A RETROSPECTIVE LONG-TERM FINANCIAL ASSESSMENT OF SUSTAINABILITY AT CAPE AGULHAS MUNICIPALITY

(2003 TO 2014)

DEAN O’NEILL

(3175432)

A FULL THESIS SUBMITTED TO THE SCHOOL OF GOVERNMENT, FACULTY OF ECONOMICS & MANAGEMENT SCIENCES, UNIVERSITY OF THE WESTERN CAPE, IN FULFILLMENT OF THE REQUIREMENTS FOR THE MASTER OF ADMINISTRATION DEGREE

SUPERVISOR: DR LEON G. PRETORIUS

JANUARY 2016
DEDICATION

This paper is dedicated to the local government community including stakeholders such as councillors, administrators and the communities that they serve, in an effort towards ensuring that municipalities are able to operate as a going concern so as to provide much needed and quality services in future.
ACKNOWLEDGEMENTS

I would like to dedicate this thesis to everyone who made it possible for me to complete it. Firstly, let me thank the Lord Almighty for the strength, perseverance and knowledge to start and complete my Masters. Secondly, thank you to the Cape Agulhas Municipality and especially Mayor Richard Mitchell for providing me with a bursary, as well as the time and the support offered by them as my employer. Thank you to my supervisor, Dr Leon G. Pretorius for guiding me all the way as well as the support and encouragement. Lastly, I would like to thank my family especially my wife and children for believing in me and being my anchor during the time it took me to complete the thesis. I would not have been able to make it without your assistance, understanding and support. I am both humbled and grateful.
Name: Dean Gabriël Ian O’Neill
Student number: 3175432

1. I hereby declare that I know what plagiarism entails, namely to use another’s work and to present it as my own without attributing the sources in the correct way. (Refer to University Calendar part 1 for definition)

2. I know that plagiarism is a punishable offence because it constitutes theft.

3. I understand the plagiarism policy of the Faculty of Economics and Management Science of the University of the Western Cape.

4. I know what the consequences will be if I plagiarize in any of the assignments for my course.

5. I declare therefore that all work presented by me for every aspect of my course, will be my own, and where I have made use of another’s work, I will attribute the source in the correct way.

Signature…………………… Date……………………..
# TABLE OF CONTENTS

DEDICATION .......................................................................................................................... ii  
ACKNOWLEDGEMENTS ........................................................................................................ iii  
CERTIFICATION .................................................................................................................... iv  
TABLE OF TABLES ................................................................................................................ x  
TABLE OF GRAPHS ................................................................................................................ x  
LIST OF ABBREVIATIONS ..................................................................................................... xi  
ABSTRACT ............................................................................................................................ xiii  
KEY WORDS: ........................................................................................................................ xv  

## CHAPTER 1: INTRODUCTION AND CONTEXT ............................................................ 1

1.1 INTRODUCTION ............................................................................................................. 1  
1.2 BACKGROUND AND CONTEXT ................................................................................... 3  
1.3 PROBLEM STATEMENT ................................................................................................. 9  
1.4 AIM AND OBJECTIVES ................................................................................................. 10  
1.5 SIGNIFICANCE OF THE STUDY ................................................................................... 11  
1.6 RESEARCH METHODOLOGY ......................................................................................... 12  
  1.6.1 Type of research method ............................................................................................ 12  
  1.6.2 Scope and delimitation ............................................................................................... 12  
1.7 RESEARCH DESIGN ....................................................................................................... 13  
  1.7.1 Gathering data............................................................................................................ 13  
  1.7.2 Sampling method and data collection ....................................................................... 13
1.7.3 Primary data ......................................................................................................... 13
1.7.4 Secondary data ..................................................................................................... 14
1.7.5 Methodological limitations .................................................................................. 15

1.8 STRUCTURE OF THE THESIS ................................................................................... 15

CHAPTER 2: LITERATURE REVIEW AND THEORETICAL FRAMEWORK ...... 16
2.1 INTRODUCTION .............................................................................................................. 16
2.2 NEW PUBLIC MANAGEMENT (NPM) .......................................................................... 19
2.3 FINANCIAL MANAGEMENT .......................................................................................... 24
  2.3.1 Budgeting ............................................................................................................... 24
  2.3.2 Accounting .............................................................................................................. 27
  2.3.3 Financial Reporting ................................................................................................. 31
  2.3.4 Auditing .................................................................................................................... 35
  2.3.5 Ratio Analysis .......................................................................................................... 39
2.4. SUMMARY ...................................................................................................................... 40

CHAPTER 3: POLICY AND LEGISLATIVE FRAMEWORK .............................................. 43
3.1 INTRODUCTION .............................................................................................................. 43
3.2 LOCAL GOVERNMENT TRANSITION ACT, NO. 2009 OF 1993 ......................... 44
3.3 CONSTITUTION OF THE REPUBLIC OF SOUTH AFRICA, 1996 ......................... 44
3.4 INTERGOVERNMENTAL FISCAL RELATIONS ACT, 1997 ................................. 46
3.5 WHITE PAPER ON LOCAL GOVERNMENT, 1998 ................................................. 46
3.6 MUNICIPAL DEMARCATION ACT, NO. 27 OF 1998 ................................................ 48
3.7 MUNICIPAL STRUCTURES ACT, NO 117 OF 1998 ................................................................. 50

3.8 MUNICIPAL SYSTEMS ACT, NO. 32 OF 2000 ................................................................. 52

3.9 MUNICIPAL FINANCE MANAGEMENT ACT, NO. 56 OF 2003 .................................... 55

3.10 MUNICIPAL PROPERTY RATES ACT, 2004 ................................................................. 59

3.11 MUNICIPAL FISCAL POWERS AND FUNCTIONS ACT, 2007 .................................... 60

3.12 SUMMARY ....................................................................................................................... 61

CHAPTER 4: RESEARCH METHODOLOGY ............................................................................. 63

4.1 INTRODUCTION .............................................................................................................. 63

4.2 RESEARCH DESIGN ....................................................................................................... 65

4.3 VALIDITY ......................................................................................................................... 67

4.4 SAMPLING ....................................................................................................................... 69

4.5 SCOPE .............................................................................................................................. 70

4.6 SUMMARY ....................................................................................................................... 71

CHAPTER 5: DATA ANALYSIS AND DISCUSSION ................................................................ 73

5.1 INTRODUCTION .............................................................................................................. 73

5.2 FINANCIAL ANALYSIS USING SELECTED FINANCIAL RATIOS ............................... 73

5.3 STATEMENT OF FINANCIAL POSITION ........................................................................ 74

5.3.1 Nett Fixed Assets vs. Accumulated Surplus ................................................................. 74

5.3.2 Long Term Liabilities Interest Bearing vs. Non-Interest Bearing .............................. 75

5.3.3 Liquidity Ratios ........................................................................................................... 76

5.3.4 Collection Rate ........................................................................................................... 78
5.3.5 Net Debtor Days ........................................................................................................... 80
5.3.6 Gross Consumer Debtors vs Net Consumer Debtors ............................................... 81
5.3.7 Consumer Debtor Type ............................................................................................ 82

5.4 STATEMENT OF FINANCIAL PERFORMANCE ............................................................. 83
5.4.1 Net Operating Surplus Margin .................................................................................. 83
5.4.2 Contribution per Revenue Source ............................................................................ 85
5.4.3 Contribution per Expenditure Item .......................................................................... 88
5.4.4 Net Surplus/Deficit Electricity and Water ............................................................... 88
5.4.5 Remuneration as a percentage of Total Operating Expenditure ................................. 90
5.4.6 Other costs as a percentage of Total Operating Revenue ......................................... 90
5.4.7 Electricity Distribution Losses .................................................................................. 92
5.4.8 Water Distribution Losses ........................................................................................ 93
5.4.9 Repairs and Maintenance as a Percentage of Property, Plant and Equipment ......... 94

5.5 CASH FLOW STATEMENT ............................................................................................ 95
5.5.1 Investment Income vs. Investment Paid ................................................................... 96
5.5.2 Funding Sources Utilised to Fund Capital Expenditure ........................................... 96
5.5.3 Net Change in Cash and Investments .................................................................... 98
5.5.4 Cash and Investment Balances .............................................................................. 99
5.5.5 Minimum Liquidity Requirement ............................................................................ 99

5.6 OBSERVATIONS REGARDING THE RATIO FINANCIAL ANALYSIS .................. 101

5.7 ANALYSIS OF DATA OBTAINED FROM INTERVIEWS ........................................... 103
5.8 SUMMARY ..................................................................................................................... 112

CHAPTER 6: CONCLUSIONS AND RECOMMENDATIONS ................................. 116

6.1 INTRODUCTION ........................................................................................................... 116

6.2 OBSERVATIONS AND LESSONS LEARNT FROM THE RESEARCH .......... 118

6.3 FACTORS THAT CONSTRAIN OR ENABLE FINANCIAL SUSTAINABILITY ..... 124

6.4 CONCLUSION ................................................................................................................ 127

6.5 RECOMMENDATIONS FOR IMPROVING FUTURE FINANCIAL
SUSTAINABILITY AT CAM ......................................................................................... 129

REFERENCES ..................................................................................................................... 132

APPENDICES ...................................................................................................................... 136

APPENDIX 1: ....................................................................................................................... 136

Semi-structured interview questionnaire ................................................................................ 136

APPENDIX 2 ........................................................................................................................ 137

Interview Schedule ................................................................................................................. 137
TABLES

TABLE 1: NUMBER OF MUNICIPALITIES POST DEMARCATIONS .................................................. 49
TABLE 2: FINANCIAL GOVERNANCE FRAMEWORK ............................................................... 56
TABLE 3: CO-OPERATIVE GOVERNMENT ........................................................................... 58
TABLE 4: INTERVIEW TABLE ............................................................................................... 70
TABLE 5: LIQUIDITY RATIOS ............................................................................................... 78
TABLE 6: ANALYSIS OF SURPLUS ....................................................................................... 86
TABLE 7: CONTRIBUTION PER REVENUE SOURCE ............................................................. 87
TABLE 8: ANNUAL INCREASE PER REVENUE SOURCE ........................................................ 87
TABLE 9: CONTRIBUTION PER EXPENDITURE ITEM ............................................................ 91
TABLE 10: ANNUAL INCREASE PER EXPENDITURE ITEM ................................................... 91
TABLE 11: REPAIRS AND MAINTENANCE VS PLANT AND EQUIPMENT .................................. 95
TABLE 12: CAPITAL FUNDING SOURCES ............................................................................ 98
TABLE 13: MINIMUM LIQUIDITY REQUIREMENTS ............................................................... 100

GRAPH 1: NETT FIXED ASSETS VERSUS ACCUMULATED SURPLUS ................................. 75
GRAPH 2: CURRENT ASSETS VERSUS CURRENT LIABILITIES ............................................ 77
GRAPH 3: COLLECTION RATE ............................................................................................. 79
GRAPH 4: NETT DEBTOR DAYS ........................................................................................... 81
GRAPH 5: GROSS CONSUMER DEBTORS VERSUS BAD DEBT ........................................... 82
GRAPH 6: TOTAL REVENUE VS TOTAL EXPENDITURE .................................................... 84
GRAPH 7: ELECTRICITY NET SURPLUS/DEFICIT .............................................................. 89
GRAPH 8: WATER NETT SURPLUS/DEFICIT ..................................................................... 89
GRAPH 9: ELECTRICITY DISTRIBUTION LOSSES ............................................................... 92
GRAPH 10: WATER DISTRIBUTION LOSSES ..................................................................... 93
GRAPH 11: INTEREST RECEIVED VERSUS INTEREST PAID ........................................... 96
GRAPH 12: GROWTH IN TOTAL OPERATING REVENUE VERSUS CAPITAL EXPENDITURE .... 97
LIST OF ABBREVIATIONS

AO       Accounting Officer
ASB      Accounting Standards Board of South Africa
AG       Auditor General of South Africa
CAM      Cape Agulhas Municipality
CFO      Chief Financial Officer
CRR      Capital Replacement Reserve
COGTA    Cooperative Governance and Traditional Affairs
Constitution  Constitution of Republic of South Africa, 1996
CPI      Consumer Price Index
MDA      Municipal Demarcation Act, 1998
DoRA     Division of Revenue Act
ESKOM    Electricity Supply Commission of South Africa
EM       Executive Mayor
FFC      Finance and Fiscal Commission
GASB     Government Accounting Standards Board
GRAP     Generally Recognised Accounting Practice
IA       Internal Auditor
IAC      Internal Audit Committee
IASC     International Accounting Standards Committee
IDP      Integrated Development Plan
IFRA     Intergovernmental Fiscal Relations Act, 1997
<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>KPA</td>
<td>Key Performance Area</td>
</tr>
<tr>
<td>LGA</td>
<td>Local Government Australia</td>
</tr>
<tr>
<td>LGTA</td>
<td>Local Government Transition Act, 1993</td>
</tr>
<tr>
<td>MBRR</td>
<td>Municipal Budget and Reporting Regulations, 2009</td>
</tr>
<tr>
<td>MDA</td>
<td>Municipal Demarcation Act, 1998</td>
</tr>
<tr>
<td>MDB</td>
<td>Municipal Demarcation Board</td>
</tr>
<tr>
<td>MERO</td>
<td>Municipal Economic Review Outlook</td>
</tr>
<tr>
<td>MFMA</td>
<td>Municipal Finance Management Act, 2003</td>
</tr>
<tr>
<td>MFPFA</td>
<td>Municipal Fiscal Powers and Functions Act, 2007</td>
</tr>
<tr>
<td>MSA</td>
<td>Municipal Systems Act, 2000</td>
</tr>
<tr>
<td>MSIG</td>
<td>Municipal Systems Improvement Grant</td>
</tr>
<tr>
<td>MTREF</td>
<td>Medium Term Expenditure and Revenue Framework</td>
</tr>
<tr>
<td>MPAC</td>
<td>Municipal Public Accounts Committee</td>
</tr>
<tr>
<td>NERSA</td>
<td>National Energy Regulator of South Africa</td>
</tr>
<tr>
<td>NPFM</td>
<td>New Public Financial Management</td>
</tr>
<tr>
<td>NPM</td>
<td>New Public Management</td>
</tr>
<tr>
<td>MPRA</td>
<td>Municipal Property Rates Act, 2004</td>
</tr>
<tr>
<td>NT</td>
<td>National Treasury</td>
</tr>
<tr>
<td>OPCAR</td>
<td>Operation Clean Audit Report</td>
</tr>
<tr>
<td>PPE</td>
<td>Property, Plant and Equipment</td>
</tr>
<tr>
<td>SDBIP</td>
<td>Service Delivery and Budget Implementation Plan</td>
</tr>
<tr>
<td>SLGR</td>
<td>State of Local Government in South Africa: Overview Report</td>
</tr>
</tbody>
</table>
ABSTRACT

The future existence of municipalities is determined by their ability to remain financially sustainable. This study is significant as municipalities need to ensure that they are financially sustainable for the continued provision and maintenance of quality and affordable services to all the residents within their jurisdiction.

The primary objective of the study was to assess the financial performance of the Cape Agulhas Municipality over a period of ten years. A secondary objective was to identify factors that constrain or facilitate improved financial management in municipalities and that may have an influence on their sustainability. The focus of the study was limited to financial management aspects of the Cape Agulhas Municipality from 2003 to 2014 and was conducted at a macro or strategic level.

The research is a longitudinal qualitative study as this methodology was deemed as the best to undertake in a study of this nature. The data collection process comprised of open ended semi-structured interviews with senior politicians and officials in the municipality. Financial data from the annual financial statements and the Auditor General of South Africa over the period of study were evaluated and analysed so as to produce financial ratios and establish trends. The financial data was assessed against the financial health measures as identified by the National Treasury to determine the financial status of the municipality.

Analysing the financial performance of the municipality produced information that can be used as an early warning system to mitigate further deterioration of the financial situation and inform future decisions in terms thereof. This study was useful as the findings may contribute towards effective municipal financial management and the financial sustainability of municipalities.
The study makes the following findings and recommendations:

The municipality experienced liquidity tensions from 2006. Although the payment ratio had been increasing over the last two years of the study, consumer debtors had been increasing and limited amounts were budgeted for the writing off of bad debt. Electricity tariff increases were significantly above the inflation rate, and salaries, wages and allowances were the largest expenditure item over the whole period of the study. In terms of provision for maintenance and repairs, these were less than half of the norm for most of the study period, and lastly the cash reserves were severely depleted from 2006 as they were used to fund long term capital projects.

