

CHAPTER 4

AUDITED FINANCIAL STATEMENTS AND RELATED FINANCIAL INFORMATION

4.1 FINANCIAL OVERVIEW (2007/08)

Rating history:	2006	2005
Long-term	A1.za	zaA-
Short-term	A1.za	zaA2

Financial and Operating Statistics		
Years ended 30 June: (R million)	2008	2007
Funds and reserves	6,355	1,320
Long-term liabilities	512,6	480,9
Investments	5,6	33,5
Net current assets	1,048	1,031
Debtors	304,1	304,0
Bank and short term investments	601,1	631,8
Total income	2,021	1,744
Operating expenses	1,838	1,671
Operating surplus	182,3	74,8

4.2 ECONOMIC STRUCTURE

Buffalo City and Nelson Mandela are the two major economic centres in the Eastern Cape. The province is generally seen as one of the poorer provinces in South Africa, with an 8,1% contribution to the gross domestic product (GDP) of the country in 2004.

Table 2

Gross domestic product per province – Current prices			
Province	2003 R billion	2004 R billion	%
Western Cape	181,7	199,4	14,4
Eastern Cape	100,7	112,9	8,1
Northern Cape	27,8	30,0	2,2
Free State	68,5	75,8	5,5
KwaZulu- Natal	207,0	231,6	16,7
North West	79,0	87,1	6,3
Gauteng	422,0	462,0	33,3
Mpumalanga	86,4	94,4	6,8
Limpopo	83,4	93,1	6,7
GDP	1 257,0	1 386,6	100

Source: Statistics South Africa

The most dominant economic sector in Buffalo City is the industrial or manufacturing sector that includes the automotive, textile, pharmaceutical, electronics and food processing industries. Forming the basis of industrial activity, the automotive industry is the largest contributor to the economy of the city and is the third largest sector in the South African economy, accounting for 33% of the country's manufacturing output.

4.3 FINANCIAL STATUS

Revenue and expenditure overview

In terms of its revenue base Buffalo City is currently the largest category B municipality in the country. It recorded an income of R1 744,6 million in 2007 and R2 021,6 million in 2008, an increase of 15.8% from the previous year. The following table indicates the relative size of some of the larger municipalities based on revenue.

Table 3

Municipality	Revenue Rm	Population
Buffalo City	1 742,9	701 890
Emfuleni	1 466,6	658 421
Mangaung	1 405,6	645 441
Rustenburg	792,4	395 540
Matjhabeng	776,3	408 170
Klerksdorp	670,6	359 202
uMhlathuze	643,6	289 190
Polokwane	597,8	508 277
Mbombela	521,5	474 806
Drakenstein	498,6	194 419

Revenue sources of Buffalo City are similar to most local municipalities and comprise primarily income from property taxes, service charges and from the sale of water and electricity. A breakdown of the gross revenue sources of Buffalo City is as follows:

Table 4

Revenue Sources				
	2008		2007	
	Rm	%	Rm	%
Property rates	325,4	16,1	293,6	16,8
Grants	578,2	28,6	478,9	27,5
Electricity	465,9	23,0	429,2	24,6
Water	172,7	8,5	152,3	8,7
Other service charges	239,3	11,8	251,2	12,3
Other income	240,1	11,9	175,4	10,1
	2 021,6	100,0	1 744,6	100,0

In 2007 and 2008 financial period, grants and subsidies from government has grown to just over a quarter of Buffalo City's income. In 2008 the City received 28,6% of its revenue in the form of grants, compared to 17,2% in 2004 , 27,0% in 2005, 25,3% in 2006 and 27.5% in 2007. Total grants of R578,2 million include the equitable share and provincial grants. Future grants appear to be on the increase, based on central government's policy to improve the service delivery at the municipal level.

The primary future revenue source is property rates levied on the value of the land, including the value of improvements. In 2008, this revenue source of R325,4 million contributed 16,1% of the total revenue. Buffalo City's property valuation demonstrates a well-diversified and stable tax base. Table 5 reflects the property valuation:

Table 5

Property Valuation		
	2007	2008
	Rbn	Rbn
Residential	6,3	6,4
Commercial	4,0	4,0
State	1,2	1,2
Municipal	0,3	0,3
Total	11,8	11,9
Average rate earned (cent)	2,50	2,72

Trading services such as water and electricity sales jointly comprise 31,6% of total revenue. Water distribution losses remain high at 40,9% compared to the national standard of around 20%. The City has set a target to reduce the distribution losses to 30% over the medium term.

