably.

Construction contracts

Contract revenue includes the initial amount agreed in the contract plus any variations in contract work to the extent that they will result in revenue and can be measured reliably. As soon as the outcome of a contract can be estimated reliably, contract revenue and contract costs are recognised in profit or loss by reference to the stage of completion of the contract.

The stage of completion is assessed by reference to the completion of a physical proportion of the work or surveys of the work performed. When an outcome of a construction contract cannot be estimated reliably, contract revenue is recognised only to the extent of contract costs incurred that are likely to be recoverable. An expected loss on a contract is recognised immediately in profit or loss.

COST OF SALES

Cost of sales includes the costs of raw water and all other direct operating costs associated with the production processes. The costs directly attributable to sales for other activities, as defined in section 30 of the Water Services Act, are disclosed as cost of sales. All other costs are considered to be administration expenses.

TAXATION

Umgeni Water and Msinsi Holdings (Pty) Ltd are tax-exempt entities in terms of Section 10 (1) (t) (ix) of the Income Taxation Act and therefore the policy is only in respect of its subsidiary, Umgeni Water Services (Pty) Ltd and associates.

The income tax charge represents the tax currently payable and deferred tax.

Current Tax

The tax currently payable is based on taxable income for the year. Taxable income differs from profit as reported in the statement of comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the reporting date.

Deferred Tax

Deferred tax is the tax expected to be payable or recoverable on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable income, and is accounted for using the liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. No deferred tax is recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

1. ACCOUNTING POLICIES continued

TAXATION continued

Deferred Tax continued

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the entity intends to settle its current tax assets and liabilities on a net basis.

FINANCE COSTS

All finance costs are reflected in the statement of comprehensive income in the period in which they are incurred.

Finance costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing cost eligible for capitalisation to those assets.

INTEREST INCOME

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Notes to the Consolidated Annual Financial Statements

For the year ended 30 June 2010

2. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

2.1. CRITICAL JUDGEMENTS IN APPLYING THE GROUP'S ACCOUNTING POLICIES

Management has made the following judgements in the process of applying the group's accounting policies that potentially have the most significant effect on the amounts recognised in the financial statements:

2.1.1 Other provisions

Other provisions included in note 22 are based on the uncertainty of revenue previously recognised.

2.1.2 Reticulation financial asset

The judgement applied to the amortisation of the reticulation financial asset included in note 13 is 6 years. This was based on the debt curve of Umgeni Water at the time of raising the financial asset in 2006.

2.1.3 Held-to-maturity financial assets

The directors have reviewed the entity's held-to-maturity financial assets in the light of its capital maintenance and liquidity requirements and have confirmed its positive intention and ability to hold those assets to maturity. The carrying amount of the held-to-maturity financial assets is R19m (2009: R742m). Details of these assets are disclosed in note 12.

2.2. KEY SOURCES OF ESTIMATION UNCERTAINTY

2.2.1 Fair value of financial instruments

Financial instruments are valued using a discounted cash flow analysis based on assumptions supported, where possible, by observable market prices or rates. Details of the assumptions used and of the results of sensitivity analyses regarding these assumptions are provided in the financial risk management section (note 28).

2.2.2 Post-retirement healthcare benefits

The key assumptions relating to the post-retirement healthcare sensitivity analysis are disclosed in note 26.3.

No further key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date exist, that management may have assessed as having a significant risk of causing material adjustment to the carrying amounts of the assets and liabilities within the next financial year.

	Group		Parent	
	2010	2009	2010	2009
	R'000	R'000	R'000	R'000
3. REVENUE				
Water sales	1,374,017	1,259,555	1,374,017	1,259,555
Wastewater	44,216	41,930	44,216	41,930
Other activities	214,810	191,203	204,147	184,011
- Household and school sanitation	123,401	128,435	123,401	128,435
- Water infrastructure	47,230	24,986	47,230	24,986
- Scientific and environmental	18,315	17,513	18,315	17,513
- Other	25,864	20,269	15,201	13,077
Included in revenues arising from water sales are revenues of approximately R1,055m (2009: R984m) from sales to the group's largest customer.				
Total revenue	1,633,043	1,492,688	1,622,380	1,485,496
4. OTHER INCOME				
Sundry income	6,884	30,109	6,237	29,411
Rental income	1,645	1,598	1,525	1,415
Total other income	8,529	31,707	7,762	30,826

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

	Group		Parent	
	2010	2009	2010	2009
	R'000	R'000	R'000	R'000
5. PROFIT FROM OPERATIONS				
Profit from operations is stated after taking the following discloseable items into account:				
<u>Included in other operating and administration expenses:</u>				
Asset impairments and write-offs	9,806	2,072	9,790	1,942
Amortisation	98,978	94,218	98,978	94,218
- Reticulation asset (refer to note 13)	97,717	93,504	97,717	93,504
- Intangible assets (refer to note 9)	1,261	714	1,261	714
Auditors' remuneration	1,292	1,327	1,152	1,081
- Audit fees - current year	1,309	1,221	1,169	977
- Audit fees - prior year (over)/under provision	(17)	106	(17)	104
Board members' emoluments (refer pg 110)	3,621	1,135	3,606	1,113
Depreciation (refer to note 8)	15,995	13,517	15,359	12,869
- Buildings and infrastructure	2,491	2,478	2,491	2,478
- Equipment and vehicles	13,504	11,039	12,868	10,391
Doubtful debts provision (refer to note 16)	(2,576)	4,401	(2,576)	4,401
Fair value adjustment of biological assets (refer to note 10)	293	(966)	633	360
Investment impairments reversed	-	(24,314)	(2,721)	(25,579)
Operating lease payments	1,026	161	405	161
Profit on disposal of property, plant and equipment	(608)	(13,459)	(592)	(13,567)
Staff costs (including retirement benefits)	230,872	210,940	214,375	193,578

	Group		Parent	
	2010	2009	2010	2009
	No.	No.	No.	No.
Number of employees at 30 June				
Permanent	853	829	771	733
Contract	110	92	110	92
Total	963	921	881	825

	Group		Parent	
	2010	2009	2010	2009
	R'000	R'000	R'000	R'000
6. INTEREST INCOME				
Interest received - investments	123,920	119,422	123,920	119,422
Interest received - reticulation financial asset (refer to note 13)	26,158	30,313	26,158	30,313
Interest received - other	490	1,458	345	1,340
Total interest income	150,568	151,193	150,423	151,075

	Group		Parent	
	2010	2009	2010	2009
	R'000	R'000	R'000	R'000
7. FINANCE COSTS				
Interest on bank overdrafts and loans	259,982	274,844	260,140	274,926
Less: borrowing costs capitalised (refer to note 8)	(29,641)	(7,355)	(29,641)	(7,355)
Interest was capitalised to work-in-progress at the gross weighted average cost of capital.				
Gross weighted average cost of capital 9.50% (2009: 12.52%)				
Total finance costs	230,341	267,489	230,499	267,571