It is recommended that the municipality stabilises the decline in current assets and continues with the diligent implementation of its credit control policy, not only to maintain the positive collection rate but also to curb the increase in consumer debtors. In order to enhance the affordability of rates and tariffs the municipality must perform a cost analysis of all rates and tariffs to ensure that they are cost reflective. The organisational structure must be reviewed annually to verify that only critical and legislatively required posts are approved and budgeted for, as this is the largest expenditure item in the municipal budget. Furthermore, a comprehensive infrastructure maintenance plan must be developed to guide decisions when the budget for maintenance and repairs is considered, not only to ensure that this budget item is closer to the national norm but that it is spent on and tracked to infrastructure with the highest priority. The municipality needs to develop and approve a long term financial plan with its related policies to curb the further decline of its cash reserves and which includes a capital funding mix that is aligned to the useful life of the infrastructure to be financed.
KEY WORDS:
financial management, performance management, financial sustainability, financial ratios, municipal budget, annual report, annual performance report, annual financial statements, basic services, financial viability and management, performance objectives, integrated planning
1.1 INTRODUCTION

The future existence of municipalities will be determined by their ability to remain financially sustainable. This is crucial to ensure the continued provision and maintenance of quality and affordable services to all the residents within their jurisdiction. In terms of section 1 of the Local Government: Municipal Systems Act, 2000, “financially sustainable” with regard to the provision of a municipal service, means the provision thereof in a manner aimed at ensuring that the financing thereof is sufficient to cover the costs of building, operating and maintaining the service.

The State of Local Government in South Africa: Overview Report (SLGR), (2009:69-70) states that financial management in municipalities is extremely challenging. It identifies a weak skills base, inadequate provincial support, abuse, fraudulent activities and weak revenue bases as well as an increasing reliance on government grants and poor debt collection as issues that negatively influence sustainable service delivery.

The Auditor General of South Africa (AG), (2014:71) echoes some of the findings of the SLGR in his general report on the audit outcomes of local government for the 2012/13 financial year. The AG found that there is an increase in consumer debtors, underspending of the capital budgets and grants, and overspending on the operational budgets. The AG also found that 25% of the auditees, meaning municipalities and their entities, either disclosed in their financial statements that material uncertainty exists with regard to their ability to operate as a going concern or they were qualified due to the non-disclosure thereof. These include nine district municipalities, 52 local municipalities and 19 municipal entities. The fact that the SLGR was released in 2009 and that municipalities are still faced with the same challenges at present, as was found by the AG, confirms that municipalities are struggling to manage their finances in a sustainable manner. This thus questions the affectivity of the legislative
interventions and, in some instances, hands-on support from the national and provincial government and specifically the treasury departments in these two spheres.

The Local Government: Municipal Finance Management Act (MFMA), 2003, which came into effect on 01 July 2004, was a calculated attempt by the national government to transform, standardise and tighten the control of municipal finances. This was done to ensure that public money is only spent on the municipal services provided for in the Constitution of Republic of South Africa, 1996 (Constitution), to make officials responsible and accountable and to allow for measures to curb corrupt activities, to name but a few.

In this regard the Local Government: Municipal Performance Regulations for Municipal Managers and Managers directly Accountable to Municipal Managers, 2006 (Performance Regulations) were promulgated effective from August 2006 to regulate performance management in the local government sphere. With these regulations, the five Key Performance Areas (KPA) identified were: Basic Service Delivery, Municipal Institutional Development and Transformation, Local Economic Development, Municipal Financial Viability and Management, Good Governance and Public Participation. Municipal Financial Viability and Management is one of the KPAs that is regulated and municipalities are therefore obliged to include it into their own performance management systems. This was done in order to emphasise the importance of ensuring financially viable and sustainable municipalities.

With the legislative framework in place and in an ideal situation, one could assume that at least the foundation was laid to ensure that municipalities become viable economic entities thus ensuring financial sustainability. However this seems not to be the case in most municipalities as the latest findings of the AG (2014:71-73) showed that, in general, the financial management in the majority of municipalities in South Africa is weak.
CHAPTER 1: INTRODUCTION BACKGROUND AND CONTEXT

The aim of this study was to undertake a long term financial assessment with specific reference to the sustainability of the Cape Agulhas Municipality. This was done by measuring the actual financial performance of the municipality against the financial health measures identified by National Treasury for municipalities over the study period. The result of this assessment together with that of the financial ratios used by the AG and NT in their assessment of municipal finances enable the researcher to come to an informed conclusion. The study was further augmented by analysing the information obtained from the interviews conducted with the political and administrative leadership of the municipality.

The chapter explains the background and problem statement of the study. The research question and objectives guiding the research is provided. This is followed by the rationale for the study and the research methodology. The chapter concludes with a chapter outline and the ethics statement.

1.2 BACKGROUND AND CONTEXT

The transformation of local government started in 1993 with the promulgation of the Local Government Transition Act (LGTA), 1993, which provided for provisional transformational structures and systems. The first national democratic election was held in 1994, thus ushering in a new democratic dispensation. The Constitution, 1996, envisaged three spheres of government (national, provincial and local) which are distinctive, interrelated and interdependent. In particular local government was assigned specific constitutional powers. Local government elections were held in 1996. Thereafter a number of policies and legislations were promulgated to transform local government to achieve its constitutional mandate. The White Paper of local government, 1998, was an assessment of the challenges facing local government and similarly to provide future policy direction. The transformation and establishment of a new system of local government was an important requirement. In this regard the Municipal Demarcation Act, (MDA) 1998 was promulgated for the redetermination of municipal boundaries. This resulted in the amalgamation of previously separated municipalities to form back-to-back municipalities. The Local Government:
Municipal Structures Act, 1998, (Structures Act) provided for the categorisation and defining of the political structures and office bearers of municipalities.

Municipalities, pre-1994, were demarcated and designed in a manner that advantaged the privileged few to the disadvantage of the majority. The MDA made allowance for criteria to take this abnormality into account. A demarcation objective was to determine municipal boundaries to establish areas that would enable a municipality to fulfil its constitutional obligations, including having a tax base as inclusive as possible of users of municipal services in the municipality. The effect of the initial demarcation, which came into operation after the local government elections in 2000, was that the number of municipalities was reduced from 843 to 284. The main purpose of the MDA was to rationalise the borders of municipalities into fewer but financially viable municipalities.

The Municipal Systems Act, 2000 (MSA), institutionalised the transformation of municipalities by providing for the appointment of the municipal manager and other senior managers, the integration of development planning, performance management, approval of staff establishments and other systems and methods to improve municipal governance, to name a few. However, and significant for this study, is that the MSA regularised the establishment of participative and accountable institutions within municipalities. The effectiveness of public participation, and especially the accountability of a municipality in terms of financial reporting to the public, is questionable. This is a problem and it is supported by the fact that community input and feedback on budget and financial reports in general are almost non-existent.

The MSA, 2000 provides a legislative framework towards addressing the service delivery inequalities of the past and creating an enabling framework for the social and economic development of communities. In support of the aforementioned, government worked towards the transformation of the financial management system within local government. The MFMA, 2003, was promulgated on 09 February 2004, with a commencement date of 01 July 2004.
CHAPTER 1: INTRODUCTION BACKGROUND AND CONTEXT

The aim of the MFMA, as stated in the preamble thereto, is to “secure sound and sustainable management of the financial affairs of municipalities, establish treasury norms and standards...” amongst others. Thus, it provides for sound financial management, transparency and regular financial reporting to the municipal council, National and Provincial Treasuries as well as the community.

The MFMA, 2003 is prescriptive and municipalities are required to comply thereto. In terms of section 121 of the MFMA, 2003, every municipality must, for each financial year, prepare and adopt an annual report which must provide a record of the activities performed during the financial year, a report on performance against the approved budget and also promote accountability to the local community on decisions taken by the council. In terms of accountability, council is then obliged to invite public comment on the annual report. The annual report, which also includes the financial statements, is audited by the AG as part of their Constitutional mandate to provide external auditing services to all public entities and spheres of government. The AG is a Chapter Nine State Institution supporting constitutional democracy. The AG is an independent and external auditor and thus provides assurance and enables oversight, accountability and governance in the public sector.

It has become common knowledge that the AG’s reports on municipalities over the last few years paint a very bleak picture on the financial state of municipalities in South Africa. In his foreword in the Consolidated General Report on the Audit Outcomes of Local Government, 2011–12, the previous AG, Mr Terence Nombembe, states that “only 5% of municipalities received a clean audit.” He states further that “the rest had material findings on either the usefulness or reliability of their annual performance reports, or non-compliance with legislation, or both.” These findings by the AG and specifically the findings pertaining to the usefulness and reliability of the financial and performance information provided by municipalities, is indicative of the ineffectiveness, or the lack of sound financial management.
CHAPTER 1: INTRODUCTION BACKGROUND AND CONTEXT

The focus on financial viability and management is further emphasised in terms of performance reporting regulations (Municipal Performance Regulations, 2006). Five Key Performance Areas were regulated including Financial Viability and Management, thus emphasising the importance of sound financial management.

Moynihan (2008:5) defines performance management as a “system that generates performance information through strategic planning and performance measurement routines and that it connects this information to decision venues, where, ideally, the information influences a range of possible decisions.” Cayer (2004:110) agrees with this to some extend by stating that performance management involves various activities to advance the efficiency and effectiveness of organisations. Bouckaert and Halligan (2008:100) encapsulate both of the above as they argue that performance management puts a program of performance management in place where it may be considered as a continuing process that regulates the planning, managing, reviewing, rewarding and development of performance.

These principles are also evident in the implementation of performance management in municipalities. As explained earlier there must be, and supported by the MSA and the MFMA, a defined link between the strategy and a fully funded budget. After this, regular measurement, reporting and if necessary, changes in previous decisions will follow. However one needs to define what needs to be measured and how the information resulting from the measurement will then be utilised to influence future decision making. For the purposes of this study it will be limited to the financial performance of the municipality by using various ratios and norms.

Mc Kinney (2004:2) defines public financial management as the process by which government uses the means to gather and allocate resources or funds centred on specific priorities and utilises methods and controls to effectively reach objectives determined by the public. Brigham (1998:1), on the other hand cites Howard and Upton “It is the application of general managerial principles to the area of financial decision making” as well as Joseph and
Massie. “Financial management is the operational activity of a business that is responsible for obtaining and effectively utilising the funds necessary for efficient operations.” with regard to their definitions of public financial management. Although there is general agreement with all these definitions relating to the local government context in some way or another, the definition of Mc Kinney is the most appropriate, in the view of the author.

Municipalities must allocate resources from their budgets in accordance with the objectives and priorities identified in the Integrated Development Plan (IDP). An IDP is a single, inclusive and strategic plan for the development of a municipality which must be adopted by a municipal council after it has been elected. It remains valid for the elected term of council but is required to be reviewed annually in order to allow for development and needs changes. The IDP is developed with inputs from the public, meaning that objectives and projects are identified in consultation with the public. Then, the municipality is obliged to report to council, the community and also to provincial and national government on the implementation of its IDP and budget. Officials and council are held responsible and accountable for the implementation of its budget and IDP by means of the compilation and publication of the audited Annual Report.

The National Treasury (NT) provides guidance in terms of what needs to be measured to determine municipal financial health. The NT, in the State of Local Government Finances and Financial Management Report, 2013, states that there is no single measure that can be used to assess the financial health of a municipality. The NT identifies eight key measures that they use to evaluate the state of a municipality’s finances, being:

- Cash as a percentage of operating expenditure.
- Persistence of negative cash balances.
- Over / (Under) spending of original operating budgets.
- Under spending of original capital budget.
- Debtors as a percentage of own revenue.
- Year on year growth in debtors.
- Creditors as a percentage of cash and investments.
Reliance on national and provincial transfers.

The National Treasury has also issued a number of standardised ratios to be considered by all municipalities in terms of MFMA Circular 71 of January 2014. The most common financial ratios used by the AG in municipalities are the following:

- Collection Rate
- Net Debtor Days
- Current Ratio
- Level of Cash Backed Reserves
- Net Operating Surplus Margin
- Creditors Payment Period.

The AG, however, only reports on a one-year period, meaning the financial year past, and also includes the corresponding figures on the preceding year that is reported on, thus only giving a two-year perspective at most, on the financial position, financial performance and cash flow data of a municipality. This manner of reporting creates a gap in the literature with regard to the absence of a medium to long term view.

The author will attempt to fill this gap in this paper. It is important as this would give a long term perspective of the financial status of the municipality. The financial health measures and the financial ratios, to be discussed later, will be used to assess the financial performance of the Cape Agulhas Municipality for the period of study. This information together with that generated from the interviews of the officials and politicians of the municipality will be utilised in the assessment.

Cape Agulhas is a typical small rural municipality and although it is large in geographical size, it has a population size of just more than 33 000 people and a growth rate of 2.4%, according to the Municipal Economic Review Outlook (MERO) (2014: 77). The MERO
identifies a poverty rate of 19.1%, and a municipal focus on social development rather than economic development. Its findings indicate that the municipal is confronted with increasing indigent support and a declining tax base resulting in a decline in cash reserves and increasing reliance on grants and financial instability. It is for these reasons that Cape Agulhas Municipality was chosen for this study.

1.3 PROBLEM STATEMENT

Municipalities are obliged to provide basic services such as water, sanitation, electricity and roads in terms of Schedules 4b and 5b of the Constitution, 1996. The sustainable provision of these services must be financed firstly by municipal own revenue and secondly, albeit to a lesser extent, by funding received for support to the indigents living within the municipal area, co-funded from the national fiscus in the form of grants. Municipalities experience difficulty to generate sufficient revenue to meet the increasing demand. According to the SLGR (2009:31), an increase in the number of service delivery protests in the country is observed and in most cases it is attributed to the perceived inefficient delivery of basic services and declining citizen confidence and trust in the system. The SLGR (2009: 13) identifies a number of priority areas that impact negatively on service delivery and governance. The focus for the purpose of this study would be on those areas that are linked to financial management, which includes poor financial management, year on year increases in consumer debtors and a growing dependency on grants from other spheres of government.

The increases in outstanding consumer debtors pointing to possible governance problems, as well as a growing dependency on grants, are highlighted as factors that might indicate future unsustainability. The inability of a municipality to collect all revenue due to it has a serious effect on the ability to fund future capital projects and to provide sufficient funding to maintain existing infrastructure. Then, there are issues directly relating to accountability or the lack thereof, like corruption and fraud, political interference in the administration as well as weak civil society formations.
These factors have a direct impact on ensuring sound financial management and it is thus no surprise that poor financial management was also identified as an area for concern in the SLGR. These factors and the general and genuine demand of communities for immediate service delivery may be an indication that all is not well in local government service delivery. Managing the finances of a municipality effectively to adequately address the most pressing needs of communities may impact positively on regaining the loss in trust as mentioned above.

However, the question that comes to mind – even if a municipality is able to effectively address the needs of the communities within its jurisdictional area, given the current realities of global economic deterioration, national fiscal constraints as well as the apparent inability of a local municipality to generate its own revenue – is how long will the municipality be able to do so and still guarantee future financial sustainability?

The framework to enable municipalities to conform to the object of the MFMA, which is to secure the sound and sustainable management of its fiscal and financial affairs, is solidly grounded within the legislation. However, judging by the AG reports on this matter as discussed earlier, there seems to be little improvement. It is expected that the ten-year assessment will highlight trends and weaknesses that need to be addressed urgently so as to ensure future financial sustainability.

1.4 AIM AND OBJECTIVES

Against this background, the aim and purpose of this thesis is to investigate the factors that constrain or contribute to the financial performance and financial sustainability of the municipality.
To operationalise the research a number of objectives were set. The primary and general objective of the study was to assess the financial performance of the Cape Agulhas Municipality over a period of ten years. The secondary and more specific objectives include:

1. To perform a literature review of the relevant legislation and analyse financial data of Cape Agulhas Municipality from 2003 to 2014.
2. To outline and use the ratios analysis and theory as an assessment tool.
3. To analyse the data/findings with a view to identifying factors that constrain or facilitate the financial performance and viability of Cape Agulhas Municipality.
4. To draw conclusions and make recommendations with regard to the impact for financing service delivery.