The sale of electricity contributed 23,0% of the City's income. Buffalo City provides electricity to the urban and semi-urban areas in its jurisdiction whereas Eskom provide to the rural areas. Distribution losses at 15% of units bought are acceptable when compared with the industry average and reflect a well-managed electricity distribution network.

The operating expenditure for 2008 of Buffalo City is largely inflexible and requires sound budgeting and discipline to keep costs within budget. The various Directorates were within the budget for the 2008 financial year.

Overall the actual costs were slightly below budget. The growth in expenses of 10% was below the revenue growth of 15,88% which resulted in the R182,3 million operating surplus after taxation and including share of surplus of associate.

The following table reflects a breakdown of the operating expenses of the municipality:

Table 6

Operating Expenditure				
	2008		2007	
	Rm	%	Rm	%
Bad debts	69,9	3,8	63,1	3,8
Electricity purchases	267,9	14,6	247,7	14,8
Water purchases	90,7	4,9	72,1	4,3
Depreciation	112,4	6,1	100,4	6,0
Employee costs	588,0	32,0	531,1	31,8
Interest paid	69,6	3,8	46,2	2,8
Other expenses	560,2	30,5	526,5	31,5
Repairs and maintenance	79,9	4,3	84,0	5,0
	1 838,6	100,0	1 671,1	100,0

Municipal services are labour intensive and staff remuneration normally constitutes a large proportion of the municipality's expense budget. The staff-to-income ratio of Buffalo City is at 32,0% which reflects a slight decrease from the 31,5% in 2007, this is still currently above the norm of 30%. Councillors' costs comprise a minor portion of total expenditure.

Electricity purchases comprise 14,6% of total expenses. This cost item might be transferred to a Regional Electricity Distributor (RED) over the following year or two.

The purchase of water comprises only 4,9% of expenses as Buffalo City controls most of its water resources. The city purchases below 20% of its water supply from the Amatola Water Board.

Maintenance expenditures on existing infrastructure are a very crucial expense item and are sometimes given less priority than others. The deferment of maintenance is common practise among municipalities. While the deferment of maintenance expenditure has short-term cash flow benefits, it has adverse long-term effects on operating costs and the sustainability of quality service delivery. Buffalo City's external maintenance costs comprise 4,3% of total expenses (5,0% - 2007) and 1,21% of the carrying value of its fixed assets (5,52% - 2007). Both these ratios have decreased from the previous years and Council remains concerned that the maintenance is not at the optimum level. The reason for the decrease from 2007 to 2008 is due mainly to acquisitions/write ons. Water and electricity infrastructure require refurbishment to bring it to acceptable service levels.

Buffalo City recorded an operating surplus in 2008. The operating budget indicates moderate increases for the next three years.

Debt management

Buffalo City's credit rating is supported by a stable balance sheet in spite of the pressure on infrastructure spending that will remain high in order to eradicate backlogs in basic services and to support and facilitate economic development.

The city's financial strategy is considered conservative and borrowings were kept at modest levels during 2008. Interest bearing liabilities increased in 2008. Long-term loans consist of local stock and other loans that bear interest at rates between 9,5% and 17,9% per annum.

The slightly lower debt level combined with the growth in revenue resulted in the debt-to-revenue ratio decreasing from 31,9% in 2007 to 28,7% in 2008. The current debt burden is already within the financial goals approved by Council who set the interest bearing debt-to-income target at 35% of revenues by 2007.

The pressures on capital expenditure are expected to remain high over the long-term. Cash outlay on capital expenditure for the 2008 financial year at R287,3 million was slightly higher than in 2007 (R238,2million) and below budget. This was primarily as a result of improved planning process of implementation of capital projects and to obtain funds in the form of grants and subsidies from higher tier government.

Buffalo City plans to spend some R1, 77billion on capital projects over the next three years. The spending in 2009 is budgeted at R902 million as compared to 2008 R413,2 million. This is an 118,3% increase from 2008. Over the next three years borrowings are expected to reach roughly R789 million.

The following table illustrates future capital expenditure plans for the next three years:

Table 7

Capital projects				
Year	Capex Rm	Own funds Rm	Borrowing Rm	Grants Rm
2009	902,0	195,1	250,0	456,9
2010	485,2	123,2	0	362,0
2011	389,0	93,9	0	295,0
Total	1 776,4	412,3	250,0	1 114,0

The ratio of interest bearing debt-to-revenue for 2008 is 28,7% which is somewhat lower than the 31.9% in 2007. The raising of the new loan will place the municipality under pressure in managing its finances. However, the City has a positive outlook in funding the new debt, as it expects additional revenue from the implementation of the General Valuation. The City is also investigating other means of increasing its revenue, an example being the implementation of a Business Taxation.