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

	Land	Buildings and infrastructure	Equipment and vehicles	Capital work in progress	Total Parent	Subsidiaries	2010 Group
	R'000	R'000	R'000	R'000	R'000	R'000	R'000
8. PROPERTY, PLANT AND EQUIPMENT							
Year ended 30 June 2010							
Net book value 1 July 2009	7,139	2,180,443	34,148	250,105	2,471,835	1,240	2,473,075
Cost	7,139	2,692,664	128,133	250,105	3,078,041	7,838	3,085,879
Accumulated depreciation	-	(512,221)	(93,985)	-	(606,206)	(6,598)	(612,804)
Additions	-	-	-	327,197	327,197	2,343	329,540
Grant funding	-	-	-	(21,946)	(21,946)	-	(21,946)
Borrowing costs capitalised	-	-	-	29,641	29,641	-	29,641
Disposals/Asset write-offs	-	-	(50)	-	(50)	(3)	(53)
Cost	-	-	(7,986)	-	(7,986)	(735)	(8,721)
Accumulated depreciation	-	-	7,936	-	7,936	732	8,668
Transfer to intangible asset	-	-	(139)	-	(139)	-	(139)
Cost	-	-	(244)	-	(244)	-	(244)
Accumulated depreciation	-	-	105	-	105	-	105
Transfers to non-current asset held for sale	(981)	(15,953)	-	-	(16,934)	-	(16,934)
Cost	(981)	(18,954)	-	-	(19,935)	-	(19,935)
Accumulated depreciation	-	3,001	-	-	3,001	-	3,001
Transfer to financial asset	-	(25,352)	-	-	(25,352)	-	(25,352)
Cost	-	(41,778)	-	-	(41,778)	-	(41,778)
Accumulated depreciation	-	16,426	-	-	16,426	-	16,426
Depreciation charge	-	(67,681)	(12,868)	-	(80,549)	(636)	(81,185)
Impairment	-	(2,640)	-	-	(2,640)	-	(2,640)
Commissioning	-	231,624	12,412	(244,036)	-	-	-
Total property, plant and equipment	6,158	2,300,441	33,503	340,961	2,681,063	2,944	2,684,007
Cost	6,158	2,859,828	132,315	340,961	3,339,262	9,446	3,348,708
Accumulated depreciation	-	(559,387)	(98,812)	-	(658,199)	(6,502)	(664,701)
Total property, plant and equipment	6,158	2,300,441	33,503	340,961	2,681,063	2,944	2,684,007

	Land	Buildings and infrastructure	Equipment and vehicles	Capital work in progress	Total Parent	Subsidiaries	2009 Group
	R'000	R'000	R'000	R'000	R'000	R'000	R'000
Year ended 30 June 2009							
Net book value 1 July 2008	7,139	2,217,324	26,138	55,166	2,305,767	1,187	2,306,954
Cost	7,139	2,668,829	114,230	55,166	2,845,364	7,239	2,852,603
Accumulated depreciation	-	(451,505)	(88,092)	-	(539,597)	(6,052)	(545,649)
Additions	-	-	-	233,371	233,371	832	234,203
Borrowing costs capitalised	-	-	-	7,355	7,355	-	7,355
Disposals/Asset write-offs	-	(424)	-	(81)	(505)	(131)	(636)
Cost	-	(526)	(4,498)	(81)	(5,105)	(233)	(5,338)
Accumulated depreciation	-	102	4,498	-	4,600	102	4,702
Depreciation charge	-	(62,326)	(10,391)	-	(72,717)	(648)	(73,365)
Impairment	-	(1,436)	-	-	(1,436)	-	(1,436)
Transfers/commissioning	-	27,305	18,401	(45,706)	-	-	-
Total property, plant and equipment	7,139	2,180,443	34,148	250,105	2,471,835	1,240	2,473,075
Cost	7,139	2,692,664	128,133	250,105	3,078,041	7,838	3,085,879
Accumulated depreciation	-	(512,221)	(93,985)	-	(606,206)	(6,598)	(612,804)
Total property, plant and equipment	7,139	2,180,443	34,148	250,105	2,471,835	1,240	2,473,075

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

8. PROPERTY, PLANT AND EQUIPMENT continued

Infrastructure consists of: pipelines, dams, weirs, reservoirs, tunnels, pump stations, sludge plants, wastewater treatment works and waterworks.

Equipment and vehicles consists of: motor vehicles, computer hardware and furniture & fittings. The subsidiaries property, plant and equipment are all classified as equipment and vehicles.

The impairment losses on infrastructure arose due to the cessation of use in the production of income.

A schedule of land and buildings is available for inspection at the registered office of Umgeni Water. A number of properties, which are not significant in nature and do not impact on Umgeni Water's operations, are subject to land claims in terms of the Restitution of Land Rights Act 22 of 1994 and have thus been transferred to assets held for sale.

	Group	
	2010	2009
	R'000	R'000
8.1 CAPITAL WORK IN PROGRESS		
57 pipeline augmentation	105,461	55,614
61 pipeline DV Harris to World's View	87,802	27,618
61 pipeline ED2 to ED4	22,651	3,517
61 pipeline ED4 to Umlaas Road	7,484	1,564
Avondale to Honolulu pipeline phase 1	1,263	77,408
Durban Heights booster pump station	1,069	38,569
Greater Mpofana regional scheme	4,408	2,661
Hazelmere PLC	2,236	810
Hazelmere to bifurcation	3,174	-
Honolulu to Mvoti	37,207	-
Lower Thukela	5,320	-
Maphephethwa Water Works	3,177	1,462
Maphumulo bulk water supply phase 1	10,774	-
Ngcebo KwaDukuza bulk water scheme	301	19,967
Richmond pipeline	10,458	4,915
South Coast booster pump station	25,417	3,404
Wartburg bulk system phase 1	2,204	1,930
Sub-total	330,406	239,439
Other projects	10,555	10,666
Costs including capitalised interest	340,961	250,105
8.2 PROPERTY, PLANT & EQUIPMENT CAPITALISED		
Summary of major projects capitalised, including interest are as follows:		
Avondale to Honolulu pipeline phase 1	117,305	-
Durban Heights northern aqueduct booster pump station	62,084	-
Ngcebo bulk water supply scheme phase 1	34,759	-
51 pipeline condition assessment	5,104	-
South Coast pipeline phase 1 (Toti to Park Rynie)	9,979	15,195
DV Harris	-	2,000
Pipeline Greendale to Howick Water Works	-	5,793
Other projects	2,393	4,317
Sub-total immoveable assets capitalised	231,624	27,305
Moveable assets capitalised	12,412	18,401
Total property, plant & equipment capitalised	244,036	45,706