1.5 SIGNIFICANCE OF THE STUDY

The National Treasury, (2004:9) states that sustainable local government is constructed on a base of balanced budgets as unfunded deficits are not permitted. Furthermore, that service delivery levels should be prioritised so that costs are affordable and that the continuation of routine maintenance will assure the sustainability of services offered by a municipality. The MFMA, 2003 established the basis for improved financial management and this is essential to ensure enhanced service delivery and sustainable municipal service delivery. Sound financial management is important, not only because it is a legislative obligation but because it has a direct impact on the future existence of municipalities as opposed to how they currently exist.

The study is significant as it will highlight specific trends and specific areas of concern over the long term that will be very important and useful to the Cape Agulhas municipal council and senior management when making future decisions regarding the management of municipal finances. Importantly, it will allow other municipalities to improve on and sustain the delivery of basic services, which is their Constitutional mandate. The study will contribute to the current debate on how to ensure the financial sustainability of municipalities. Importantly the study will contribute to policy formulation aimed at strengthening financial management at the municipal level.
1.6 RESEARCH METHODOLOGY

1.6.1 Type of research method

The research is a longitudinal qualitative study. This methodology is deemed as the best to undertake a study of this nature. The data collection process comprises of different methods. Open ended semi-structured interviews were used to gain a deeper understanding of what informs financial decisions by politicians and senior officials in the municipality. In addition, the financial data from the annual financial statements and AG reports over the period of study was evaluated and analysed in order to produce financial ratios and establish trends that assist in determining the general financial position, financial performance and cash position of the municipality over the period of study.

1.6.2 Scope and delimitation

The period for the purposes of this study is eleven years, from 2003 to 2014. This time frame was chosen in order to provide for a longer period to observe financial trends, but it is also the period in which the financial and performance management reforms were legislated and implemented at the local government level. The geographical scope is limited to that of the jurisdictional area of the Cape Agulhas Municipality. The study focussed on the financial management aspects of the municipality and was conducted at a macro level, meaning at the executive and senior management level and did not drill down into the different specific line departments within the organisational structure of the municipality.
CHAPTER 1: INTRODUCTION BACKGROUND AND CONTEXT

1.7 RESEARCH DESIGN

1.7.1 Gathering data

As the head of the administration at the Cape Agulhas Municipality, the author has easy access to the executive politicians and senior managers responsible for the financial management in the municipality. The existing networks to executive politicians, senior managers and other relevant resources in the municipality were utilised in order to access and obtain appointments.

1.7.2 Sampling method and data collection

Purposive sampling was used in the study. To that end the sample deliberately included the political leadership and senior management of the municipality. All persons identified have expert knowledge and participate in managing the financial affairs of the municipality.

1.7.3 Primary data

Primary data was gathered using semi-structured interviews as the preferred methodology technique for collecting information from councillors and officials. The Executive Mayor and Leader of the Opposition as well as senior officials, including the Chief Financial Officer (CFO) and Internal Auditor, were interviewed. The Executive Mayor, who is responsible for the IDP and Budget processes and who also approves the Service Delivery and Budget Implementation Plan (SDBIP) of the municipality, was interviewed in order to get a political perspective on the implementation of financial performance management within the municipality as well as an insight into his understanding of the relationship between strategy and budget and if and how decisions are influenced by financial ratios and trends.

The interviewing of the Opposition Leader in council was to avoid bias and also access alternative political perspectives. This would also assist in determining if there might be
major differences between the perspectives of the ruling party and that of the opposition and how, if possible, common ground is reached. The internal auditor and the CFO were interviewed in order to get an administrative perspective on the same issues as they are perceived to have expert and contextual knowledge on the subject of financial management. In summary the sampling method as indicated was purposive as these participants are the best suited to provide relevant, useful and full information that is required for this study.

1.7.4 Secondary data

Secondary data was collected from the AG’s reports on the municipality as well as annual financial statements and reports generated by the municipality for the eleven-year study period. The majority of this information is readily available and easily accessible from the archives of the municipality. Data generated will relate to financial ratios, percentage change rates from year to year, and identifying trends. The reliability of the data from the financial information can be confirmed with relative ease as the information to be used has been audited. The annual financial statements are audited by the AG who also audits the information in the annual reports. The AG makes specific findings as to the reliability and completeness of information provided.

The analysis involves the identification of financial information that will allow the generation of financial ratios and trends, against the norms and standards of NT so as to determine the financial position and financial performance over the period of study. The ratios also informed some of the questions used in the interviews. The analysis relating to the ratios (Nett Fixed Assets versus Accumulated Surplus, Current Ratio, Collections Rate, Nett Debtor Days, Nett Operating Surplus Margins, Repairs and Maintenance as a percentage of Property, Plant and Equipment (PPE) and Creditors Payment Period) was done but not limited to the following procedure. It started with an explanation of the ratio, what it means and the implications thereof. This was followed by the identification of norms and trends. Where necessary an explanation was given for peaks, plateaus and troughs as well as for points of convergence and divergence. Finally the response of the municipality was indicated.
1.7.5 Methodological limitations

Limitations of the research methodology and techniques could be bias, due to the researcher being a participant observer and his position within the municipality. In this regard all efforts was made to ensure reliability, validity and independence of participants. The research is limited to the period of the study and more specifically the Cape Agulhas Municipality and no comments can be made about any other municipalities. A further limitation was that the research focussed on the macro level within the municipality and did not drill down to specific departmental levels. However this was done intentionally as the participants are executive and opposition politicians responsible for the development and approval of financial policies and budgets. The officials in their capacity as senior managers have an advisory role to play, and are responsible for the implementation and control of policies and budgets of council. Together they are responsible and accountable to ensure the financial health of the municipality.

1.8 STRUCTURE OF THE THESIS

This thesis is comprised of six chapters which will be structured as follows. Chapter 1 provides an introduction to the research topic, a background, context and motivation for the study, its aims and objectives and the research methodology. Chapter 2 provides an outline of the theoretical and literature review. Chapter 3 offers a comprehensive overview of the relevant South African legislation and policy documents for the research topic. Chapter 4 offers a detailed discussion about the research methodology used in the investigation. Chapter 5 comprises and provides an analysis of the data collected. Chapter 6 is the last chapter providing the conclusion and recommendations as well as the relationship to other research and any areas for further research.
CHAPTER 2: LITERATURE REVIEW AND THEORETICAL FRAMEWORK

2.1 INTRODUCTION

Effective financial management is critical in ensuring financial sustainability in municipalities or any other entity, public or private. Since the purpose of this study was to do a retrospective assessment of the financial sustainability at CAM, the focus was on financial management and the components thereof that impact on sustainability.

The MSA, 2000, defines financial sustainability in relation to the provision of municipal services as follows:

“the provision of a municipal service in a manner aimed at ensuring that the financing of that service from internal and external sources, including budgeted income, grants and subsidies for the service, is sufficient to cover the costs of –

(a) the initial capital expenditure required for the service;
(b) operating the service; and
(c) maintaining, repairing and replacing the physical assets used in the provision of the service;”

Thus meaning that in order for a municipality to provide services in a sustainable manner it must ensure that the assets needed for the provision of the services must be financed sufficiently to cover the initial capital costs, the costs of operating the services as well as those for the maintenance and repair of the asset for the full duration of its useful life. The costs for the replacement of the asset must also be covered, meaning that sufficient capital should be provided in the Capital Replacement Reserve (CRR) to ensure future replacement.

The Local Government Australia (LGA) quotes the Common Wealth definition of financial sustainability as follows:
CHAPTER 2: LITERATURE REVIEW AND THEORETICAL FRAMEWORK

“...a government’s ability to manage its finances so it can meet its spending commitments, both now and in the future. It ensures future generations of taxpayers do not face an unmanageable bill for government services provided to the current generation.” (LGA 2012:2)

After some extensive work had been done in terms of an inquiry into the financial sustainability in local government and after broad consultation, the LGA then adopted its own definition of the term, being:

“A council’s long term financial performance and position is sustainable where planned long-term service and infrastructure levels and standards are met without unplanned increases in rates or disruptive cuts to services.” (LGA 2012:3)

The major difference between these two definitions and that of the MSA, 2000, is the fact that the South African definition lacks a specific reference to the actual long-term financing, although it is implicated by the reference to “future costs of maintaining, repairing and replacing the assets” used for the delivery of a service. There are however other shortcomings in the South African legislation regarding long-term planning in general and, for that matter, financial planning. As mentioned earlier, the IDP’s, (which is the principle planning document of a municipality) range of planning is medium-term as section 26(h) of the MSA, 2000, refers to a five-year plan. The same section also refers to a financial plan including budget projections for three years, the so-called Medium Term Expenditure and Revenue Framework (MTREF). Therefore municipalities, up until 2009, as can be seen from the discussion in the next paragraph, were not statutorily required to effect long-term planning and even thereafter, the instruction was ambiguous, to say the least.

The MFMA, 2003, and specifically the Municipal Budget and Reporting Regulations, 2009, (Footnote 1 to Regulation 7(1)) makes specific reference to a policy related to long-term financial plan. Long-term financial planning is not generally the norm amongst municipalities and CAM only adopted a long-term financial plan with its 2015/16 budget. This lack of long or longer term budget planning can have a negative impact on the financial stability of a
municipality, which is the purpose of this paper. However, long-term planning is not the only enabler of financial sustainability, as can be seen from the ensuing discussion: municipalities need to ensure effective and efficient financial management.

The chapter start with an analysis of New Public Management (NPM) in order to establish whether there are any relationships between the theory of NPM and public financial management in municipalities in South Africa. There were certainly many changes to the legislation governing local government that started in the 1990s and continued into the first decade of the new millennium. Although it is much later than the NPM changes in the developed countries in Europe as well as Australia, New Zealand and the USA, it is the view of the author that the legislation that has been promulgated by the democratic government since 1994 was definitely influenced by NPM principles, as can be seen as the discussion unfolds further in this chapter.

Financial management is an enabler for local government to plan, mobilise and use financial resources effectively and efficiently to fulfil its obligation of accountability to the citizens that they serve. Farvacque-Vitkovic and Miholy (2014:93) state that public financial management has four essential components: budgeting, accounting, auditing and reporting. These components will be discussed next in order to show their importance in achieving financial sustainability. It is important to understand the link between effective and sustainable budgeting, standardised accounting practices and the provision of credible financial records for auditing purposes so as to provide trustworthy reports to the public and higher government institutions. For the purposes of this study a more comprehensive discussion was on auditing specifically and the ratios and norms that can be generated from the information in the financial statements in Chapter 4. The information produced from these ratios and norms over the period of the study can then be used to ascertain the financial health of CAM.
CHAPTER 2: LITERATURE REVIEW AND THEORETICAL FRAMEWORK

2.2 NEW PUBLIC MANAGEMENT (NPM)

Public management scholars are of the view that NPM started in the 1950s after the Second World War. Pollitt and Bouchaert (2011:5) use the analogy of waves to describe the changes in public management since the first wave in the 1950s. Reform then was generally of a technical and legal nature with a focus on organisational and procedural changes and limited to national and sectoral government. Reforms were also country specific. “Germans made their reforms in the light of German circumstances and history, as did the French, British, the Americans, and so on” (Pollitt and Bouchaert: 2001:5). This meant that there was little international cooperation or debate and the first waves of change were happening almost exclusively in the United States (USA), United Kingdom (UK) and France according to Premchaud, (1983); Pollitt, (1984), Wildavsky (1979) and Pollitt and Bouchaert (2001:5). It is interesting to note that these countries, except for Russia, were the victors of the Second World War and the business of rebuilding Europe after the war may have been the catalyst to reform in the public sector.

The second wave (early 1970s and early 1980s) took place in a period of rapid advances in science and technology and seems to be linked to the international economic disturbances of the 1970s and the widening belief that governments had become bloated, unaffordable and ineffective (Pollitt and Bouchaert 2011:6). There was thus a need for government to conduct itself in a more business-like manner, meaning to institute money-saving measures, operate efficiently and become more responsible towards the people/citizens that it served. This time the reform trend spread to countries like Australia, Canada, New Zealand and Sweden as well as the USA and UK, as mentioned previously. This impetus for improved efficiency and service quality dissipated to more countries and was evident through the 1980s and lasted well into the 1990s. However, according to Pollitt and Bouchaert (2011:7), further into the 1990s the reforms began to change. Even though the initial reforms remained a priority on the political agendas they moved to issues of governance, partnerships, one-government and then to trust and transparency. Efficiency and quality still remained as drivers of change, but they became overshadowed by these new issues.
CHAPTER 2: LITERATURE REVIEW AND THEORETICAL FRAMEWORK

Another catalyst to public change was the rapid development of information technologies during the late 1990s and early in the new millennium, giving effect to the notion of e-government. The developments in Information and Communication Technologies (ICT) sector had the possibility to transform productivity in the public sector, provide good information at a faster pace to the citizens, provide better access to services and it could improve participatory democracy due to its virtual and informal nature. Municipalities in South Africa are currently obliged to develop and maintain a website in terms of section 21B of the MSA, 2000. The genesis of social media platforms such as Facebook and Twitter also provides easy and affordable access to government, politicians and administrators. In recent times we have seen the Presidency of South Africa, Premiers of Provinces and municipalities having Facebook or Twitter pages besides their statutory websites.

Globalisation is another issue which has become more pronounced during this period. Vujakovic (2010:4), cites Caselli, 2006, who claims that globalisation has three dimensions which are commonly accepted in contemporary theory namely, economic, political and cultural and then defines globalisation as “a process of growing interaction between economies, societies and nations across large distances.” The implications of this phenomenon on public administrations relate to the development of local capacity for the representation of government internationally and how national government decisions, in terms of its economy, can either sustain or hamper its economic competitiveness. These external pressures or catalysts often require compulsory changes in the operations of government and may even, for example in the case of new technologies and their ability to quickly analyse and evaluate similar municipalities’ accounting systems, put the spotlight more on the ineffectiveness of one municipality as compared to that of another.

Another event that prompted government reform internationally was the global economic meltdown in 2008. Politicians spoke about austerity measures once again. Remembering that downsizing, money-saving measures and efficient operations were already measures of reform in the second wave, implementing austerity measures at this time was not that easily achievable. Governments were required to become even more efficient. However, due to the
sheer magnitude of the economic and financial crisis, these saving measures were not sufficient to render any meaningful impact. This meant that for budget cuts on government spending to be effective, it would mean cutting funding for actual service delivery as so-called wastage was already sufficiently addressed in previous reforms of this nature. Pollitt and Bouchaert (2011:9) state that due to the above “real cuts in real services were unavoidable” and that this led to wide-spread demonstrations against the reality of cuts in the public service domain all over Europe, starting in the autumn of 2010.

Since the so-called first wave of reform, public management has evolved from the staunch, unyielding, legal and technical reforms of the past to an internationally recognised set of models and approaches of a competitive nature. However scholars in NPM seem to be divided on a specific definition thereof. Pollitt and Bouchaert (2011:10) make the assumption that it is a “two-level phenomenon”, stating that primarily it is a broad theory that improvement in public sector can be achieved by cloning “business concepts, techniques and values”. On a secondary level, NPM is a package of specific concepts and practices. These include a more pronounced focus on performance, preference to organisational downsizing and professionalism, performance related remuneration, competitive bidding and a customer focus instead of seeing the public only as consumers of services.

Aucoin in Osborne (ed. 2002: 26) argues that NPM comprises of a mixture of ideas obtained from both corporate management and institutional economics or from public choice. However, Hood (1989:349) is of the opinion that the main themes of NPM are moving from policy emphasis to performance measurement emphasis, from reliance on old bureaucracies to more flexible autonomous organisations and a pronounced move towards competitive bidding. There is also a move towards cost effectiveness, more decision-making powers to managers and self-regulation, thus agreeing with some of the principles of corporate, general and financial management shared in Aucoin’s definition above.
Lynn (2006:107) cites Toonen’s analytical model of NPM where the themes are closely linked to those of Hood and Aucoin as discussed above. They include a business management approach to government, improved quality and performance, less bureaucracy, market focus, competitive tendering as well as contracting and quality management, all of which has also been identified by Pollitt and Bouchaert. Lynn (2006:108) is of the opinion that when one looks at the commonalities in the practices of NPM there is a strong suggestion of convergence of practices and principles internationally, and therefore by implication “the national sovereignty of administrative reform has been shattered by globalisation in its many guises”.