Buffalo City's interest charges at 3,8% of revenue is relatively low. The additional borrowings are going to increase the finance charges, but the real affect will be approximately 2,7% of total revenue in 2010, this is due to the increase budgeted revenue for 2010, the interest charge is still considered to be within the affordability measures of a municipality. Additional payments should be in the region of R16 million per annum, with an average loan life of between 15 and 20 years.

The net decrease in cash and cash equivalents at 30 June 2008 from R631,8 million to R610,1 million has resulted in a net movement of R21,7 million for the year.

Liquidity management

Buffalo City's liquidity position is considered sound given the net cash resources and monthly cash flows. The city has an active cash management system in operation to control this crucial aspect of its finance. Over the last decade municipalities have been burdened by a culture of non-payment for services resulting in generally low collection rates and increasing outstanding debtor's balances.

During 2008 Buffalo City's gross debtors grew by 8,5% to R546,1 million before contribution to the bad debt provision from the operating account to the amount of R69,9 million. The net debtors after provisions for bad debts increased from R304,0 million to R304.1 million. The debtors' collection period as a percentage of billings is 94.61%. This ratio is less than ideal, it does however compare well with that of the other large cities in South Africa.

The age analysis of Buffalo City's outstanding debtors indicates balances older than 120 days of R344.9 million but provisions of only R242,0 million were raised against them.

Table 9

Debtors Age Analysis			
Days	2006 Rm	2007 Rm	2008 Rm
Current	134.0	134.8	144,6
60 Days	22.9	21.8	24,6
90 Days	17.1	13.1	20,0
120 Days	15.5	12.5	12,0
120+ Days	308.3	320.9	344,9
Gross debtors	497.8	503.1	546.1
Provisions	201.4	199.1	242,0
Net debtors	296.4	304.0	304,1

Maintaining and improving the current collection rate is crucial for the financial sustainability of the city, and it remains a key rating consideration. The city's current ratio of 1,87:1 will also be adversely affected should the additional write-off occur.

Investment and bank balances have declined marginally during the year from R668,6 million to R618,2 million, this includes R2,4 million Investment in Associate. However, the cash investments reflect the cash backing of certain reserves, in aggregate R66.1 million, as well as unspent conditional grants of R152,0 million. Some R2,2 million are sinking fund investments linked to the redemption of long-term loans and the remaining R397,8 million are available as the city's own discretionary funds which is considered adequate relative to monthly operational cash requirements.

The improvement in the cash flows from operations in 2008 contributed to an improved coverage ratio and working capital. Cash from operations cover interest payments with 4,32 times in 2008.

4.4 SUMMARY

The Buffalo City Municipality overall financial profile is encouraging. The municipality is financially viable, with sound financial management policies and systems. The revenue collection and debt management is strong and the sustainability of the municipality in the short to long term promising. Finally, the municipality is well placed to deal with the demands for improved service delivery.

4.5 CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2008

The following audited financial statements are presented herein.

1. Consolidated Statement of Financial Position
2. Consolidated Statement of Financial Performance
3. Consolidated Statement of Changes in Net Assets – Municipality
4. Consolidated Statement of Changes in Net Assets – Economic Entity
5. Consolidated Cash Flow Statement
6. Accounting Policies
7. Notes to the Consolidated Financial Statements
8. Appendices
 - a. Schedule of External Loans
 - b. Analysis of Property, Plant and Equipment - Municipality
 - c. Analysis of Property, Plant and Equipment –Economic Entity
 - d. Segmental Analysis of Property, Plant and Equipment
 - e. Segmental Statement of Financial Performance
 - f. Actual vs Budget (Revenue and Expenditure)
 - g. Actual vs Budget (Acquisition of Property, Plant and Equipment)
 - h. Consolidated Conditional Grants and Receipts
 - i. Disclosure of Consolidated Conditional Grants

I am responsible for the preparations of these Consolidated Annual Financial Statements, which are set out on pages ... to ..., in terms of section 126 (1) of the Municipal Finance Management Act (56 of 2003) and which i have signed on behalf of the Municipality.

I certify that the salaries, allowances and benefits of Councillors as disclosed in Note 23 of the Consolidated Annual Financial Statements are within the upper limits of the framework envisaged in section 219 of the Constitution of the Republic of South Africa (1996), read with the Remuneration of Public Office Bearers Act and the Minister of Provincial and Local Government's determination.

V.R Lwana
Acting Municipal Manager