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

	Group		Parent	
	2010	2009	2010	2009
	R'000	R'000	R'000	R'000
8. PROPERTY, PLANT AND EQUIPMENT continued				
8.3 CAPITAL COMMITMENTS				
Commitments in respect of capital expenditure:				
- contracted for but not provided for in the financial statements	145,352	208,380	145,352	208,380
- authorised but not contracted for	1,012,988	306,725	1,012,988	306,725
The expenditure is substantially for the expansion, augmentation and upgrades of pipelines and water works.				
Total capital commitments	1,158,340	515,105	1,158,340	515,105
Estimated capital expenditure to be incurred as follows:				
- Within one year	637,964	332,000	637,964	332,000
- Two to five years	387,946	183,105	387,946	183,105
- More than five years	132,430	-	132,430	-
	1,158,340	515,105	1,158,340	515,105
The proposed capital expenditure will be financed through internally generated funds and borrowings.				
9. INTANGIBLE ASSETS				
SOFTWARE				
Net book value 1 July	3,185	1,125	3,185	1,125
Cost	33,717	30,943	33,717	30,943
Accumulated amortisation	(30,532)	(29,818)	(30,532)	(29,818)
Additions	4,917	2,774	4,917	2,774
Transfers from property, plant and equipment (refer note 8)	139	-	139	-
Amortisation	(1,261)	(714)	(1,261)	(714)
Total intangible assets	6,980	3,185	6,980	3,185
Cost	38,811	33,717	38,811	33,717
Accumulated amortisation	(31,831)	(30,532)	(31,831)	(30,532)
Total intangible assets	6,980	3,185	6,980	3,185
10. BIOLOGICAL ASSETS				
10.1 PLANTATIONS	1,533	2,166	1,533	2,166
Opening carrying amount	2,166	2,526	2,166	2,526
Fair value adjustment	(633)	(360)	(633)	(360)
The carrying value was based on an estimated 283 hectares at an estimated average net standing value of R5,401 per hectare.				
10.2 GAME	4,648	4,588	-	-
Opening carrying amount	4,588	4,159	-	-
Disposals	(280)	(897)	-	-
Fair value adjustment	340	1,326	-	-
The carrying value was based on an estimated 476 game, the most significant categories being Blue Wildebeest, Kudu and zebra.				
Total biological assets	6,181	6,754	1,533	2,166
11. INVESTMENTS IN SUBSIDIARIES AND ASSOCIATES				
Investments in associates	5,703	3,994	-	-
Cost	2,590	2,590	-	-
Share of post-acquisition reserves	3,113	1,404	-	-
Loans to/(from) subsidiaries and associates	-	-	4,882	3,440
Msinsi Holdings (Pty) Ltd	-	-	(141)	(283)
Umgeni Water Services (Pty) Ltd	-	-	5,023	3,723
Total investments in subsidiaries and associates	5,703	3,994	4,882	3,440

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

11. INVESTMENTS IN SUBSIDIARIES AND ASSOCIATES continued

	Principal activity	Place of incorporation	Proportion of ownership interest		Proportion of voting power held	
			2010 %	2009 %	2010 %	2009 %
Investments in subsidiaries						
Umgeni Water Services (Pty) Ltd	Water analysis	RSA	100	100	100	100
Msinsi Holdings (Pty) Ltd	Land & environmental management	RSA	100	100	100	100

The above entities remained subsidiaries throughout the year.

Umgeni Water has subordinated its right to claim R5.0m (2009:R3.7m) owing by Umgeni Water Services (Pty) Ltd until the assets, fairly valued, exceed the liabilities.

Umgeni Water continues to provide financial support to Msinsi Holdings (Pty) Ltd to ensure that the company continues to trade in the foreseeable future without any disruption in its business.

	Principal activity	Place of incorporation	Proportion of ownership interest		Proportion of voting power held	
			2010 %	2009 %	2010 %	2009 %
Investments in associate of Umgeni Water Services (Pty) Ltd						
Durban Water Recycling (Pty) Ltd	Water recycling	RSA	18.5	18.5	18.5	18.5

Umgeni Water Services has significant influence over Durban Water Recycling (Pty) Ltd through the exercise of voting power rights and is thus accounted for as an associate.

Durban Water Recycling (Pty) Ltd's financial year end is 31 December. There have been no material transactions or events since then to the reporting date of the group.

	Carrying amount		Directors' valuation	
	2010	2009	2010	2009
	R'000	R'000	R'000	R'000
Investments in associate of Umgeni Water Services (Pty) Ltd				
Durban Water Recycling (Pty) Ltd	5,703	3,994	5,703	3,994

	2010	2009
	R'000	R'000
Summarised financial information of associate:		
Total non-current assets	42,613	45,984
Total non-current liabilities	43,346	53,627
Total current assets	45,317	42,395
Total current liabilities	13,758	13,161
Total capital and reserves	30,826	21,591
Total revenue of associate	53,518	50,069
Share of profit for the year	2,993	1,264

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

	Group		Parent	
	2010	2009	2010	2009
	R'000	R'000	R'000	R'000
12. INVESTMENTS				
12.1. LONG TERM INVESTMENTS	18,622	22,481	18,622	22,481
Held-to-maturity	18,622	22,481	18,622	22,481
12.2. SHORT TERM INVESTMENTS	1,178,673	1,213,416	1,178,673	1,213,416
Loans and receivables	1,178,673	493,666	1,178,673	493,666
Held-to-maturity	-	719,750	-	719,750
Amounts invested in the money market which were previously classified as available-for-sale have been reclassified to loans and receivables to reflect the group's true intention in terms of these investments. Refer to note 28 financial risk management and financial instruments for maturity profile and fair value of investments.				
Total investments	1,197,295	1,235,897	1,197,295	1,235,897
13. OTHER FINANCIAL ASSETS				
13.1. RETICULATION FINANCIAL ASSET	85,475	157,034	85,475	157,034
Opening balance	157,034	220,225	157,034	220,225
Amortisation	(97,717)	(93,504)	(97,717)	(93,504)
Interest income	26,158	30,313	26,158	30,313
13.2. RIGHT OF USE AGREEMENTS	18,083	-	18,083	-
Portion of 57 pipeline (refer note 8)	25,352	-	25,352	-
Impairment	(7,150)	-	(7,150)	-
Amortisation	(248)	-	(248)	-
Interest income	129	-	129	-
Other financial assets are classified as loans and receivables, the carrying value approximates fair value.				
Total other financial assets	103,558	157,034	103,558	157,034
14. ASSETS HELD FOR SALE				
Powaprops 31 (Proprietary) Limited	105	105	-	-
Ixopo Hope Farm	2,453	-	2,453	-
Darvill Doornhoek Farm	981	-	981	-
Shongweni Dam	13,500	-	13,500	-
The Darvill Doornhoek Farm and Shongweni Dam are subject to land claims. These assets were transferred at their carrying amounts with no further depreciation until disposed of.				
Total assets held for sale	17,039	105	16,934	-
15. INVENTORIES				
15.1. STORES	7,612	7,514	7,577	7,498
Pipe inventories	764	806	764	806
Maintenance spares	2,004	2,032	2,004	2,032
Chemicals	2,980	2,687	2,980	2,687
Stock-in-transit	-	48	-	48
Miscellaneous	1,864	1,941	1,829	1,925
15.2. WATER INVENTORY	1,030	1,631	1,030	1,631
Water inventory consists of closing stock of raw and treated water.				
Total inventories	8,642	9,145	8,607	9,129

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

	Group		Parent	
	2010	2009	2010	2009
	R'000	R'000	R'000	R'000
16. TRADE AND OTHER RECEIVABLES				
Trade debtors	259,786	178,847	259,786	178,831
Sundry debtors	7,639	10,080	6,964	9,280
Less: provision for doubtful debts	(2,512)	(5,133)	(2,512)	(5,133)
Opening Balance	(5,133)	(732)	(5,133)	(732)
Utilised during the year	45	1	45	1
Reversed/(provided for) during the year	2,576	(4,402)	2,576	(4,402)
Total trade and other receivables	264,913	183,794	264,238	182,978

Trade debtors comprise bulk water and wastewater sales to a number of municipalities of which eThekweni Metropolitan Municipality and Msunduzi Local Municipality comprise a significant proportion - 90.9% (2009: 92%) of sales.

Trade debtors are granted credit terms of 30 days from date of invoice to settle outstanding debts. The average credit period, at financial year-end, is 52 days (2009: 39 days).