New Public Management in its simplest form can then at best be described as the adoption and the application of private business concepts and practices to those of public management in order to provide effective and efficient services. However, as the focus of this paper is on financial sustainability essentially, I will briefly discuss the notion of New Public Financial Management (NPFM) as it relates to specific reforms in public financial management.

New Public Financial Management can be seen as the reforms and changes in public financial management that fall within the general reforms related to NPM. This view is supported by Guthrie, et al (2005:2) where they identified five key elements of financial reform which include changes to financial reporting systems, developing market-based and market-oriented management systems and structures in order to deal with public service pricing and provision, developing a performance measurement approach, developing delegations of powers in terms of budgets and changes to internal and external audits in the public service. New Public Financial Management specifically highlights the significant increase in the financial and accounting dimensions of public sector management reform and the provision of services, and will continue relentlessly in future, according to Guthrie, et al (2005: 3,17).

Cangiano, Curristine and Lazare (2013:1,2) are of the opinion that Public Financial Management (PFM) in its most basic and traditional sense is concerned with the manner in which governments manage their budgets within the common phases of formulation, adoption
and implementation. PFM also deals with procedures and processes that include all aspects of expenditure management. However, their recent observation is that there is a significant shift from expenditure management to financial management. This shift indicates a widening scope from that of a narrowly defined budget to all aspects of public resource management, which includes resource allocation, debt management, risk management and a focus on medium to long term budget planning.

New Public Financial Management has further progressed from its historic focus on compliance and control to providing information for the purposes of financial analysis and future policy making in an effort to ensure future financial sustainability. The presence of unsuitable and incorrect budgetary procedures and directives may lead to expenditure increases that are not sustainable and overspending due to unbudgeted liabilities. The lack of good and available financial information also impedes the sustainability of government finances.

Cangiano, Curristine and Lazare (2013:2) are of the view that this connection between policy and process highlights the significance of PFM and stimulates current innovations with regard to PFM practice. This opinion reflects the reality of PFM in the local government sphere in South Africa since the promulgation of the MFMA, 2003, and the regulations related thereto. Financial reforms are driven by the legislation and this relatively new legislation was informed by the NPM and NPFM principles, as will be shown later in the discussion of the legislation in Chapter 3. However, judging by the audit findings of the AG in recent times, the majority of municipalities are still battling with compliance and control issues and because of this, they are not yet in a position to produce information that conforms to the four principle qualitative characteristics of understand-ability, relevance, reliability and comparability as prescribed by the Accounting Standards Board (ASB) of South Africa.
The discussion that follows focuses on financial management. More specifically, it focuses on the four pillars or components of public financial management being budgeting, accounting, reporting and auditing.

2.3 FINANCIAL MANAGEMENT

Good financial management is a critical element of municipal management as it enables municipalities to plan, organise and allocate financial resources effectively and efficiently while also giving effect to their responsibility to remain accountable for their decisions to the people who they serve. In this section the four essential components of public financial management: budgeting, accounting, reporting and auditing, are discussed including their applications for municipalities. These components are discussed in this specific order as it will then be easy to show the linkages and interactions of one to the other.

2.3.1 Budgeting

A budget is an operational and financial plan for the subsequent financial year that municipalities must develop annually to realise local government goals and objectives using both financial and non-financial information. Financial information contains estimations of available financial resources while non-financial information relates to community needs, policy and political concerns. Budgets are developed in terms of a process – the budget process – which commonly starts several months before the start of a financial year. This process is important in order to map a municipality’s choice of expenditure priorities as well as to identify the resources that are needed to realise planned expenditures.

Farvacque-Vistorik and Miholy (2014:94) cite Mikesell, 2011, who states that “The Budget process provides the medium for determining, what government services will be provided and how they will be financed”. Budgeting in local government is thus the process of allocating limited resources in an environment of unlimited demand/need for a specific financial year, and since the inception of the MFMA in July 2004, multiple financial years. This will be discussed in detail later in the next chapter. A budget includes the information regarding types
and amounts of expenditure as well as the proposed revenue streams to finance the expenditures.

A budget can be used as an instrument to improve planning. As stated previously, a budget is essentially a financial plan which implies that a certain amount of planning must go into the development of the budget. The adoption of a budget implies that decisions were made on the basis of a planning process in terms of how a municipality plans to achieve its goals and objectives. The function of planning is thus of major importance in any government institution, in order to ensure that decisions to provide goods and services are for the good and in the interest of the public. Also, that those decisions are informed taking into account the vast scope and diversity of government activities and that planning and decision-making is participatory, meaning that it should be implemented in consultation with the community that it serves.

Budgets are also instruments of financial control. They should be used by council, the executive and administrative branches of government. For example, the Mayor or Municipal Manager can apply the budget to monitor actual expenditure against the expenditure planned at the beginning of the financial year. Similarly, and perhaps more importantly, directors and line managers within the different departments in a municipality can use the budget to monitor and control expenditures and revenues. This can improve operational efficiency and accountability as council – who has oversight over the implementation of the budget – can use the information generated from actual implementation and planned implementation to monitor whether resources are applied efficiently to address the priorities that were identified in the budget planning process. In addition, the control function in budgeting not only includes the curbing of expenditures within the limits of available funding but also ensures that the approved budget is implemented and that financial reports generated from the budget information are accurate. This function also allows for the documentation of information for cost estimates that can be used in the preparation of subsequent budgets.
Budgets for municipalities commonly combine two budgets: an operating budget and a capital budget. Operational budgets are usually larger and contain more detail than capital budgets; operational budgets include income/revenues from current year transactions and also provide for expenditures during the same financial year. Capital budgets contain income from capital transactions (sale of property, loans, and capital grants) as well as the expenditure for infrastructure and goods whose useful life extends beyond one year.

Farvacque-Vistorik and Miholy (2014:95) propose the following three principles of a good budget that should be kept in mind when preparing local government budgets: firstly, broad goals to guide government decision-making should be established followed by credible approaches for achieving goals that have been set by the development of appropriate programmes and strategies; secondly, the local government should be equipped with a budget that is consistent with the goals and approaches that have been decided upon; and finally the local government should be enabled to monitor and evaluate its performance and to make adjustments to meet the contingencies and changing circumstances.

There are some commonalities between these principles and the current legislation governing budget planning and subsequent adoption for local government in South Africa. Both the MSA, 2000 (Section 23(b)) and the MFMA, 2003 (Section 21(a)) allow for the establishment of objectives and goals that must guide decisions in terms of the budget. Credible approaches to achieve these objectives and goals find execution in terms of the Service Delivery Budget Implementation Plan (SDBIP), MFMA, 2003 (section 53(1)(c)(ii)) which the Mayor must approve within 28 days of the adoption of the budget. The IDP, which is the principle planning document of a municipality and identifies the objectives, goals and development programs and projects in the medium to long term, must be supported by a credible budget. The above legislated practices and approaches find relevance in budget principles 1 and 2 as proposed by Farvacque-Vistorik and Miholy.

In practice this means that no project or program can be supported or allowed for in the municipal budget if it was not identified and approved in the municipality’s IDP, thus finding
common ground with budget principle 3 above. Finally, Chapter 6 of the MSA, 2000 compels municipalities to approve and adopt a performance management system. Section 41(c) of the MSA, 2000, allows for the monitoring of performance as well as the measurement and review of performance. Adjustments can be made within the financial year if the performance evaluation shows that they are necessary due to circumstances beyond the control of the executive or administration of council. The budget may also be adjusted if the key performance indicators that were adjusted are linked to it. This is definitely linked to the fourth budget principle above.

### 2.3.2 Accounting

The basic concepts of accounting will be discussed in this section and specifically the role that accounting plays as the basis for the documentation, classification and organisation of financial information in a methodical manner. A brief discussion about the types of accounting, including their relationships to the auditing function as well as the current prevailing accounting standards, is outlined.

The role of accounting is to provide accurate, timely and complete information regarding revenues, expenditures, as well as assets and liabilities. In a municipality, this information may include billed amounts for municipal services provided, payments received as well as payments to employees, vendors and contractors. Information generated from accounting systems informs council, management and any external stakeholders about the financial resources, efficiency of financial management and financial position of a municipality, during and at the end of a financial year. The identification of the manner in which transactions and proceedings are described in financial reports and the design of systems that enable the easy production of meaningful reports as well as operational control systems are all concerns of accounting.

Several types of accounting exist that fulfil a specific role in the financial management of entities and organisations. Farvacque-Vistorik and Miholy (2014:110) are of the opinion that
the majority of accounting types include financial accounting, management accounting, cost accounting and public sector or commercial accounting. A short description of each is given below.

Financial accounting uses financial information to generate reports on the financial transactions and financial position of an entity. Cost accounting generates information on the cost of operations and assists with the measurement and control of the costs of individual services and functions. Management accounting uses the statistics and information generated from cost accounting in order to produce reports that will assist management in decision making. This is done by using a number of different analytical and presentation methods. Public sector and commercial accounting are similar with regard to their elementary principles. The differences come into play when specific accounting practices are preferred and suited for specifically government or commercial organisations.

However this difference has become less pronounced in recent times in South Africa because municipalities are currently moving from cash-based accounting to accrual-based accounting. The Accounting Standards Board (ASB) of South Africa issued a framework for the preparation of financial statements for entities within the public sector, which includes municipalities, in June 2004. This is similar to, for example, in the United States where the Government Accounting Standards Board (GASB) sets standards for government accounting. In March 2009, the ASB also issued a framework determining the GRAP reporting standards. Accounting standards are an enabler for accountants to apply a common method in terms of how financial transactions are to be treated and reported on, so as to ensure the comparability of financial reports.

The accounting of financial transactions differs subject to the basis of accounting or when the transaction is recorded, meaning that if it is recorded at the time of its occurrence or when cash is exchanged. With cash-based accounting, financial transactions are only recorded with the exchange of money. Income is recorded when cash is received and expenditure is recorded
when it is actually paid. Accrual-based accounting does not take the exchange of cash into account. Revenue is recorded when earned and expenditure is recorded when incurred and not necessarily when the actual cash has been received or paid. It is also recorded as such in the financial statements.

Traditionally local governments in South Africa used cash-based accounting, but with the implementation of the MFMA, 2003, as well as the changes to the reporting systems and standards as described above, the change was made to accrual-based accounting. Farvacque-Vistorik and Miholy (2014: 127) are of the view that as local governments progressed into distinct and autonomous organisations it became necessary to adopt and implement accounting systems and procedures more suited to their business requirements. This view is supported by the changes in accounting types, basis of accounting and reporting standards that emerged as the MFMA, 2003, was implemented by municipalities in South Africa, from July 2004.

The ultimate purpose of accounting systems is to allow for the efficient recording of financial data and to use this data to compile financial reports. Typically, the financial reports for municipalities are made up of the following three financial statements: Statement of Financial Position (Balance Sheet), Statement of Financial Performance (Income Statement), and Cash Flow Statement.

- **Statement of Financial Position**

This financial statement, also called the balance sheet, depicts the financial position of a municipality at any given date or, in the case of annual financial statements, at the end of the financial year. In the case of public entities such as municipalities, the statement is comprised of two components, namely assets and liabilities. The Statement of Financial Position assists in the assessment of financial security of the municipality in terms of liquidity as well as financial and credit risk.
• **Statement of Financial Performance**

This financial statement is also called the income statement and it depicts the financial performance, reports on total revenues and total expenditures. In other words, it shows how much income was earned and what the municipality spent during a particular financial year. This statement provides a sense of how well a municipality is functioning.

• **Cash Flow Statement**

This financial statement depicts a presentation of the movement of cash over the financial year, and it is classified under operating, investing and financing activities. It gives the user a significant understanding of the liquidity and growth of the municipality because it shows the net increase/decrease in cash and cash equivalents over a specific period. This information can assist analysts – especially if historic information is analysed over a number of years – to project future cash flows in order to provide input into future economic decisions. When the main changes in the financial position over a period are summarised, this statement can highlight certain priorities for management. For example, if a municipality decides to increase capital expenditure to provide new infrastructure it may indicate a higher future revenue stream to fund the operations, maintenance and replacement of the infrastructure within the future operational budgets of that municipality.

The key function of municipalities is to provide quality services to the citizens in an efficient and effective manner. As the financial and human resources to provide these services are becoming increasingly scarce, it becomes more important for councils and senior management to have intimate knowledge of the finances of the municipality. Accounting and the establishment of accounting systems that enable the efficient recording and gathering of financial data as well as the analysis and structured presentation of this data will make it useful for councils and management to make well-informed future decisions.
2.3.3 Financial Reporting

Financial reports are comprised of a combined set of financial information. They are a means of providing information to users to make choices and decisions about how the limited resources in local government need to be applied. These reports may also be used for financial performance monitoring which will be discussed later. Potential users of financial reports in local government include investors, employees, creditors, suppliers and perhaps more importantly, the citizens and other spheres of government such as the provincial and national treasuries as well as sector departments.

The ASB issued a framework for the preparation and presentation of financial statements in June 2004, which has subsequently been regularly amended to specifically allow for the phased implementation of certain GRAP standards. The purpose of the framework is to set out principles on which standards of GRAP will be based for the public sector. The specific significance of these standards, for the purposes of this study, are the qualitative characteristics of financial statements which are required for good financial reporting and the attributes that make the information provided in them useful to the users.

According to the ASB (2004:13), there are four principle qualitative characteristics: understand-ability, relevance, reliability and comparability, which will be discussed.

Understand-ability

Information provided in the financial statements should be easily understandable to the users. For this purpose it is assumed that the users have a reasonable knowledge of government, its activities and environment and its accounting, and in addition, they have an inclination to attentively study the information. The ABS is of the opinion that information about complex matters should not be excluded if there is a perception that it would be difficult for the users to understand. The full information is important as it can influence any decisions made by the users in some way or another. Also, when the competency of the users is considered it may
CHAPTER 2: LITERATURE REVIEW AND THEORETICAL FRAMEWORK

not be fitting to assume that they will have realistic knowledge of “accountability, stewardship and political objectives”. Should financial statements be useful to a large range of users for general purposes, it is expected that the preparers thereof may assume a reasonable knowledge to be able to use such statements. The ABS indicates that in cases where a reasonable knowledge does not exist, the role of oversight and regulatory bodies, for example the internal audit committee, Municipal Public Accounts Committee (MPAC) or a local business chamber, becomes important. When these committees or public representative forums are well-supported by council and manned by competent and unbiased members, they may have the ability to represent the interest of the taxpayers to a large extent.

Relevance

Information must be relevant to the decision-making wants of the users in order to be useful and it is relevant when it has the ability to guide proper stewardship by assisting users in evaluating past, present and future events/actions or if it confirms and improves past evaluations done by the users. Information relating to financial positions and financial performance can often be used as a benchmark for predicting or forecasting future financial position and performance. Therefore financial information must be predictive in nature. The ABS (2004:14) states that the ability to effect predictions from financial statements is enhanced by the way in which past information is displayed. It makes the example that revenue and expenditure items of a significant size, nature or incidence should be separately disclosed to improve the informative value thereof.

Materiality

Information relevancy is impacted by its nature and materiality. Relevancy, in some cases, can be determined by the sufficiency of the nature of the information alone, while in other cases both nature and materiality are important. Information becomes material if its exclusion, misstatement or the non-disclosure thereof may have an impact on the decisions which were made by its users on the basis of the financial statements. The size of items or the judgement error regarding circumstances of exclusion, misstatement or non-disclosure in the financial
Reliability

In order for information to be useful it also needs to be reliable. Reliable information does not have any material errors and bias and can be relied on by users to faithfully depict that which it purports to or reasonably expects to represent. Financial information must also be tested against the following principles in order to be considered reliable.

Faithful Representation

For information to be reliable it must faithfully represent the transactions and events it purports to represent or within reason be expected to represent.

Substance over Form

To faithfully represent information on transactions and events that it purports to represent it is required that it be accounted for and depicted in unity with its substance and economic representativeness and not just its legal form. This needs to be done as the substance of transactions or other events is not at all times dependent with that which is clear from its legal or contrived form.

Neutrality

Information contained in the financial statements must be neutral or free from bias. When the selection or presentation of information is done in such a way that it could influence decision-
making or judgement so as to achieve a predetermined result, the financial statements are not neutral.

**Prudence**

Reliable information in the financial statements must be complete within the thresholds of materiality and cost. Exclusions can lead to information being false or misleading, thus making it untrustworthy and lacking in terms of its relevance.