Of the trade receivables balance at the end of the year, R101m (2009: R92m) is due from eThekweni Metropolitan Municipality, the group's largest customer.

Trade and other receivables are classified as loans and receivables and the carrying value approximates fair value. A further analysis of financial risk relating to trade receivables is included in note 28.

	Group		Parent	
	2010	2009	2010	2009
	R'000	R'000	R'000	R'000
17. INTEREST AND PREMIUM RECEIVABLE				
Interest and premiums have been accrued for where biannual coupon bonds and zero-coupon bonds have earned interest, but have not been received at year-end.	12,314	3,282	12,314	3,282
Interest and premium receivable relating to current investments are classified as loans and receivables, the carrying value approximates fair value.				
Total interest and premium receivable	12,314	3,282	12,314	3,282

18.1. BANK AND CASH

Cash and cash equivalents consist of:

Bank and cash on hand	1,690	7,699	-	4,775
Bank overdraft	(17,421)	-	(17,421)	-

The carrying amount of bank and cash is held at amortised cost and approximates its fair value.

The group's outstanding guarantees are disclosed under note 25.

Total bank and cash	(15,731)	7,699	(17,421)	4,775
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Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

	Group		Parent	
	2010	2009	2010	2009
	R'000	R'000	R'000	R'000
18.2. RECONCILIATION OF PROFIT FOR THE YEAR TO NET CASH GENERATED FROM OPERATING ACTIVITIES				
Profit for the year	540,712	527,014	540,024	525,638
Adjusted for non-cash items:				
Interest income	(150,568)	(151,193)	(150,423)	(151,075)
Finance costs	230,341	267,489	230,499	267,571
Fair value adjustment of biological assets	293	(966)	633	360
Losses on biological assets (on sale and death)	110	17	-	-
Asset impairments and write-offs	9,806	1,941	9,790	1,941
Investment impairments reversed	-	(24,315)	(2,721)	(25,579)
Amortisation - reticulation financial asset	97,717	93,504	97,717	93,504
Amortisation - Darvill revenue in advance	(3,572)	(3,572)	(3,572)	(3,572)
Amortisation - intangible asset	1,261	714	1,261	714
Depreciation	81,185	73,365	80,549	72,717
Profit on disposal of property, plant and equipment	(608)	(13,459)	(592)	(13,568)
Increase in provisions and non-current liabilities	25,901	25,869	26,540	24,995
(Decrease)/increase in doubtful debts provision	(2,576)	4,401	(2,576)	4,401
Profit from associate	(2,985)	(1,264)	-	-
Operating surplus before working capital changes	827,017	799,545	827,129	798,047
Working capital changes	19,604	(54,267)	18,856	(54,890)
Increase in accounts receivable	(78,539)	(38,000)	(78,682)	(38,576)
Decrease in inventory	502	1,138	521	1,122
Increase/(decrease) in accounts payable	97,641	(17,405)	97,017	(17,436)
Net cash from operating activities	846,621	745,278	845,985	743,157
19. CAPITAL				
Capital consists primarily of contributions made by the Department of Water Affairs	442,847	442,847	442,847	442,847
Total capital	442,847	442,847	442,847	442,847
20. DEBT				
Long-term	1,400,166	917,448	1,400,166	917,448
Short-term	117,282	1,061,455	117,282	1,061,455
Debt consists of interest-bearing liabilities held by Umgeni Water at amortised cost and is unsecured.				
Total debt	1,517,448	1,978,903	1,517,448	1,978,903

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

20. DEBT continued

20.1. Analysis of debt held at amortised cost

	Terms of repayment	Weighted average interest rate as at 30 June 2010	Group		Parent	
			2010	2009	2010	2009
			R'000	R'000	R'000	R'000
Bank loans			917,448	1,029,852	917,448	1,029,852
Fixed rate	semi annual	9.18%	467,448	529,852	467,448	529,852
Variable	semi annual	8.50%	450,000	500,000	450,000	500,000
Bonds	on maturity					
Fixed rate (net of discount)	2011	10.70%	600,000	949,051	600,000	949,051
Total debt			1,517,448	1,978,903	1,517,448	1,978,903
Refer to note 28 financial risk management and financial instruments for maturity profile and fair value of debt.						
Reconciliation of movement in debt for the year						
Balance at the beginning of the year			1,978,903	2,078,335	1,978,903	2,078,335
Loans raised			600,000	-	600,000	-
Loans repaid			(1,086,095)	(122,186)	(1,086,095)	(122,186)
Discount amortised			24,640	22,754	24,640	22,754
Balance at the end of the year			1,517,448	1,978,903	1,517,448	1,978,903

Umgeni Water has a financial structure that underlies loan 56 and in terms of the final settlement thereof, it has made a deposit with and ceded it in favour of Rand Merchant Bank, for future settlement and with right of set-off against an equal liability. Accordingly these assets and liabilities have been offset and are not reflected in the annual financial statements.

21. OTHER NON-CURRENT LIABILITIES

Amounts owing to customer

Amounts owing to a customer in terms of a settlement agreement, held at amortised cost which approximates fair value.

	Group		Parent	
	2010	2009	2010	2009
	R'000	R'000	R'000	R'000
Amounts owing to customer	16,965	18,125	16,965	18,125
Total other non-current liabilities	16,965	18,125	16,965	18,125

22. PROVISIONS

Group

	Leave pay	Legal fees	Bonus	Other	Total 2010	Total 2009
	R'000	R'000	R'000	R'000	R'000	R'000
Opening balance	20,320	6,299	9,454	24,372	60,445	119,788
Provided for during the year	4,796	617	12,088	850	18,351	13,194
Utilised during the year	(2,162)	-	(9,784)	(3,186)	(15,132)	(72,538)
Closing balance	22,954	6,916	11,759	22,036	63,664	60,444

Parent

Opening balance	19,350	6,299	9,454	23,017	58,120	118,340
Provided for during the year	4,352	617	12,088	-	17,057	11,162
Utilised during the year	(1,791)	-	(9,784)	(1,624)	(13,199)	(71,382)
Closing balance	21,911	6,916	11,759	21,393	61,978	58,120

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

22. PROVISIONS continued

The leave pay provision is based on the number of days leave due to employees at financial year end times their cost to company per day.

Legal fees are raised to the extent that it is probable Umgeni Water will be required to honour obligations.

The provision for bonus is raised to recognise the performance of employees, which is payable at the Board's discretion in line with the Performance Management Scheme.

A provision of R21m is being held for tax structured loans that have not reached the prescription period.

All provisions are raised in the ordinary course of business and no material unutilised provisions were written back.