**Comparability**

Financial statements must be able to be compared by users through time so as to identify trends in financial position and financial performance, which is the case for the purposes of this study. In the same sense users must also be able to compare the financial statements of different entities or municipalities. Therefore the display and measurement of the financial effect of the same transactions and other events must be applied consistently within the entity and in the same manner for different entities. Compliance by all with accounting standards, policies and practices assists in achieving comparability.

Financial reporting is a legislative requirement for municipalities in South Africa and contributes towards ensuring transparency and accountability in municipal governance. Accounting standards and the framework for the preparation and presentation of financial statements issued by the ASB are linked to international best practice. The development of the framework was informed by the International Accounting Standards Committee (IASC) as well as the International Public Sector Accounting Standard on Presentation of Financial Statements and the Accounting Standards Board of the United Kingdom (ASB 2004:01).

The principles of Accountability and Transparency as discussed above in the NPM theory section basically mean that in terms of financial management, municipalities must be held
accountable for the decisions that they take, because financial reporting to predetermined standards within a set framework, as well as the publishing of these reports, assists with transparency. One should however be aware that even if municipalities comply with the qualitative characteristics of financial statements, these reports are still highly technical in nature and the users thereof must have a certain level of education in order to firstly, understand and secondly, interpret the information.

It is the view of the author that this reality with regard to the inability of the majority of users to understand and interpret financial reports impacts negatively on transparency and accountability. This is a definite reality in South Africa because the majority of its population is not highly trained or skilled in general, let alone possessing the skills to read and interpret technical financial statements. The statement is further supported by the fact that input solicited on the annual reports, which includes the annual financial statements, is either non-existent or very little.

2.3.4 Auditing

Auditing assists in ensuring that funds are not subjected to fraud, waste and abuse as well as mistakes in reporting. In the public sector, auditing can contribute towards ensuring that an entity conducts its business in compliance with specific rules, procedures and legislation.

Auditing can be described as a systematic process of objectively getting and evaluating evidence regarding assertions about economic actions and events. An audit consists of a series of steps, done sequentially, which include internal controls and substance testing of transactions and balances. The outcome of an audit is an audit report which the auditor produces for the benefit of users. The auditor expresses a finding in the form of an opinion regarding the fairness with which the financial statements reflect the auditees’ financial position, financial performance and cash flows. For municipalities, other objectives such as compliance to legislation, for example the MFMA and its regulations, as well as rules and
standards (GRAP) are equally important so as to highlight the misuse or misappropriation of public funds.

The AG who has the constitutional obligation to audit the public sector in South Africa, audits the annual financial statements of government, and its entities which includes municipalities. The audits for municipalities are usually a financial and compliance audit. A financial audit is historical in nature (for the financial year past) and the AG performs an independent evaluation in order to certify the fairness, accuracy and reliability of the financial information. The focus of this type of audit is to verify whether the financial statements prepared by the municipality reflect the true financial position thereof. The AG examines the accounting treatment of the different transactions in the municipality’s financial statements and if the disclosed information reflects the principal transaction.

As alluded to earlier, a compliance audit focuses on the municipality’s compliance to the relevant legislation, regulations and procedures with regard to the treatment of public funding. The AG expresses its findings by means of an audit report which includes its opinion regarding the completed audit. There are several types of audit opinions. An unqualified audit opinion conveys the auditors’ belief that the financial statement is a true and fair representation of the municipality’s financial position. This is the so-called clean audit.

However an auditor may also issue an unqualified audit opinion, with findings on other matters. This means that the audit is unqualified but not “clean” as there are matters of material concern that the auditor wants to bring under the attention of the users. For example, in the 2012/13 financial year, the Cape Agulhas Municipality had an unqualified audit with material misstatements which were corrected during the audit process. These findings were as a result of significant uncertainties regarding litigation and the wage curve agreements, material impairments and losses as well as material inconsistencies in information included in the annual report (AG Report CAM: 2013: 3&3).
These findings resulted therein that the municipality did not achieve a so-called clean audit. However, in the 2013/14 financial year the Cape Agulhas Municipality received an unqualified audit with no findings as the findings in the previous financial year were adequately addressed and no material matters arose during the 2013/14 audit by the AG.

Then there are also qualified opinions with findings which basically mean that a municipality submitted statements to the AG with material misstatements that could not be rectified before the publishing of the financial statements. The worst finding the AG can produce is that of an adverse or disclaimed nature. An adverse finding results when financial statements are produced that include so many material misstatements that the AG basically disagrees with almost all the amounts and disclosures as stated. In the case of a disclaimed finding, the auditee could not provide the AG with evidence for the majority of the amounts and disclosures in the financial statements, thus resulting in the inability of the AG to express an opinion on the credibility of the financial statements.

Farvaque-Vitkovic and Miholy (2014:143) are of the opinion that external audits fulfil a key role in improving the accountability of municipal governments and provide valuable feedback to councils and management regarding the quality of their financial management. They however state that the experience in the majority of developing countries shows that audits do not always fulfil the critical role as expected due to various reasons, including late audits, capacity shortages and the fact that audits are limited to compliance to legislation only.

These objectives of improving accountability and providing feedback are shared by the AG as it states that, as the supreme audit institution in South Africa it “exists to strengthen our country’s democracy by enabling oversight, accountability and governance in the public sector through auditing, thereby building public confidence.” (AG, WC 2013/14:11) Although there has been a steady increase in the number of municipalities achieving clean audits and unqualified audits without findings, 39% for both in 2007/08 to 58% for both in 2013/14, there is still a significant number of municipalities who received qualified and
adverse opinions, 22% and 1% respectively and 16% disclaimed with findings (AG LG Report 2013/14:24).

The AG is of the opinion that these results can be improved if there is true political will to change and when leadership actively strives for quality and sustainability in fulfilling their duties. To improve or maintain the current audit outcomes, the AG proposes that attention be paid to the following three major causes: slow response by management or leadership to address the previous years’ causes of poor audit outcomes; key positions vacant or key officials lacking appropriate competencies; and lack of consequences for poor performance and transgressions (AG LG Report 2013/14:6).

The AG Reports are tabled annually to Parliament, all Provincial Legislatures and by means of inclusion into an annual report to all councils as well as the general public, who are primarily the users, as discussed earlier in this chapter. These reports assist national and provincial government departments to develop support plans to the municipality. For example, the national and provincial treasuries as well as COGTA assess the audit action plans of municipalities quarterly by measuring adherence to the activities as identified. The audit action plan or OPCAR (Operation Clean Audit Report) is an initiative that was pronounced by the Minister of COGTA on 22 September 2009 (AG WC Report 2013/14:11) in an effort to reach 100% clean audits for all provincial departments and municipalities by 2014. With regular engagements between the relevant municipalities and the departments on their progress on the OPCAR, these departments can then provide specific support.

This support can be in the form of actual assistance from provincial officials to local officials by means of knowledge sharing or by providing grants, like the Municipal Systems Improvement Grant (MSIG), in order to obtain specialist support through consultants as well as the procurement of electronic financial systems to assist in accounting. Although much progress has been noted as alluded to here, 2014 has passed and the departments’ (COGTA) goal of 100% clean audits has not been met.
In fact, it is the view of the author that this goal was too ambitious to start off with, given the reality of the number of municipalities with clean audits at the time, 2009; but the fact that the minister has been changed several times since the elections in 2009 has also had a negative effect on the reaching of this goal. According to the Pretoria News of 29 May 2014, this department has had five ministers since 2008 which has negatively influenced sound governance and administration. The department itself did not receive a clean audit report up to the date of the article. So the department’s ability to successfully reach its own goals, in terms of political will and leading by example can thus become questionable. This assertion is supported by the actual audit results mentioned previously.

2.3.5 Ratio Analysis

The audited information from the financial statements can be used to calculate ratios. The NT has determined, after some research was done, that there are more than two hundred financial ratios, with different results, used by municipalities to determine their financial status MFMA Circular 71, (2014:1). This manner of assessment results in differences in interpretation, unreliable submission and a general misinterpretation of a municipality’s financial status. This often leads to the improper diagnosis of the real challenges and thus unsuitable responses to correct these challenges.

The aim of the Circular was an attempt to bring consistency in interpreting and applying specific financial information by making use of standardised financial ratios. The NT also cautions against the use of ratios and norms in isolation and advises that a number of interrelated ratios should be analysed together so as to obtain a wider view of a municipality’s financial performance. The analysis of different ratios in a combined manner will enable council and officials as well as the public to have a better sense of the financial status of the municipality as it will assist in identifying the areas of financial management that need to be monitored and improved. The ratios and norms to be used in this study and their meanings, for example liquidity ratios, nett debtor days and collection rates, will be discussed in further detail in Chapter 5.
2.4. SUMMARY

From the discussion above, the importance of planning, development and execution as well as reporting on the four components of public financial management can contribute towards effective and efficient government institutions. This discussion also highlights the fact that these components cannot be seen as stand-alone items operating in silos. They are intrinsically linked and dependent on each other so as to achieve a desired outcome. For example if the budget of a municipality is not fully funded and structured in terms of legislative requirements, this could lead to difficulties in correctly accounting for revenue and expenditures which would in turn have an impact on the auditing of the financial information that can lead to a negative audit opinion. All of these components and the actions emanating from them must be, in terms of the prescripts of almost all local government legislation, done in such a manner that enables the input and participation of the citizens that government serves.

Public participation or the ability to actively solicit useful input and comment from the public, in itself is a challenge. Municipalities need to be aware of the manner in which participation is solicited, as well as the education level and different languages of citizens in a specific constituency, and then also ensure that sufficient time and human as well as financial resources are made available to enhance participation. This is important in order to give effect to transparent decision-making and reporting which would, in an ideal situation, contribute towards keeping public representatives and officials accountable for decisions that were or are to be taken. However, even though the issues of accountability and transparency have been on the political agenda of South Africa for more than a decade, the general perception is that fraud and corruption is still prevalent within all spheres of government. Now, one can argue that this situation is a consequence of a more transparent government, where fraudulent and corrupt activities are exposed due to transparency, but on the flipside it can also mean that there is a general and growing disregard for ensuring a government free of fraud and corruption.
This then begs the question of whether there is a real political will to address the issue effectively and if that is so, does the so-called punishment fit the crime? There have been various reported cases of the same people in government being responsible for fraudulent and corrupt activities either being deployed to other positions or being suspended with pay without the actual conclusion of the disciplinary processes. The reality is that these disciplinary cases drag on for months, sometimes years, while the guilty party is on full pay. While the guilty party is on suspension, another person needs to act in his/her position thus resulting in double expenditures on the salaries budget of the specific municipality or government department.

Then there is the disregard for the statutory watchdogs against fraud and corruption, like the Public Protector, where even the president refuses to give effect to the recommendations that she makes in her reports. A case in point is where the Public Protector found that the President and his family had unduly benefitted from the R 243 million upgrade of his private homestead at Nkandla in KwaZulu-Natal. The Public Protector recommended that the President should pay for the non-security upgrades. The Mail & Guardian reported on 27 July 2015 that, according to the report of the Public Protector, the President was aware of the so-called non-security upgrades and did not raise any concerns about the scale of the project, but instead was concerned about the slow pace of the upgrades. The same report also states that the President declined to answer numerous questions by the Public Protector, including those regarding the cost of the project.

The President instead appointed various committees to investigate this situation, which ended in these committees determining that he does not need to pay back any money and that in fact more upgrades are needed to ensure the security of himself and his family. This recommendation was adopted by parliament due to the majority votes of the ruling party and instead the focus now is on the relevant officials responsible for the project. These shenanigans only fuel the suspicions of fraud and corruption and are not conducive to transparency and good governance.
These actions, or perceived inactions, in government make a mockery of the notions of accountability, transparency and good governance, thus resulting in the loss of public confidence in government. In addition, they create a general sentiment that these practices are accepted which in turn, exacerbates the prevalence thereof.
CHAPTER 3: POLICY AND LEGISLATIVE FRAMEWORK

3.1 INTRODUCTION

The transformation of the local sphere of government, as the sphere of government at the coalface of service delivery, was necessitated due to the disproportionate and unequal manner in which it was governed and managed by the apartheid regime. The levels of services between the so-called white suburbs and the black townships differed vastly. A high level of service was provided in the suburbs whilst those in the townships were of an inferior nature, thus creating a situation that resulted in huge service delivery backlogs in these areas after the advent of democracy. In order to redress these imbalances a focussed effort was needed by all spheres of government as local government simply did not, and in some instances still does not have, the skills, competencies, abilities and perhaps most important for the purposes of this study, the finances, to address this matter effectively and efficiently.

The local sphere of government was the last sphere of government to be reformed post-apartheid. This statement is verified by the timeline of promulgation of legislation specifically related to local government (Constitution, 1996; MDA, 1998; Structures Act, 1998; MSA, 2000; MFMA, 2003; MPRA, 2004; MFPFFA, 2007). This particular suite of legislation emanated from the White Paper on Local Government, 1998 and was promulgated to transform and establish a new system of local government. In some way, restructuring national and provincial spheres makes sense due to the constitutional interdependency of government as well as these two spheres providing a supporting function to local government.

This chapter begins with a discussion on the Local Government Transition Act, 1993, then the Constitution, 1996, which is the supreme act guiding the development of subsequent legislation, moving onto the White Paper, 1998, which can be seen as the “gateway” for local government reform, and ending with the MFPFA, 2007, focusing specifically on the relevance of the different legislation to municipal financial management.
3.2 LOCAL GOVERNMENT TRANSITION ACT, NO. 2009 OF 1993

The Local Government Transition Act, 1993, (LGTA) paved the way for the promulgation of a plethora of legislation regarding local government that would span over almost two decades since the start of democracy in 1994. The LGTA, 1993, provided for revised interim measures in order to promote the restructuring of local government, the establishment of provincial committees for local government, the establishment of negotiation forums, the establishment of appointed transitional councils, the delimitation of jurisdictional areas and the election of transitional councils.

It further allowed for issuing of proclamations by the Administrators of the various provinces and the establishment of Local Government Demarcation Boards in the provinces. Lastly, it made provision for the repeal of certain laws and any other matters connected therewith. This was the pre-interim phase leading up to the first democratic local government elections held between 1995 and 1996 after the first national democratic elections on 29 May 1994. Although the LGTA, 1993, provided some direction with regards to the fundamental changes that were yet to come, it was promulgated with the specific objective of regulating the transition from the old to the new dispensation. As a point in case, it made provision for the provincial MEC of Finance to approve over and unauthorised expenditures. Municipalities thus had limited powers in financial management at that point in time.

3.3 CONSTITUTION OF THE REPUBLIC OF SOUTH AFRICA, 1996

The Constitution, 1996, however, ensured that local government not only became a tier of government as it used to be, but an equal sphere thereof. It allowed for three spheres, national, provincial and local government, which are distinctive, interrelated and interdependent. According to De Vos, 2014:258, the particular design of the constitutional system is an integrated multi-sphere system of government or an integrated model of federalism, meaning that these three spheres function interdependently and are interrelated on and to each other, but have to preserve their own individual characteristics and duties.
The then controversial issue of powers and functions for each sphere of government was also addressed by the Constitution, thus allowing for the exclusivity of certain powers and functions to specific spheres. Likewise, to express the interrelations and interdependence envisaged, other powers and functions are either shared or are concurrent between all spheres. It must however be noted that there is still some ambiguity regarding the functions and powers, specifically with reference to libraries and museums which are a provincial function, but have always been provided for by the municipalities, giving rise to the notion of so-called “unfunded mandates” that may have negative effects on the budgets of municipalities.

The constitution made specific reference to the revenue-generating power of municipalities. In terms of municipal fiscal powers and functions section 229 of the Constitution, municipalities may levy property taxes and surcharges on fees for services that they provide. Section 230A empowers a municipality to raise loans for capital or current expenditure in accordance with national legislation while section 214 allows for the equitable division of revenue raised at a national level among the three spheres of government. Municipalities thus have a constitutional right to raise their own funding and raise loans but similarly, they have the right to an equitable share of nationally raised income. These income streams are generally the main sources of revenue reflected in a municipal budget although this is not limited to them only. The Constitution thus provides the basic framework within which municipalities can access revenue for the provision of services.