	Group		Parent	
	2010	2009	2010	2009
	R'000	R'000	R'000	R'000
23. ACCOUNTS PAYABLE				
Trade accounts payable	49,895	43,355	48,165	42,055
Accruals	64,888	74,206	64,868	74,206
Amounts due to related parties:				
- Water purchases accrual (DWA)	93,597	62,317	93,597	62,317
Sundry creditors	52,165	42,817	50,546	41,373
Section 30 customer advances	95,761	38,856	95,761	38,856
Receiver of Revenue - VAT	17,895	15,011	17,895	15,011
Trade accounts payable and accruals comprise amounts outstanding for trade purchases.				
Trade and other payables are carried at amortised cost and the carrying value approximates fair value.				
Total accounts payable	374,201	276,562	370,832	273,818
24. OPERATING LEASE ARRANGEMENTS				
At the reporting date, the group had no outstanding commitments under non-cancellable operating leases.				
The group as the lessor - rental income				
The group owns a number of properties from which rental income of R1.5m (2009: R1.4m) was earned.				
At the reporting date, the group had contracted with tenants for the following future minimum lease payments.				
	3,773	3,045	3,773	3,045
0 - 1 year	938	1,230	938	1,230
1 - 5 years	2,835	1,815	2,835	1,815
> 5 years	-	-	-	-
Total operating lease arrangements	3,773	3,045	3,773	3,045
25. CONTINGENT LIABILITIES				
Collateral				
Collateral security has been given to certain financial institutions in respect of mortgage loans advanced to employees under the home ownership scheme.				
	90	90	90	90
Guarantees				
Guarantees have been given by certain financial institutions in respect to payments to utility service providers.				
	1,022	1,196	1,022	1,196
Total contingent liabilities	1,112	1,286	1,112	1,286

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

	Group		Parent	
	2010	2009	2010	2009
	R'000	R'000	R'000	R'000
26. POST-RETIREMENT BENEFIT OBLIGATIONS				
All the Umgeni Water retirement benefit plans are governed by the Pension Funds Act (No. 24 of 1956) of South Africa. All full-time employees are compelled to belong to either the defined benefit or the defined contribution plan.				
Summary of net liabilities for post-retirement benefit obligations:				
Defined benefit plan (refer 26.2)	12,353	16,384	12,353	16,384
Post-retirement healthcare benefits (refer 26.3)	177,389	153,088	177,389	153,088
Total post-retirement benefit obligations	189,742	169,472	189,742	169,472

26.1 DEFINED CONTRIBUTION PLAN

The total cost charged to income represents the group's portion of the contribution payable to this scheme. At reporting date all amounts due and payable to this scheme had been paid.

	Group	Parent
	2010	2009
	R'000	R'000
	9,372	6,681

26.2 DEFINED BENEFIT PLAN

The Umgeni Water Retirement Fund was established with effect from 1 December 1985 and was closed to new members with effect from 6 February 2007. The scheme is funded and actuarially valued every three years. The effective date of the most recent valuation is 30 June 2010.

The assets of the Umgeni Water Retirement Fund are held separately from those of the entity in a trustee administered fund, registered in terms of the Pension Funds Act, 1956.

	Group		Parent	
	2010	2009	2010	2009
Key assumptions used in the actuarial valuation were as follows:				
Discount rate	9.25%	9.50%	9.25%	9.50%
Expected return on plan assets	10.25%	10.50%	10.25%	10.50%
Expected rate of salary increases	6.75%	7.00%	6.75%	7.00%
Pension increase allowance	4.60%	4.00%	4.60%	4.00%

	Group		Parent	
	2010	2009	2010	2009
	R'000	R'000	R'000	R'000
Amounts recognised in profit/loss in respect of the defined benefit plan are as follows:				
Current service cost	16,789	17,625	16,789	17,625
Interest on obligation	37,346	39,525	37,346	39,525
Actuarial loss	1,423	1,141	1,423	1,141
Expected return on plan assets	(32,693)	(32,313)	(32,693)	(32,313)
Total included in staff costs in statement of comprehensive income	22,865	25,978	22,865	25,978

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

	Group		Parent	
	2010	2009	2010	2009
	R'000	R'000	R'000	R'000
26. POST-RETIREMENT BENEFIT OBLIGATIONS continued				
26.2 DEFINED BENEFIT PLAN continued				
The amount included in the statement of financial position arising from the group's obligation in respect of its defined benefit plan is as follows:				
Present value of funded defined benefit obligation	414,533	375,903	414,533	375,903
Fair value of plan assets	(363,417)	(296,983)	(363,417)	(296,983)
Under funded status	51,116	78,920	51,116	78,920
Unrecognised net actuarial losses	(38,763)	(62,536)	(38,763)	(62,536)
Net liability in statement of financial position	12,353	16,384	12,353	16,384
Movement in the net liability recognised in the statement of financial position is as follows:				
Net liability at start of year	16,384	14,057	16,384	14,057
Net expense recognised in the statement of comprehensive income	22,865	25,978	22,865	25,978
Company contributions	(26,896)	(23,651)	(26,896)	(23,651)
Net liability at end of year	12,353	16,384	12,353	16,384
Movements in the defined benefit obligation in the current period were as follows:				
Defined benefit obligation at beginning of year	375,903	368,499	375,903	368,499
Current service cost	16,789	17,625	16,789	17,625
Member contributions	6,596	6,216	6,596	6,216
Interest cost	37,346	39,525	37,346	39,525
Actuarial loss/(gain)	3,042	(32,903)	3,042	(32,903)
Benefits paid	(18,734)	(21,827)	(18,734)	(21,827)
Risk premiums	(6,409)	(1,232)	(6,409)	(1,232)
Defined benefit obligation at end of year	414,533	375,903	414,533	375,903
Movements in the present value of plan assets in the current period were as follows:				
Fair value of plan assets at beginning of year	296,983	295,917	296,983	295,917
Expected return on plan assets	32,693	32,313	32,693	32,313
Member contributions	6,596	6,216	6,596	6,216
Employer contributions	26,896	23,651	26,896	23,651
Actuarial loss/(gain)	25,392	(38,055)	25,392	(38,055)
Benefits paid	(18,734)	(21,827)	(18,734)	(21,827)
Risk premiums	(6,409)	(1,232)	(6,409)	(1,232)
Fair value of plan assets at end of year	363,417	296,983	363,417	296,983
	Group		Parent	
	2010	2009	2010	2009
The major category of plan assets, and the expected rate of return at the end of the reporting period for each category, are as follows:				
Cash	16.41%	17.56%	16.41%	17.56%
Equity	51.87%	58.97%	51.87%	58.97%
Bonds	7.64%	3.64%	7.64%	3.64%
Property	5.73%	5.27%	5.73%	5.27%
International	17.04%	12.21%	17.04%	12.21%
Other	1.31%	2.35%	1.31%	2.35%
Total	100.00%	100.00%	100.00%	100.00%

The group expects to make a contribution of R19m to the defined benefit plan during the next financial year.

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

26. POST-RETIREMENT BENEFIT OBLIGATIONS continued

26.3 POST-RETIREMENT HEALTHCARE BENEFITS

The scheme is unfunded and the group has recognised its full past service liability. Actuarial valuations are done annually. Employees who joined Umgeni Water after 28 February 2002 cannot elect to join this scheme.

	Group		Parent	
	2010	2009	2010	2009
Key assumptions used in the actuarial valuation, performed at 30 June 2010:				
Discount rate	9.00%	9.25%	9.00%	9.25%
Expected rate of increase in medical indices	7.50%	8.00%	7.50%	8.00%

	Group		Parent	
	2010	2009	2010	2009
	R'000	R'000	R'000	R'000
Amounts recognised in profit/loss in respect of the post-retirement healthcare costs are as follows:				
Current service cost	5,838	5,303	5,838	5,303
Interest on obligation	14,032	10,375	14,032	10,375
Actuarial loss	7,776	8,962	7,776	8,962
Total included in staff costs in statement of comprehensive income	27,646	24,640	27,646	24,640

The amount included in the statement of financial position arising from the group's obligation in respect of its post-retirement healthcare obligations is as follows:

Opening balance	153,088	131,162	153,088	131,162
Net expense recognised in the statement of comprehensive income	27,646	24,640	27,646	24,640
Company contributions	(3,345)	(2,714)	(3,345)	(2,714)

Net liability at end of year	177,389	153,088	177,389	153,088
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Movements in the post-retirement healthcare obligation in the current period were as follows:

Projected benefit obligation at beginning of year	153,088	131,162	153,088	131,162
Current service cost	5,838	5,303	5,838	5,303
Interest cost	14,032	10,375	14,032	10,375
Actuarial loss	7,776	8,962	7,776	8,962
Employer contributions	(3,345)	(2,714)	(3,345)	(2,714)
Projected benefit obligation at end of year	177,389	153,088	177,389	153,088

The group expects to make a contribution of R4m (2009: R3m) to the defined benefit plan during the next financial year.

An analysis of the impact of changes in the underlying assumptions used in the actuarial valuation are presented in the table below:

Sensitivity factor	Central assumption	Accrued Liability			
		Increase	Decrease	Increase	Decrease
		%	R'000	%	R'000
1% change in medical aid inflation rates	8.00%	21.0%	37,232	(16.3%)	(28,926)
1 year change in expected retirement age	60 years	(4.5%)	(7,966)	4.7%	8,325
1% change in discount rate	8.0%	(15.9%)	(28,281)	20.8%	36,943

The information presented above is as per the latest valuation, which was performed on 30 June 2010.

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

27. RELATED PARTIES

Umgeni Water, its subsidiaries and other public entities enter into various sale, purchase and service transactions in the ordinary course of business. Material related party transactions are as follows:

	Group		Parent	
	2010	2009	2010	2009
	R'000	R'000	R'000	R'000
Management fee paid to Msinsi Holdings (Pty) Ltd	-	-	14,000	14,217
Interest paid on Msinsi Holdings (Pty) Ltd loan	-	-	(179)	(100)
Purchases from Msinsi Holdings (Pty) Ltd	-	-	126	233
Raw water purchases from DWA	83,870	77,744	83,870	77,744
Loans (from)/to subsidiaries and associates:				
Msinsi Holdings (Pty) Ltd	-	-	(141)	(283)
Umgeni Water Services (Pty) Ltd	-	-	5,023	3,723

Refer to Remuneration Report on page 110 for directors' and executives' emoluments.

28. FINANCIAL RISK MANAGEMENT AND FINANCIAL INSTRUMENTS

28.1 CAPITAL RISK MANAGEMENT

Umgeni Water's objective for managing capital is to enhance shareholder (The Executive Authority) value by providing efficient and reliable water services to customers at the lowest economic cost while reducing debt, remaining financially self sufficient and generating sufficient surplus to meet the required capital expenditure programme. This objective has remained consistent with the prior years.

As a government business enterprise, Umgeni Water strives towards a target optimal capital structure, which is made up of a combination of financial liabilities (refer note 20) and capital and reserves as disclosed in the Statement of Changes in Equity on page 114. This structure is agreed annually between Umgeni Water and its Executive Authority (The Department of Water Affairs) in the shareholders compact and is managed in terms of the targeted debt to equity ratio and Umgeni Water's tariff policy.

28.1.1 Capital management

Capital and reserves is consistent with the prior year and consists of:

	Group		Parent	
	2010	2009	2010	2009
	R'000	R'000	R'000	R'000
Capital	442,847	442,847	442,847	442,847
Accumulated profit	1,645,157	1,104,445	1,639,294	1,099,270
Total	2,088,004	1,547,292	2,082,141	1,542,117

Performance against the corporate strategic objectives to enhance shareholder value (Parent only)

INDICATOR	2010 TARGET	2010	2009
Capital & reserves (R'000)	1,953,543	2,082,141	1,542,117
Profit for the year (R'000)	470,178	540,024	525,638
Debt:equity ratios*	0.62	0.73	1.28
<i>Total interest-bearing debt / capital & reserves</i>			

* Due to the tightening of liquidity in the financial markets and the economic recession in South Africa during 2009, the Board adopted a strategy of pre-funding the cash flow requirements. The budgeted target did not include this pre-funding strategy.

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

28. FINANCIAL RISK MANAGEMENT AND FINANCIAL INSTRUMENTS continued

28.1 CAPITAL RISK MANAGEMENT continued

28.1.2 Debt management

Debt management strategies

Umgeni Water's treasury strategy focuses on solvency and debt management through the cash flow tariff model, after taking into account the long-term business plans, water demand curves, and future capital expenditure. The liability curve and debt redemption is then actively managed:

- By targeting an optimal debt level.
- Asset liability matching, through a redemption strategy framework which pro-actively manages liquidity and refinancing risk associated with large debt maturities such as bonds.
- Within approved borrowing limits.
- By maintaining an external credit rating.

(a) Optimal debt level

Umgeni Water strives to be within its current optimal debt level of R1.6bn with the target debt interest rate structure of 70% fixed and 30% floating so as to minimise volatility of both the tariff and income statement.

	Group	
	2010	2009
	R'000	R'000
Gross Debt (Refer note 20)	1,517,448	2,003,544
Optimal debt level	1,600,000	1,400,000
Within/(exceeding) optimal debt level	82,552	(603,544)

During the current year Umgeni Water settled the UG65 bond with a maturity value of R973m and issued a new bond UG21 for R600m with a maturity date of 2021. The UG21 bond together with the DBSA loans constitute 96.4% of the total funding structure of R1,517m.

(b) Asset liability management

Asset and liability matching focuses on two components:

- The first being the matching of maturity dates of financial assets and liabilities whereby financial assets will be used to repay debt on its maturity. This will typically be applied in a redemption strategy.
- The second component is whereby debt is matched with periods when the business will generate excess cash after operating expenditure and interest cost. The surplus cash will therefore be applied to debt redemption.

Taking the business environment and market conditions into account, the following framework is used in managing the redemption portfolio build-up over a 3-year period prior to the settlement of a bond:

- 10% of the capital redemption value provided for 3 years before maturity;
- 40% provided for 2 years before maturity;
- 75% provided for 1 year before maturity; and
- the balance of 25% is funded during the year of maturity.

(c) Managing debt within approved borrowing limits

The borrowing limits for the period 2009 to 2011 have been approved by the Minister of Water and Environmental Affairs with the concurrence of the Finance Minister as follows:

	Unconditional	Conditional	Total
	R'000	R'000	R'000
2009	2,300,000	500,000	2,800,000
2010	2,800,000	-	2,800,000
2011	1,800,000	1,000,000	2,800,000

Managing debt within the approved borrowing limits involves monitoring of existing debt against the limits and continual evaluation of future cash flows and funding requirements.

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

28. FINANCIAL RISK MANAGEMENT AND FINANCIAL INSTRUMENTS continued

28.1 CAPITAL RISK MANAGEMENT continued

28.1.2 Debt management continued

Utilisation of borrowing limits

Unconditional borrowing limit
Gross borrowings (Refer to note 20)
Collateral and guarantees
Unutilised borrowing limits

	Group	
	2010	2009
	R'000	R'000
Unconditional borrowing limit	2,800,000	2,300,000
Gross borrowings (Refer to note 20)	(1,517,448)	(2,003,544)
Collateral and guarantees	(1,112)	(1,286)
Unutilised borrowing limits	1,281,440	295,170

(d) Maintaining an external credit rating

The ability of Umgeni Water to raise debt at competitive interest rates is significantly dependant on the external credit rating by a Ratings Agency. The credit rating is maintained through protection of operating cash flows by anticipating adverse market and business conditions and continuous monitoring of strategies devised to counteract the adverse market conditions.