The Constitution further allows for the establishment of a National Treasury with the powers to regulate financial management and also distribute grants to municipalities. The establishment of an independent national Auditor General was also allowed for in the Constitution. The Auditor General has the specific task of auditing, making findings and providing an audit opinion on the financial statements of all spheres of government.
3.4 INTERGOVERNMENTAL FISCAL RELATIONS ACT, 1997

The Intergovernmental Fiscal Relations Act, 1997, (IFRA) was assented to on 26 November 1997 with a commencement date of 01 January 1998. The IFRA, 1997, was developed to give effect to section 214 of the Constitution, 1996, which envisioned an act of Parliament that would allow for the equitable division of revenue raised nationally to all three spheres of government.

Thus the aim of the IFRA, 1997, is to promote co-operation between all three spheres of government on fiscal, budgetary and financial matters and to describe a process for the determination of the equitable sharing of nationally raised revenue. The act allows for the establishment of a Budget Council and a Local Government Budget Forum with its respective functions and meeting requirements, as well as the process for revenue sharing among the spheres of government.

The equitable share allocation to municipalities is an unconditional grant which has become an important income source for municipalities. The main purpose of this grant is to assist municipalities in the provision of basic services to indigent consumers. All grants and allocations from national government to local government are promulgated annually by means of the Division of Revenue Act (DoRA) and municipalities can only include grants in their budgets once they have been made public in this manner.

3.5 WHITE PAPER ON LOCAL GOVERNMENT, 1998

The aim of the White Paper on Local Government, 1998, (White Paper) was to facilitate the transformation of local government as well as to ensure the realisation of a developmental local government. This policy, together with the Constitution, was the catalyst for the generation of the suite of legislation on local government that followed. In terms of institutional transformation, the most important pieces of legislation were the Structures Act, 1998 and the MSA, 2000.
Developmental local government in the White Paper, 1998, is described as a local government that is committed to partnering or working together with citizens and community groups in order to find sustainable means to meet the socio-economic and physical needs of the community with the goal of improving the quality of their lives. This intent is given effect to with the advent of the IDP which is allowed for as a legislative requirement for planning in the MSA, 2000.

Section 3 of the White Paper, 1998, is dedicated to cooperative government and intergovernmental relations, as envisaged in Chapter 3 of the Constitution, 1996, but it also provides further clarity as to the roles and responsibilities of national and provincial government. These issues are important to the financial management and sustainability of local government as they have an impact on the prioritisation of projects within the budget in terms of expenditure. As municipalities become more reliant on the revenue transfers from national and provincial governments in the form of grants, good intergovernmental relationships are needed to ensure the efficient and effective expenditure of these grants.

This is critical, otherwise municipalities may just function as extensions of national and provincial government where the expenditure priorities in their budgets are determined by the criteria of conditional grants received from national and provincial departments. Other than the obvious issues of future sustainability and public participation, the real issue here, in the view of the author, is that of an autonomous local government, which could be seriously compromised if there is too much reliance on grants and transfers. Municipalities should guard against this and constantly seek ways to enhance their own revenue-raising powers as envisioned in the Constitution.
3.6 MUNICIPAL DEMARCATION ACT, NO. 27 OF 1998

The Constitution further dictates that an independent authority must determine municipal boundaries and delimit wards within the municipal area (section 155(2) (b)). This gave rise to the promulgation of the Municipal Demarcation Act, 1998 (DMA) which is the key act that directs the demarcation processes in the country. The DMA, 1998, provides for the establishment of a Municipal Demarcation Board (MDB) which has the primary function of demarcating municipal boundaries as well as delimiting the areas within the boundaries into municipal wards.

The significance of the DMA, 1998, for the purposes of this study, was that as municipalities were demarcated to be larger in size and demographics, meaning that as the size grows to include more people, the tax-base also grows, thus allowing for improved future financial sustainability. Although in an ideal situation this would make sense, the reality was that the inherited black local government structures were mainly technically bankrupt with huge service delivery backlogs, low service levels, and due to the so-called rates boycott of the 1980s, huge outstanding debtors. With re-demarcation, immediate cross-subsidisation between the former all-white and those of the black municipal councils was made possible.

Since the end of the apartheid regime, the quantity of municipal structures has decreased significantly at first, and to lesser extent after, the local government elections in 2000, as can be seen from Table 1 below. However the most significant change was in 1995/96 when some 1 262 municipal structures were amalgamated into 843 municipalities.

After the MDB was established in 1999, the number of municipalities was reduced to 284, 283 and 278 respectively, before the municipal elections in 2000, 2006 and 2011. The Finance and Fiscal Commission (FFC) (2015:308), predicts that this declining trend will continue prior to the 2016 municipal elections, following the current round of demarcations that the MDB is considering at the time of writing of this report.
Table 1: Number of municipalities post demarcations

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of local municipalities</th>
<th>Number of district municipalities</th>
<th>Number of metropolitan municipalities</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Post – 2000 Demarcation</td>
<td>231</td>
<td>47</td>
<td>6</td>
<td>284</td>
</tr>
<tr>
<td>Post – 2006 Demarcation</td>
<td>231</td>
<td>46</td>
<td>6</td>
<td>283</td>
</tr>
<tr>
<td>Post – 2011 Demarcation</td>
<td>226</td>
<td>44</td>
<td>8</td>
<td>278</td>
</tr>
<tr>
<td>Post – 2016 Demarcation</td>
<td>215</td>
<td>43</td>
<td>8</td>
<td>226</td>
</tr>
</tbody>
</table>

Source: MDB (2013)

The FFC (2015:308) contends that concerns have been raised by various stakeholders on the effect of the demarcation on municipal financial and fiscal performance to the extent that this may have contributed to the establishment of municipalities that are not financially viable or sustainable. According to the FFC (2015:310) empirical evidence on the impact of the consolidation of municipalities is at best mixed. The reality is also that most of the studies were done in municipalities in first world countries such as the United States of America and some Europe countries, which would not necessarily compare well with those in South Africa. However, a study that was commissioned by the FFC using four South African and two international municipalities, surprisingly, yielded the same results.

The FFC (2015:325) concludes that demarcation processes are costly, sometimes disruptive and may result in a municipality losing focus in terms of its core business. It states that the case studies and econometric models show that the demarcation process can actually “result in unintended economic consequences and significant transaction costs, especially during the transition phase.” Factors that are usually negatively affected are own revenue and human resources. Revenue is affected because disruptions in billing systems are not uncommon when the different systems of the previous municipalities are to be married into one system while human resources will definitely be affected with the shifting of staff between one municipality and another, within the newly demarcated municipal area.
Other issues relating to financial sustainability that, especially during the transition phase, may render negative consequences are those of supply chain, long term service delivery contracts, information systems, asset registers and maintenance and repairs. The FFC is of the opinion that the redefinition of boundaries obfuscates upcoming projections and budgeting as these processes rely on historical trends and data and that IDPs are also compromised. As alluded to earlier, an IDP is the principle planning document of a municipality and in order for it to be credible and implementable it must be linked to a fully funded budget.

The FFC thus recommends that in order to minimise the effects of amalgamation, stakeholders should compare the costs of amalgamation to the costs of alternative reforms and that certain conditions should be met before the amalgamation takes effect. It further mentions that the two-year period between the decision to demarcate and the implementation thereof should be used more effectively so as to allow stakeholders enough time to plan and put measures in place to enable a smooth process of transition. However, it is the view of the author that these recommendations by the FFC – which they regard as their input into the 2015/16 DoRA that annually informs the division of nationally raised revenue to provincial and local government – are too late as the majority of demarcations have already been effected and that these proposed measures are of little value currently for the affected municipalities. However there is agreement that the recommendations should be implemented for any new decisions to demarcate by the MDB.

3.7 MUNICIPAL STRUCTURES ACT, NO 117 OF 1998

Section 155 of the Constitution, 1996, allows for the categorisation of municipalities, for example metropolitan (Category A), local (Category C) and district (Category B) municipalities. A category A municipality has exclusive municipal executive and legislative authority in its area, while a category B municipality shares municipal executive and legislative authority in its area with a category C municipality within which area it falls, and a category B municipality has municipal executive and legislative authority in an area that includes more than one municipality.
This is important because the powers and functions delegated to municipalities are conferred in terms of this categorisation which then gives effect to what services the budget of a specific category of municipality may be spent on. This section also directs that national legislation must define the different types of municipality that may be established within each category, not only giving effect to the promulgation of the DMA, 1998, referred to above, but also the Local Government: Municipal Structures Act, (Structures Act)1998.

In the preamble to the Structures Act, the purpose of the Act is described as follows;

To provide for the establishment of municipalities in accordance with the requirements relating to categories and types of municipality; to establish criteria for determining the category of municipality to be established in an area; to define the types of municipality that may be established within each category; to provide for an appropriate division of functions and powers between categories of municipality; to regulate the internal systems, structures and office-bearers of municipalities; to provide for appropriate electoral systems; and to provide for matters in connection therewith.

Cape Agulhas Municipality is a category C municipality which was established by Provincial Notice 495/2000 as a municipality with an executive mayoral, combined with a ward participatory system on 22 September 2000, by the then MEC for Local Government in the Western Cape, Minister P Uys. This notice allowed for five municipal wards, five ward councillors and five proportional councillors. The notice was later, before the local government elections in 2006, amended to allow for only nine councillors.

The Executive Mayor, Executive Deputy Mayor, Speaker and the members of the mayoral committee were determined as full-time councillors. The council was demarcated to include the previous local authorities of Napier, Bredasdorp, Elim, Arniston, and Struisbaai and also included two small settlements of Klipdale and Protem after the disestablishment of the district management areas in 2011. It is thus no coincidence that both the DMA and the Structures Act were promulgated in 1998, as the first legislated the processes for the spatial
establishment and the latter legislated the processes for the executive and functional establishment of municipalities in South Africa.

Other than the issues already explored earlier in this chapter with regard to the impact of the legislation on the finances of a municipality, another burden that municipalities have to deal with is that of the salaries of councillors. Before the elections in December 2000, a councillor received a small allowance but after December 2000 the remuneration package of a councillor was restructured to include both a basic salary and allowances. The remuneration of councillors is now regulated by the Remuneration of Public Office Bearers Act, 1998, and is determined annually by the minister responsible for local government in terms of sections 7(1), 8(5) (a) and 9(5) (a), thereof and can only be implemented by a council after a council decision on the matter and the concurrence of the MEC in a province responsible for local government.

3.8 MUNICIPAL SYSTEMS ACT, NO. 32 OF 2000

The next act that was promulgated as an integral part of a suite of legislation to give effect to transformation of local government into a new system was the Local Government: Municipal Systems Act, (MSA) 2000. The purpose of the MSA, 2000, and the subsequent amendments thereto are stated as follows before the preamble;

To provide for the core principles, mechanisms and processes that are necessary to enable municipalities to move progressively towards the social and economic development of local communities, and ensure universal access to essential services that are affordable to all; to define the legal nature of a municipality as including the local community within the municipal area, working in partnership with the municipality’s political and administrative structures; to provide for the manner in which municipal powers and functions are exercised and performed; to provide for community participation; to establish a simple and enabling framework for the core processes of planning, performance management, resource mobilisation and organisational change which underpin the notion of developmental local government; to provide a framework for local public administration and human resource development; to empower the poor and ensure that municipalities put in place service tariffs and credit control policies.
that take their needs into account by providing a framework for the provision of services, service delivery agreements and municipal service districts; to provide for credit control and debt collection; to establish a framework for support, monitoring and standard setting by other spheres of government in order to progressively build local government into an efficient, frontline development agency capable of integrating the activities of all spheres of government for the overall social and economic development of communities in harmony with their local natural environment; to provide for legal matters pertaining to local government; and to provide for matters incidental thereto.

The MSA, 2000, is the first act thus far, in the so-called suite of local government acts, where mention is made to ensuring financially and economically viable municipalities. The significance of this statement is further emphasised by the fact that it is included in the preamble to the act. Financial sustainability is also defined in Chapter 1 in relation to the provision of municipal services, meaning:

“the provision of a municipal service in a manner aimed at ensuring that the financing of that service from internal and external sources, including budgeted income, grants and subsidies for the service, is sufficient to cover the costs of –

(d) the initial capital expenditure required for the service;
(e) operating the service; and
(f) maintaining, repairing and replacing the physical assets used in the provision of the service;”

Chapter 2 of the MSA, 2000, focuses on the legal nature of a municipality as well as the rights and duties of both the municipal council and the local community and the duties of the municipal administration, who must exercise them within the legal boundaries of the Constitution, 1996 and any other applicable legislation. However it is, in the view of the author, Chapters 4 and 5 relating to community participation and integrated development planning that set the scene for the implementation for developmentally orientated governance. Municipalities are required to encourage and create conditions for the local community to participate in the affairs of the municipality with the preparation, implementation and review of its IDP, performance management system and the monitoring and review of its performance.
The community must also be involved in the preparation of the budget and in any strategic decisions relating to the provision of municipal services. As a financial plan – which must include a budget for at least the next three years – is a core component of the IDP, it thus means that the community can influence the budget and has a right to be informed of the financial status of a municipality.

Experience has shown however that the opposite is closer to reality than what is expected. IDP and budget meetings are very poorly attended, thus resulting in limited community input to these important instruments, specifically the finances of a municipality. It is also true that the IDP and budget documents of a municipality can be highly technical and thus not that easily understood by the public at large in order to ensure meaningful engagement and interrogation thereof, which could result in expressive and valuable community input.

Chapter 6 of the MSA, 2000, is dedicated to performance management. It compels municipalities to adopt a performance management system that is aligned to its resources, best suited to its circumstances and in line with the priorities, objectives, indicators and targets of the municipality as stated in the IDP. Performance agreements must be concluded with the senior management and all other staff of a municipality whose performance must be measured and assessed regularly, and finally a performance report must be included in the annual report.

Section 38(c) in this chapter once again states that a municipality must administer its affairs in an economical, effective, efficient and accountable manner. The so-called “3Es” is a common thread referred to in almost all local government legislation (Section 25 of MDA, Constitution Section 152, Structures Act preamble, MSA). The rest of the MSA, 2000, is dedicated to local public administration, human resources, municipal entities, provincial and national monitoring and legal matters.
3.9 MUNICIPAL FINANCE MANAGEMENT ACT, NO. 56 OF 2003

The MFMA, 2003, had an implementation date of 01 July 2004. However, NT recognised that not all municipalities were able to implement the act in its entirety and therefore municipalities were categorised into high, medium and low capacity municipalities; with different implementation dates and exemptions for municipalities and municipal entities to specific provisions in the act with the same implementation date.

Cape Agulhas Municipality is categorised as a low capacity municipality and received exemption to fully comply with certain provisions by 30 June 2006 (certain budget planning and approval provisions) and 30 June 2008 for full implementation of the requirement to produce compliant financial statements in accordance with GRAP.

According to the NT (2004:5) the MFMA is supported by five principles which form the bedrock of the key reforms envisioned therein, and which are consistent with other local government legislation. The anticipation then was that these principles and the subsequent specific reforms will encourage a “stronger, better managed and more accountable local government.” This means a local government that is better positioned to meet the needs of communities within its jurisdiction by providing services in a consistent and sustainable manner. The five principles will be discussed next.

Promoting sound financial governance by clarifying roles
A key objective which supports the MFMA, 2003, is the development of sound financial governance in all municipalities. This means that a system to clarify the responsibilities of the mayor, councillors and officials must be developed, including the separation of these responsibilities. It needs to be done to enable an environment of accountability and oversight supported by a culture of transparency and consistent reporting within the municipality. The executive mayor/mayoral committee must provide political leadership, recommend policy and watch over the implementation thereof. The responsibility of council is to approve policy and exercise oversight over the mayor and the administration through the mayor. The officials
remain responsible for implementation and to offer professional advice to the executive mayor or committee. The NT (2004:6) summarises the governance framework as follows:

### Table 2: Financial Governance Framework

<table>
<thead>
<tr>
<th>Responsible for</th>
<th>Oversight over</th>
<th>Accountable to</th>
</tr>
</thead>
<tbody>
<tr>
<td>Council</td>
<td>Approving policy and budget</td>
<td>Mayor</td>
</tr>
<tr>
<td>Mayor</td>
<td>Policy, budgets, outcomes, management of/oversight over municipal manager</td>
<td>Municipal Manager</td>
</tr>
<tr>
<td>Municipal Manager</td>
<td>Outputs and implementation</td>
<td>Administration</td>
</tr>
<tr>
<td>CFO</td>
<td>Outputs</td>
<td>Financial management</td>
</tr>
</tbody>
</table>

**Source:** NT, 2004

**A more strategic approach to budgeting and financial management**

Before the promulgation and implementation of the MFMA, 2003, the budgets of municipalities were incremental for only for one-year and were done using financial information from the past. Budget and planning processes did not run concurrently and budgets were presented in a significantly detailed manner. According to the NT (2004:6), this manner of budgeting hampered processes for effective policy and planning and was not conducive to participation. As capital and revenue estimates were unrealistic the results were poor service delivery performance and unfulfilled community expectations. No or little linkage could be perceived between the budget and a broadly defined long-term financial strategy.