Umgeni Water's national credit rating as issued by Fitch Ratings Agency is: AA+ long-term and F1+ short-term.

28.2 FINANCIAL RISK MANAGEMENT

Umgeni Water's exposure to risk, its objectives, policies and processes for managing the risk and the methods used to measure it have been consistently applied in the years presented, unless otherwise stated. The Corporate Treasury function provides services to the business, co-ordinates access to domestic financial markets, monitors and manages the financial risks relating to the operations of Umgeni Water through the short, medium and long-term funding strategy, and highlights the risk implications of various financial transactions.

The use of financial derivatives is governed by Umgeni Water's policies approved by the Board of directors, which provide written principles on foreign exchange risk, interest rate risk, credit risk, the use of financial derivatives and non-derivative financial instruments, and the investment of excess liquidity. Compliance with policies and exposure limits is reviewed by the internal auditors on a continuous basis. Umgeni Water does not enter into or trade financial instruments, including derivative financial instruments, for speculative purposes. The principal financial risks to which Umgeni Water is exposed as a result of its financial instruments are: interest rate risk; liquidity risk and credit risk (which include counterparty risk).

CATEGORIES OF FINANCIAL INSTRUMENTS

	Group		Parent	
	2010	2009	2010	2009
	R'000	R'000	R'000	R'000
Financial assets				
Held-to-maturity	18,622	742,231	18,622	742,231
Loans and receivables	1,561,148	845,475	1,558,783	841,735
Other investments ⁽¹⁾	1,178,673	493,666	1,178,673	493,666
Other financial assets	103,558	157,034	103,558	157,034
Trade and other receivables	264,913	183,794	264,238	182,978
Interest and premium receivable	12,314	3,282	12,314	3,282
Cash and cash equivalents	1,690	7,699	-	4,775
Financial liabilities				
Held at amortised cost	1,966,911	2,306,756	1,963,542	2,304,012
Long-term debt	1,400,166	917,448	1,400,166	917,448
Amounts owing to customer	16,965	18,125	16,965	18,125
Accounts payable	374,201	276,562	370,832	273,818
Short-term debt	117,282	1,061,455	117,282	1,061,455
Interest payable	40,877	33,166	40,877	33,166
Bank overdraft	17,421	-	17,421	-

⁽¹⁾ Other investments include amounts invested in the money market which were previously classified as available for sale have been reclassified to Loans and receivables to reflect the entity's true intention in terms of these investments.

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

28. FINANCIAL RISK MANAGEMENT AND FINANCIAL INSTRUMENTS continued

28.2 FINANCIAL RISK MANAGEMENT continued

28.2.1 Interest rate risk

Interest rate risk is the risk that adverse changes in interest rates cause a reduction in net income for Umgeni Water. Umgeni Water is exposed to interest rate risk as funds are borrowed at both fixed and floating interest rates. Borrowings issued at floating interest rates expose Umgeni Water to cash flow interest rate risk.

Mitigation approach

The risk is managed by maintaining an appropriate mix between fixed and floating rate borrowings: 70% fixed to 30% floating interest rate profile.

The interest rate profile of Umgeni Water is summarised as follows:

	Group	
	2010	2009
	R'000	R'000
Loans linked to JIBAR	450,000	500,000
Loans with a fixed interest rate	1,067,448	1,503,543
Total gross debt	1,517,448	2,003,543

	Recommended ratio	Group	
		2010	2009
Ratio of fixed to floating interest rate			
Fixed	70%	70%	75%
Floating	30%	30%	25%

The sensitivity analyses below have been determined based on the exposure to interest rates for both derivatives and non-derivative instruments at the reporting date. For floating rate liabilities and investments, the analysis is prepared assuming the amount of liability and investment outstanding at the reporting date was outstanding for the whole year. A 50 basis point increase or decrease is used when reporting interest rate risk internally to key management personnel and represents management's assessment of the reasonable possible change in interest rates. The sensitivity analysis assumes that all other variables remain constant and has been prepared on the same basis for the prior year.

If interest rates had been 50 basis points higher/lower and all other variables were held constant, the entity's profit for the year ended 30 June 2010 would decrease/increase by R1,7m (2009: decrease/increase by R2,1m).

The sensitivity to interest rates has decreased during the current period mainly due to the ratio of fixed to floating interest rate debt being at its optimal level of 70% fixed to 30% floating (2009: 75% fixed to 25% floating).

28.2.2 Liquidity risk

Liquidity risk will result in Umgeni Water being unable to raise sufficient funds in the required currency and at the correct time to meet its financial obligations. This will impact on the organisation's ability to achieve its financial strategies, namely, 'Enhance Shareholder Value'.

Mitigation approach

To mitigate liquidity risk, Umgeni Water has:

- Short-term funding facilities to meet ongoing cash requirements for which facility options are in place with four banks (FNB, Standard, ABSA, Nedbank);
- A Domestic Medium Note (DMTN) Programme has been established allowing for longer dated debt such as bonds to be issued with relative ease;
- Provided for a R 200m cash buffer investment to cater for a delay in payments by its customers;
- A redemption strategy framework, which provides guidelines for managing the risks associated with refinancing large debt maturities; and
- Borrowing limits approved by National Treasury, which are currently: R 2,800m for 2010, and R 1,800m for 2011.

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

28. FINANCIAL RISK MANAGEMENT AND FINANCIAL INSTRUMENTS continued

28.2 FINANCIAL RISK MANAGEMENT continued

28.2.2 Liquidity risk continued

Liquidity risk inherent in contractual cash flows

The following tables detail the remaining contractual maturity for non-derivative financial liabilities. The tables have been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which Umgeni Water can be required to pay. The table includes both interest and principal cash flows which may differ from the carrying values of the liabilities at the reporting date.

Financial liabilities - debt	Weighted average effective interest rate	Group					Total
		< 1 month	1-3 months	3 months-1 year	1-5 years	>5 years	
		R'000	R'000	R'000	R'000	R'000	
2010							
Fixed interest rate instruments	10.03%	-	77,072	97,052	773,345	987,659	1,935,128
Variable interest rate instruments	8.50%	-	44,177	43,013	372,330	172,321	631,841
Total		-	121,248	140,065	1,145,675	1,159,980	2,566,969
2009							
Fixed interest rate instruments	13.35%	361	45,311	1,166,086	484,138	145,045	1,840,941
Variable interest rate instruments	10.10%	-	49,908	46,553	403,672	241,006	741,139
Total		361	95,219	1,212,639	887,810	386,051	2,582,080

The following table details the expected maturity for non-derivative financial assets. The tables below have been drawn up based on the undiscounted contractual maturities of the financial assets including interest that will be earned on those assets except where Umgeni Water anticipates that the cash flow will occur in a different period.

Financial assets – other investments	Weighted average effective interest rate	Group					Total
		< 1 month	1-3 months	3 months-1 year	1-5 years	>5 years	
		R'000	R'000	R'000	R'000	R'000	
2010							
Fixed interest rate instruments	7.42%	194	578	135,901	29,101	4,075	169,849
Variable interest rate instruments	7.12%	148,479	261,185	661,538	-	-	1,071,202
Total		148,673	261,763	797,439	29,101	4,075	1,241,051
2009							
Fixed interest rate instruments	9.68%	157,666	190,000	851,712	22,481	-	1,221,859
Variable interest rate instruments	6.98%	83,376	-	-	-	-	83,376
Total		241,042	190,000	851,712	22,481	-	1,305,235

The total investments are managed under the following portfolios:

Investment portfolios	2010	2009
	R'000	R'000
Redemption assets	-	719,750
Liquidity buffer	200,000	100,000
Long-term investments	18,622	22,481
Short-term investments	978,673	393,666
Total	1,197,295	1,235,897

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

28. FINANCIAL RISK MANAGEMENT AND FINANCIAL INSTRUMENTS continued

28.2 FINANCIAL RISK MANAGEMENT continued

28.2.2 Liquidity risk continued

Primary source of funding and unused facilities

The primary source of funding to meet Umgeni Water's requirements are revenue, cash inflows from maturing financial assets purchased, debt issued in the market and other loans. The following sources of funding are available to Umgeni Water to meet its short, medium and long-term funding requirements and will supplement the primary liquidity sources under stress conditions:

Domestic Medium Term Note Programme (DMTN)

Umgeni Water has established a Domestic Medium Term Note Programme to issue bonds to meet long term capital expenditure funding requirements.

The programme has an authorised amount of R3 billion, and is a useful funding tool in terms of the following:

- Refining the duration of the stock of debt.
- Refining the fixed to floating ratio of the debt book.
- Meeting short-term liquidity requirements.
- Filling gaps in the debt maturity profile.

The UG21 was issued at a total nominal value of R600m under the DMTN Programme on 02 March 2010 at a fixed rate of 10.70%

General banking facilities

Umgeni Water has the following committed and uncommitted bank facilities available:

Type of facility	Committed	Uncommitted
	R'000	R'000
Working capital facility	100,000	-
Multipurpose Treasury Facility	-	100,000
General credit facility	50,000	99,000
Call borrowings facility	65,000	-
Bridging facility ⁽¹⁾	300,000	-

⁽¹⁾ The bridging facility expires in July 2010 and will not be renewed in terms of the funding requirements.

Bank loans

This method of funding allows Umgeni Water to refinance short-term debt into longer-term debt with the view of achieving greater asset/liability matching. Specifically, Umgeni Water has a R1.5 billion loan facility with the DBSA, of which R350m was drawn down in 2006, and will expire in September 2010.

28.2.3 Credit risk management

Credit risk concentration will result in Umgeni Water being exposed to counter-party failure. This has the potential to impact on the organisation's ability to remain within its optimal debt level.

Mitigation approach

- According to its Investment Policy Umgeni Water will mitigate credit risk by conducting transactions only with counter parties and issuers who satisfy soundly based and acceptable assessment processes, and only after formal limits have been set. In addition, same-day settlement limits will be set wherever possible and/or strict settlement procedures set and adhered to, and
- Continuous monitoring of the credit quality of counterparties.

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

28. FINANCIAL RISK MANAGEMENT AND FINANCIAL INSTRUMENTS continued

28.2 FINANCIAL RISK MANAGEMENT continued

28.2.3 Credit risk management continued

(a) Trade and other receivables

The management of risk in relation to trade and other receivables is summarised as follows:

- Umgeni Water aims to minimise loss caused by default of customers through specific policies and procedures.
- Compliance with these policies and procedures are the responsibility of the General Manager Finance and Financial Manager. Monitoring of compliance with these policies is carried out by internal audit. All known risks are required to be fully disclosed and accounted for and are provided for as doubtful debts.

The average credit period allowed is 30 days from invoice date. Interest is charged at prime rate on any debt over 30 days from date of invoice. Trade receivables over 30 days are provided for based on estimated irrecoverable amounts from the sale, determined by reference to past default experience.

Monitoring exposure

Umgeni Water monitors exposures on an ongoing basis utilising various reporting tools and flagging potential risks which are reported to National Treasury in terms of S41 of the Municipal Finance Management Act. The following reports are used to monitor credit risk:

- Age analysis reports; and
- Status report for significant overdue debtors.

	Group	
	2010	2009
	R'000	R'000
There were no financial assets past due or impaired and whose terms have been renegotiated	-	-
Carrying amount of financial assets impaired during the year	2,512	5,133
Analysis of the ageing of financial assets (trade receivables) which are past due but have not been impaired:		
30 days	40,665	5,726
60 days	3,063	1,967
90 days	-	5,827
120+ days	-	-
Total	43,728	13,520

(b) Other investments

Concentration of credit risk is managed by setting credit limits at counterparty-specific level. The credit limit calculation is based on 5% of shareholders funds but subject to a maximum limit of R600m and limited to parties where 5% of shareholders funds exceed R100m. Only counterparties with a long-term rating of AA and short-term rating of F1 and better can qualify for a credit limit. Consumption of the credit limit is measured at nominal value except in the case of zero coupon bonds where credit limit consumption is based on current market value.

Maximum credit risk exposure to Umgeni Water:

The table that follows shows the credit limits and carrying values of assets attributable to the counterparties at balance sheet date using the Fitch Rating Agency credit rating symbols.

Notes to the Consolidated Annual Financial Statements continued

For the year ended 30 June 2010

28. FINANCIAL RISK MANAGEMENT AND FINANCIAL INSTRUMENTS Continued

28.2 FINANCIAL RISK MANAGEMENT continued

28.2.3 Credit risk management continued

Counterparty	Rating	Credit limit	Group					
			Held-to-maturity		Loan and receivables		Total	
			2010	2009	2010	2009	2010	2009
		R'000	R'000	R'000	R'000	R'000	R'000	
Investec Bank Limited	A+/F1	-	-	145,655	-	72,000	-	217,655
ABSA Bank Limited	AAA/F1+	600	-	192,451	270,862	124,862	270,862	317,313
FirstRand Bank Limited	AA/F1+	600	18,622	22,481	197,434	34,804	216,056	57,285
Standard Bank of South Africa Limited	AA/F1+	600	-	136,361	259,000	-	259,000	136,361
Nedbank Limited	AA-/F1+	600	-	245,283	341,000	226,000	341,000	471,283
Calyon Corporate & Investment Bank	AA-/F1+	350	-	-	-	36,000	-	36,000
Corporation for Public Deposits	Government Guarantee	3,000	-	-	110,377	-	110,377	-
Total			18,622	742,231	1,178,673	493,666	1,197,295	1,235,897

28.2.4 Fair value of financial instruments

The financial assets and financial liabilities of Umgeni Water are not traded on active liquid markets therefore the fair value of these financial instruments is determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions for similar instruments.

Except as detailed below, the directors' consider the carrying amounts of the financial assets and financial liabilities recorded at amortised cost in the financial statements to approximate their fair value.

	Group 2010		Group 2009	
	Carrying value	Fair value	Carrying value	Fair value
	R'000	R'000	R'000	R'000
Financial liabilities				
Bank loans	917,448	938,218	1,029,852	1,272,348
Bond at fixed interest rate	600,000	613,412	949,051	985,227
Total	1,517,448	1,551,630	1,978,903	2,257,575