One of the major reforms introduced by the MSA, 2000, was the requirement to develop an IDP which must be developed with the assistance and concurrence of the communities in a municipality. Municipalities were then, in terms of the MFMA reforms, required to adopt
new methods to the preparation, monitoring and implementation of budgets and to ensure that there is alignment between the budget and the IDP in order to address the challenges, as discussed above. The statutory span of the IDP, in terms of time, is for a period of five years but the ultimate goal is that municipalities must have a long term vision and plan informed by realistic revenue and expenditure projections. This plan is important as it will assist the municipality in determining what revenue is needed for continued service delivery and how, if necessary, service standards need to be adjusted, to remain financially sustainable in future.

Municipalities are also required to table three-year budgets and to manage their finances over the medium term through constant rounds of forecasting, implementation and review. It is the view of NT (2004:7) that this approach will promote a culture of performance management and together with the SDBIP inculcate performance driven and accountable service delivery. The objective is for municipalities to approach budgeting and financial management strategically, in order to consider the impact of their longer term decisions.

**Modernisation of financial management**

In terms of financial management system improvements, the MFMA, 2003, sets national norms and standards specifically related to local government and not nationally prescribed rules and procedures, thus allowing municipalities to set their own internal procedures, processes and mechanisms and therefore allowing for autonomy for approval thereof. However, municipalities are required to take the nationally prescribed norms and standards into consideration when developing and approving their own.

The standards assist in facilitating improved performance, measurable outcomes, accounting practice reform, better disclosure and reporting and best practice management procedures. Asset and liability management actions are also prescribed. The reforms aimed at constructing the internal structure of a municipality are emphasised by the encouragement of a disciplined approach to financial management and service delivery, the assignment of resources aligned to strategic priorities and operational efficiency.

**Promoting co-operative government**

Chapter 5 of the MFMA, 2003, is dedicated to co-operative government and seeks to promote cooperation methods to fiscal and financial management within the different sectors and forge
links with other spheres of government and organs of state like the Department of Water Affairs and NERSA. This chapter also sets a procedural framework for financial dispute resolution between organs of state.

According to NT (2004:8) the framework for co-operative government as envisioned by the MFMA can be summarised as provided in Table 3 below.

Table 3: Co-Operative Government

<table>
<thead>
<tr>
<th>National Government</th>
<th>Provincial Government</th>
<th>Local Government</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Supports and assists municipalities with compliance if necessary</td>
<td>• Has coordinating role in rollout of MFMA</td>
<td>• Provides the other spheres with financial and service delivery information</td>
</tr>
<tr>
<td>• Assists with capacity building by providing financial and technical assistance</td>
<td>• Assists and supports municipalities where needed</td>
<td>• Liases with other municipalities and districts on strategic budget issues</td>
</tr>
<tr>
<td>• Issues guides, manuals and regulations and provides grant allocation details</td>
<td>• Intervenes when financial problems become evident in a municipality</td>
<td>• Provides national and provincial government with financial and budget information</td>
</tr>
</tbody>
</table>

Source: NT, 2004

Promoting sustainability

The NT (2004:8) views the purpose of the MFMA, 2003, as the establishment of a basis for improved financial management, which is essential for the improvement and sustainability of municipal services in the future. The MFMA reforms should not impede on or compromise a municipality’s right to exercise its powers or perform its constitutional functions but should regulate matters in an approach that creates a more sustainable sphere of local government. Budgets that are fully funded must be passed and borrowing is only allowed for the current
year and capital expenditure, thus ensuring that municipalities can only spend what has been collected by their current expenditure, and loans or overdrafts cannot be carried over to the next financial year.

As it is a requirement of the MFMA, 2003, to report on a more regular basis (monthly budget statements, mid-year performance reports and annual reports) in a format determined by the NT to improve accuracy, it has the ability to facilitate an environment where impending and real financial problems can be detected early and thus allow council to respond accordingly with possible remedies. Councils must use realistic revenue and expenditure estimates to develop and adopt credible budgets while the budgets for capital projects must take into account the future projected operational costs. In addition, councils must ensure that robust internal control systems are established and that their financial management systems are continuously reviewed in order to improve the effectiveness and efficiency of these processes.

Finally, councillors must realise that these reforms place a greater responsibility on them to practise oversight over municipal finances and that they must use the financial information available to them in monthly, quarterly, bi-annual and annual reports to inform the decisions they take. They need to be more disciplined with regard to the spending of public funds and account to the communities that they serve.

3.10 MUNICIPAL PROPERTY RATES ACT, 2004

The Constitution, 1996, envisions a local government that is developmental in nature when addressing the service delivery needs in the country while also promoting the economic and financial sustainability of municipalities. In order to deliver on this mandate it is important that local government be provided with access to sufficient revenue sources. Income from property rates is a significant source of revenue for municipalities to fulfil and achieve their constitutional objectives, specifically with regards to service backlogs in the so-called previously disadvantaged areas.

It is therefore critical for municipalities to exercise this right to impose property taxes within a legal framework that augments certainty, uniformity and simplicity across the country and also takes into account the imbalances of the past and the ability of the poor to pay property
taxes. The Municipal Property Rates Act, 2004, (MPRA) was then enacted on 17 May 2004 with a commencement date of 02 July 2005. However due to complexity of the reforms, specifically in the manner that valuations were done before enactment and the fact that the MPRA, 2004, now required actual market values on the full property, implementation was also phased in, as was the case with the implementation of the MFMA, 2004. The other major reforms were those pertaining to the appeal procedures, promulgation of rate levies and the adoption of rates policies.

Before the enactment of the MPRA, 2004, local municipalities only levied property rates on residential properties within their jurisdiction. This has changed as municipalities are now so-called wall-to-wall municipalities that include all the properties within their area according to section 2(1). These include farms, state-owned property and that owned by other state agencies, although the act requires that exemptions and rebates be granted on state property and those used for agricultural purposes. This must however be regulated by a policy to be adopted by council.

The CAM implemented the MPRA, 2004, fully from 01 July 2009 and is currently using its second general valuation roll after implementation to levy taxes.

### 3.11 MUNICIPAL FISCAL POWERS AND FUNCTIONS ACT, 2007

The Municipal Fiscal Powers and Functions Act, 2007, (MFPFA) was enacted on 07 September 2007. The specific aim of the act is to regulate the exercise by municipalities of their power to impose surcharges on fees for services provided under section 229(1) (a) of the Constitution. It further provides for the authorisation of taxes, levies and duties that municipalities may impose in terms of section 229(1) (b). These taxes and surcharges exclude those that municipalities are already empowered to charge for trading services and property tax. The reality is however that, even though this act allows municipalities to explore other sources of revenue, it is in fact very limited as it excludes taxes and levies already charged by municipalities at its enactment. It also excludes the imposition of income tax, value added tax, general sales tax or customs duty as this is a national competence. It may include for instance,
fuel levies, but the application process is tedious and it can only be imposed with the approval of the Minister of Finance.

### 3.12 SUMMARY

As can be seen from the above discussion, the earlier pieces of legislation, Constitution, MDA, Structures and MSA, were enacted to specifically regulate the powers and functions of local government, the geographical and spatial footprint, the structural composition of its councils as well as the institutional arrangements of its administration. This suite of legislation also regulated the importance of development and budget planning, as well as public participation and the appointment of senior managers.

The notions of performance management, delegation systems, contract employment, service utilities and outsourcing, which are all linked to NPM, as discussed earlier in this chapter, have all been legislative requirements for local government since the promulgation of the MSA, 2000. Even though some of these elements of NPM are not all directly linked to public financial management and sustainability, they are important to show how the “personality” of reforms has changed over time from the legal and organisational to that of accountable, transparent and participatory governance.

The MFMA, 2003, heralded public financial management reforms in South Africa from 01 July 2004. This statement was affirmed by the then Minister of Finance, Mr Trevor Manual, in 2004, where he stated that the aim of the MFMA, 2003, is to modernise budget and financial management practices in local government so as to increase the capacity of municipalities in service delivery to all residents, customers and users (National Treasury 2004). It further aims to establish a sound financial governance framework to provide clarity and separation of the roles and responsibilities of the executive mayor or committee, non-executive councillors as well as officials.
CHAPTER 3: POLICY AND LEGISLATIVE FRAMEWORK

The MFMA, 2003, also regulates specific responsibilities and delegations of the accounting officer, other senior managers and, specifically, officials working with supply chain management functions. It specifies the establishment of a budget and treasury office. These reforms are specific to the organisation. The main budget and reporting reforms that came into being with the promulgation of the act were those of multi-year budgeting and planning, in-year reporting, annual reports, supply chain management and PPPs as well as the development of unit standards and training. These elements of public financial management are linked to NFPM principles discussed previously and are more specific to the purpose of this paper.

The implementation of the legislated reforms in the South African local government sphere certainly was not easy. Due to the complexity of the legislation, the obvious capacity constraints in government in general, the cost of compliance and in some cases political unwillingness, municipalities are still struggling with the implementation of reforms. The unintended consequences include a dependence on consultants, malicious compliance, other spheres of government support and a focus on compliance rather than service delivery. However, these issues are not the focus of this study, but it is the view of the author that they provide context to the implementation reality of financial management reforms in South Africa and specifically their impact on sustainability issues.
CHAPTER 4: RESEARCH METHODOLOGY

4.1 INTRODUCTION

Remenyi (1996:22) is of the opinion that when research is undertaken “three major philosophical questions” must be addressed when starting a research project. These are: “Why research? What to research, and How to research”. In the previous chapters the questions of “why” and “what” were addressed. The purpose of this chapter is thus to address the “how” question. Brynard and Hanekom (2006:35) describe research methodology as the “how” of collecting and processing data within the research process framework.

As stated in Chapter 1 the qualitative research methods will be used for the collection of data in this study. According to Maree (2009:51), qualitative research methodology is concerned with understanding the process as well as the social and cultural context underlying different patterns of behaviour. Struwig and Stead (2010:12) caution that qualitative research methodology can be very broad and the researcher has to be specific in describing how it will be utilised in the research project. Yin (2011:7) agrees that qualitative research has a broad area of inquiry as it has relevance to many differing disciplines and professions.

Scholars in research methodology are in agreement that the qualitative research method involves the collection of data from people in a specific situation under real world conditions (Maxwell 1996:17, Maree, et al 2009:257 and Yin 2011:7). It is also an inductive approach involving people with an emphasis on ‘words’ rather than ‘numbers’. Yin, (2011:7-8) argues that instead of trying to find a singular definition of qualitative research, five features thereof need to be considered.

“Studying the meaning of peoples’ lives; under real-world conditions.” People will be carrying on with the business of living their lives irrespective of the fact that a research study
is performed or not. People will also interact socially with minimum interruption by “artificial research procedures”. They will also have their individual opinions and may voice these opinions not necessarily limited to a research questionnaire for example and they will not be confined by the research setting, for example a laboratory. In this study the actions and behaviours of the councillors and officials will be looked at in terms of the decisions that they have taken with regard to financial management against the information obtained from the financial ratios and norms.

“Representing the views and perspectives of people in a study.” Qualitative research can enable the representation of the views and perspectives of people who participate in a study. This could be one of the main purposes of a qualitative study and therefore the actions and notions that result from this type of study can embody meaning assigned to real-life events, by the people who live them instead of values, prejudices or meanings of the researchers. The views and perspectives of the people in this study are obtained from the interviews. These are discussed fully in Chapter 5.

“Covering the contextual conditions within which people live.” Qualitative research is concerned with the contextual conditions (social, institutional and environmental) within which people live their lives. These conditions may reasonable impact or influence human events, for example researchers need to be aware of the strong paternalistic traditions in some rural villages in South Africa, where the chief needs to approve any interactions with the people in the village. Choices and decisions are made in a municipality which influence the lives of not only the people that they serve but also how these decisions are to be implemented by the officials. This manner of working creates specific contextual conditions only relevant in a specific municipality.

“Contributing insights into existing or emerging concepts that may assist in explaining human social behaviour.” Qualitative research is more than just a journal or account of the daily lives of people who are subjected to a study. Yin (2011:8), states that if this was not the
case, it would be “a rather mundane version of real world events”. It is research propelled by the need for the explanation of events through current and developing concepts. For the purposes of this study the concepts that are explored are those of financial sustainability, financial management and financial accountability. These might not be new or emerging concepts internationally but are necessarily ones that many municipalities are still grappling with in South Africa.

Striving to use “multiple sources of evidence” instead of reliance on a single source. The fifth feature of qualitative research relates to the collection, integration and presentation of data from an array of sources of evidence to form part of any particular study. This variety of sources will be dependent on the study of a particular setting in the real world as well as the people who live in it. The difficulty of the setting and the assortment of the people in the study will determine what instruments to use to produce the evidence source. These instruments can include interviews, observations and the inspection of documents and objects. To conclude the study it may be necessary to triangulate the data from different sources to add to the credibility and trustworthiness thereof. As explained earlier, interviews will be used to collect evidence but this will be augmented by the information in the annual financial statements, AGSA reports and reports from NT that were used to give effect to the qualitative research feature of the use of multiple sources of evidence. Triangulation of the data over the period of study together with that obtained from the different interviews was used to test its credibility and trustworthiness and come to a more informed conclusion.

**4.2 RESEARCH DESIGN**

Yin (2011:75) is of the view that research design is “logical blueprints” that involve the relations among research questions, the data to be collected and the strategies for data analysis in order for the findings of the study to address the envisioned research questions. This logic also assists in strengthening the validity and accuracy of the study.
In this paper the researcher has purposefully started the research design at the beginning of the study, thus the decision to use semi-structured questionnaires and data collection as research instruments. However as Yin (2011:77) states the design process is recursive, meaning that elements of the design can be decided upon or put into place during the progression of the study, and the researcher may at a later stage during the study do exactly that if the need arises. Joseph Maxwell, cited by Yin (2011:77), agrees to some extent with this and states that the process is interactive, meaning that the purpose, research questions, conceptual context, methods and unease for validity are interacting continuously in qualitative studies. There is a definite possibility that information obtained from the data collection, in this case the conceptual context and the financial data, could inform and even strengthen the actual questions for the interviews.

Research questions were designed to determine the extent to which financial data is used to influence decision making at a macro level. The semi structured interviews were formulated around these questions.

1. Does the internal audit committee make recommendations to council that is informed by the ratios?
2. Is the financial position considered when making budgetary decisions?
3. Debt collection remains a challenge for most municipalities. Is this true for Cape Agulhas Municipality and what procedures and methods does the municipality use to ensure effective debt collection.
4. Did the double digit increases on bulk electricity from ESCOM over the last five years have any impact on the revenue realised from electricity sales in the municipality? If yes, what was the impact and how will it influence the future financial sustainability of the municipality.
5. What measures does council have in place to ensure effective budgetary control in order to ensure that no material over or under-expenditure occurs.
6. NT maintains, and it is common financial practice, that capital funding be linked to the reasonable lifespan of the infrastructure to be built. How did council finance its capital projects over the last ten years?
7. Does the council consider financial trends and ratios when performance indicators are identified for the performance contracts of the senior managers?
8. Is there any assistance needed by council in terms of financial management? If yes, what kind of assistance?
9. Do you think the NT norms in general are conducive to financial viability?
10. Is there something that you feel I might have missed that may be important?

4.3 VALIDITY

According to Yin (2011:78) the validity of a study is influenced by the proper collection and interpretation of its data in order to produce conclusions that accurately reflect and represent the real world studied. In this study the validity of the data generated from the information collected will be easily validated as the audited financial statements are used to generate trends and ratios. The financial information was already verified as true by the Auditor-General and public documents which are readily available for verification.

The financial ratios and the trends identified will also be easily validated as they will be produced using internationally and nationally recognised methods of calculation. This data will be generated from financial information spanning over an eleven year period giving a long term perspective of the financial situation in the municipality. Quasi-statistics, meaning the use of actual numbers instead of adjectives will be generated and these can be compared with the national norms.

Validity of the data generated from the interviews will be more difficult to substantiate as it is related to the perceptions and views of the interviewees. However in this case, the researcher has endeavoured to include a mix of politicians, including the leader of the opposition party in council, the Mayor, as well as senior financial officials and the internal auditor in his sample. The mix of participants generated detailed and varied data. Validation can thus be supported by triangulation as converging evidence from different sources are collected. The interviews were recorded and transcribed in order to have a valid record of the information.
Maxwell (2009:244-245) compiled Seven Strategies for Combating Threats to Validity in Qualitative Research, being:

- Intense long term involvement – to provide for a comprehensive and in-depth understanding of the research environment.
- “Rich” data – field observations and interviews must be covered fully with comprehensive and diverse data.
- Respondent validation – feedback must be obtained from study subjects to lessen the possibility of misinterpretation on their reported behaviours and views.
- Search for discrepant evidence and negative cases – in order to test opposing or competitive explanations.
- Triangulation – collecting converging evidence from dissimilar sources.
- Quasi-statistics – using actual numbers instead of adjectives.
- Comparison – to explicitly compare the results across different settings, groups or events.

Struwig and Stead (2010:143) prescribes the following ways for the confirmation or validation of qualitative data:

**Descriptive validity**

It is information that is factually accurate and comprehensive or it was omitted partially or distorted. The input from research participants or fellow researchers after examining the data will assist in improving the descriptive validity thereof.

**Interpretive validity**

This refers to whether the meaning and perspectives of the participants are reported accurately. The perspectives and language of the participants are emphasised instead of the researcher’s interpretation and terminology.

**Theoretical validity**
CHAPTER 4: RESEARCH METHODOLOGY

This refers to whether common agreement has been reached between researchers and participants regarding the concepts and theories that were used regarding the description of the phenomena. The importance of the researcher to discuss the interpretation of the data with the participants regarding the concepts used and the theory developed from the data will enhance validity.

**Triangulation**

Do independent measures confirm or contradict the findings of the researcher? A number of methods like observation, interviews, quantitative measures or documents can be used to analyse the data.

**Researcher effects**

This refers to the extent to which a researcher bias influence the reporting and interpretation of findings. Any bias or prejudices needs to be declared in the beginning of the study.

There are some commonalities between Maxwell’s seven strategies and the validation methods of Struwig and Stead. These strategies and means of validating the qualitative data obtained were used in the research design of this study to support the validity.

**4.4 SAMPLING**

Yin (2011:87) is of the view that sampling is the selection of specific data collection units, including the number of them, to be incorporated in the study. Brynard and Hanekom (2006:54) describe sampling as a technique used to select a smaller group in order to determine the characteristics of a larger group, while Maree et al. (2009:79) refer to it as the process employed to select a portion of the population in a study. Sampling is thus a selection process, using specific sampling tools (random, purposive, snow-balling) that the researcher uses to determine the specific number of participants in a study.

In this study purposive sampling was used to select a sample. According to Yin (2011:88) purposive sampling is most likely to be used in qualitative research as the purpose is to select
CHAPTER 4: RESEARCH METHODOLOGY

a specific sample that will produce data that are most relevant, and also plenteous, related to the topic of study. Maree et al. (2009:79) agree with this and are of the opinion that qualitative research is based on non-probability and purposive sampling in general as the selected participants possess characteristics specific to them as holders of data that are needed for the study. Struwig and Stead (2010:121) share both these opinions and state that as qualitative research is mainly focussed on the “depth and richness” of the data, purposive sampling would be chosen above others by researchers using this research methodology. The decision to choose purposive sampling in this study was therefore made with the obvious purpose of identifying and obtaining sources that would provide the most relevant and plentiful information in answering the research questions from practitioners and people with expertise.

Table 4: Interview table

<table>
<thead>
<tr>
<th>Interviewee</th>
<th>Date</th>
<th>Time taken</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive Mayor</td>
<td>13 August 2015</td>
<td>26 minutes</td>
</tr>
<tr>
<td>Leader of Opposition</td>
<td>14 August 2015</td>
<td>41 minutes</td>
</tr>
<tr>
<td>Chief Financial Officer</td>
<td>12 August 2015</td>
<td>01 hour 19 minutes</td>
</tr>
<tr>
<td>Internal Auditor</td>
<td>11 August 2015</td>
<td>43 minutes</td>
</tr>
</tbody>
</table>

4.5 SCOPE

The scope of the study was limited to the Cape Agulhas Municipality and the selected members of the population representing the municipality are the Executive Mayor (EM) and the leader of the opposition party within Council, who are both senior politicians and responsible for the strategic direction thereof. On an implementation level, the selected members are the Chief Financial Officer (CFO) and Internal Auditor (IA). Four semi-structured interviews were conducted with all these participants. The EM is responsible for the budget processes, budget control and the identification of financial problems in terms of Chapter 7 of the MFMA, while the role of an opposition party generally keeps the EM and the
majority to account for decisions taken. The CFO must assist the Accounting Office (AO) in managing and co-ordinating the financial administration of the municipality, section 77(2), MFMA, 2003. The IA has an advisory role to the AO in matters relating to internal audit, internal control, accounting procedures and practices and compliance to legislation, amongst others, section 165(2) (b), MFMA, 2003.

All these participants are, in some way or the other, linked to the financial management functions within the municipality. The politicians who are responsible for directing, approval and oversight, the financial officials as the custodians and the implementers, as well as the IA responsible for controls, procedures and compliance, should work together to maximise efficiency. This is the reason for purposefully choosing them as a sample to represent the municipality.

4.6 SUMMARY

This chapter gives insight into the thought process that was followed by the researcher when the decisions were taken with regard to the research design and the theory that informed the process. Qualitative research methods and specifically semi-structured interviews were chosen as the best method to gather information from the respondents as they allow for the gathering of specific information but also have room for further probing of issues. The respondents participated at their own will and were allowed to give input freely and bring any matter that they felt necessary to the attention of the researcher. The sampling was purposive as these respondents were either practitioners or people with expertise who are directly involved in the financial affairs of the municipality.

Financial data was collected from the annual audited financial statements as included in the annual reports over the period of study. This information was used to generate the ratios which, in turn, were measured against the norms as identified by the NT for municipalities in order to determine the financial status of the CAM. As mentioned previously the validity of the financial data is strengthened by the fact that they were audited by the AGSA. Issues of
validity and reliability were also highlighted and strategies and measures to improve valid and reliable qualitative information were discussed. Finally the chapter looked at the scope of the research.
CHAPTER 5: DATA ANALYSIS AND DISCUSSION

5.1 INTRODUCTION

This chapter is the presentation of the data analysis and the discussion thereof. The first part of the chapter used various financial ratios as the tool to collect the data regarding the financial state of Cape Agulhas Municipality (CAM). The second part of the chapter is qualitative in nature and presents and discusses the data collected during the interview process. The chapter concludes with bringing the two parts together in a summary.

5.2 FINANCIAL ANALYSIS USING SELECTED FINANCIAL RATIOS

In January 2014, the NT issued MFMA Circular Number 71, with the purpose of providing a set of uniform key financial ratios and norms applicable to municipalities and municipal entities. This was done in terms of section 216(1)(e) of the Constitution and section 2 of the MFMA that enables NT to introduce uniform treasury norms and standards to ensure sound and sustainable management of the fiscal and financial affairs of municipalities.

For the purposes of this study, the ratios and norms analysed below were used to interpret the financial position, financial performance and cash flow statement of CAM from 2003 to 2014. It should be noted that during this period the municipality had continually adjusted and aligned their accounting practices in accordance with the Generally Recognised Accounting Practice (GRAP) as it impacts on the annual comparison of financial performance. Financial information is reflected per annum as per the audited financial statements. The ratios will be clustered into the following categories:

1. Statement of Financial Position
2. Statement of Financial Performance

The purpose of each ratio under these categories will be explained, followed by a summary of the actual assessment and interpretation thereof over the period of study.
5.3 STATEMENT OF FINANCIAL POSITION

5.3.1 Nett Fixed Assets versus Accumulated Surplus

The purpose of this ratio is to measure the relationship between the fixed assets and the long term funds of the municipality. It measures to what ability the municipality has generated or accumulated sufficient surplus to finance fixed assets. The norm should be 1 or less than 1 meaning that the accumulated surplus in relation to nett fixed assets should be equal or more than that amount spent on acquiring fixed assets. Cape Agulhas Municipality has invested R 285.3 million into Property, Plant and Equipment over the period of study. This largely represents the movement seen in Net Fixed Assets although Net Fixed Assets represents the investment less depreciation. The balance of the major fluctuation reflected below in Graph 1 in 2008/09 is mainly as a result of changes in accounting practices as CAM started with the implementation of GRAP standards in the same financial year.

This has resulted in an increase of R160.49 million of Property, Plant and Equipment from 2007/08 to 2008/09. The widening in the gap between the two curves, as can be noted between 2008/09 and 2013/14, was due to revaluations. The ratio has been slightly more than the norm for the majority of the period of study. This is not ideal as it means that the municipality utilised short term funds to fund fixed assets. Although the widening of the gap can be ascribed to revaluations, the municipality must monitor this negative trend closely so as to bring the ratio closer to or less than 1.
CHAPTER 5: DATA ANALYSIS AND DISCUSSION

Graph 1: Nett Fixed Assets versus Accumulated Surplus


5.3.2 Long Term Liabilities Interest Bearing versus Non-Interest Bearing

Cape Agulhas Municipality has maintained minimal use of external loans over the years and thus long term interest bearing loans remained flat throughout the period of the study. However, non-interest bearing liabilities such as provision for the rehabilitation of landfill sites and post employee benefits were reported from 2009/10 onwards as a result of the reform of accounting standards. Although these liabilities do not affect the gearing level of the municipality, they play a vital role as the general accounting practice should be that sufficient cash is set aside to cover these non-cash items.

The risk lies therein that non-interest bearing liabilities are increasing at a steep rate year-on-year and care should be taken to monitor the increasing provision required. However, the long term interest bearing debt remained at low levels over the period of study and decreased noticeably from 2010. Long term debt at CAM was only R0.5 million and constituted a negligible Debt/Operating Revenue ratio of 0.5% in the financial year ending 30 June 2014.
The low debt appetite is a consequence of the municipality’s strategy to fund its capital expenditure from its own cash reserves and a limited proportion from capital grants. This manner of funding was confirmed by all respondents in the interviews as will be discussed later in this paper.

The effect of this strategy of council in funding its capital budget is that, while it discharged CAM from the challenges associated with indebtedness, it has put the municipality’s minimum liquidity requirements under severe pressure, as can be seen from the discussion on liquidity ratios that follows. The downside of this reliance on own revenue hampers the acceleration of future capital projects.

5.3.3 Liquidity Ratios

The relationship between Current Assets and Current Liabilities is an indication of CAM’s liquidity position. As a minimum, the current assets should at least cover current liabilities as a ratio of 1:1. For a healthy position the ratio should exceed 2:1. Table 5 below indicates that CAM has maintained outstanding liquidity positions in the past: improving from 7:1 in 2004/05 to 9:1 in 2005/06.

However the ratio has since shown a declining trend to the current level of 1.77:1 as at 30 June 2014. It is evident that Current Assets have grown at a faster pace than Current Liabilities but ever since the decline in Cash and Investments was noted in 2009/10, Current Assets seemed to rather decrease as well. Should debt that is older than 30 days be excluded from this calculation, the ratio drops slightly to 1.6:1, which is even further below the norm of 2:1. This indicates that the municipality will experience liquidity tensions in the near future if drastic measures are not put in place to curb this downward trend.

Current assets amounted to R40.2 million at the end of June 2014, indicating the lowest position during the period of the study following the decreasing trend since 2009 which was
also the year when the country experienced an economic recession following the global trend. Once again, as mentioned previously, this reduction in the current assets of the municipality can be linked mainly to the depletion of its cash and cash equivalents which represented 89% of current assets in 2008. Graph 2 below provides a graphic representation of the trend discussed above.

The municipality now needs to strive to maintain a healthy liquidity level of above the norm of 2:1. It is therefore crucial that the municipality reduce its funding of capital expenditure from its own cash reserves and increase its financial leverage in the future financial years by exploring a capital expenditure funding mix that does not compromise its ability to cover its short term obligations; however the municipality must also ensure optimal revenue collection and reduce the outstanding debtors by ensuring that all revenue that can be collected is indeed collected. A discussion on the collection rate follows later.

**Graph 2: Current Assets versus Current Liabilities**

**Source:** CAM AFS (2003 – 2014)
Table 5: Liquidity Ratios

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Assets:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Liabilities</td>
<td>7.75</td>
<td>7.04</td>
<td>9.22</td>
<td>6.70</td>
<td>5.62</td>
<td>4.64</td>
<td>3.08</td>
<td>3.16</td>
<td>2.74</td>
<td>2.44</td>
<td>1.77</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Assets –</td>
<td>6.70</td>
<td>6.60</td>
<td>8.80</td>
<td>6.30</td>
<td>5.30</td>
<td>4.40</td>
<td>3.10</td>
<td>3.10</td>
<td>2.60</td>
<td>2.30</td>
<td>1.6</td>
</tr>
<tr>
<td>Debtors &gt; 30 days:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current Liabilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


5.3.4 Collection Rate

This ratio indicates the collection rate or level of payments at the municipality. It measures increases or decreases in Debtors relative to annual billed revenue. The norm is 95%. According to the information in Graph 3, the municipality’s debtor collection department has proven its capacity to maintain the payment rates at levels above 95% reaching a 100% collection rate as at 30 June 2014. The ratio also speaks to the quality of revenue management within a municipality relating to its ability to set affordable tariffs and to bill accurately. However a concerning trend can be noted with a growth in debtor levels and the collection ratio declining from 100% in 2009/10 to 96% in 2012/13.

The drop from 99% to 97% between 2008 and 2009 can be ascribed to the high increases in electricity tariffs by ESKOM. According to the BusinessTech of 22 June 2015, ESKOM recorded the highest increase of 31.3% in 2009. These increases have to be absorbed by municipalities who purchase bulk electricity from ESKOM and will ultimately reflect in the approved electricity tariffs of a municipality. Higher than inflation increases – in 2009 the inflation rate was 7.1% according to the same article in BusinessTech mentioned above –
become unaffordable for consumers and this could be the reason for the drop in the collection rate over the period discussed above.

The higher collection rate in 2010 could be a consequence of increased collection efforts due to the lower collection the previous year as the ESKOM increase still stayed within double digits till 2013, when it dropped to 8%. The collection rate also dropped significantly from 2010 to 2013 and rose again to 100% in 2014. Besides the high tariff increases, there was also a local government election in May 2011. It has become common practice that councils instruct their administrations to relax debt collection efforts just before elections, so this could also have contributed towards the decline in the collection rate from 2010 to 2013. However, it is the view of the researcher that the rampant ESKOM tariff increases currently pose the greatest risk of affordability to municipalities in general. The lower approved increases over the last two years of the study should be maintained thus allowing councils to approve more affordable tariffs.

**Graph 3: Collection Rate**

5.3.5 Net Debtor Days

Net Debtor Days is a reference to the average number of days required for a municipality to receive payment from its consumers for bills issued to them for services provided. The ratio reflects the collection period and the NT norm is 30 days. Although the collection rate is still, and has constantly been above the norm of 95%, a concerning trend can be noted from 2011/12 to 2013/14 of an increase above the 30 day norm in Net Debtor Days. This can be ascribed to a growing number of consumers not being able to afford municipal services, and it is also reflected in the fact that the Gross Consumer Debtors has grown from R6.62 million at the start of the period of study in the 2003/04 financial year to a record high of R28.70 million in 2013/14.

The ratio gives an indication of the quality of a municipality’s credit control policy, the affectivity of the implementation of the policy as well as the quality of its revenue management. A ratio above the norm shows that a municipality is open to major cash flow risk but it can also show that the collection of arrear amounts is challenging as a result thereof. More importantly, especially for cash-strapped municipalities, it indicates that large amounts of possible cash are tied up in consumer debtors and that revenue and cash flow management needs to be enhanced. The negative trend over the last two years of the study can clearly be seen in Graph 4 below. The municipality needs to specifically monitor the increasing trend and, as mentioned above, ensure that measures are put in place that will ensure the collection of debt timeously. The under-collection of debt within the period that it becomes due contributes towards the growth in outstanding debtors. This is not good practice as the older debtors get, the more difficult it gets to recover it and it may become irrecoverable, which means that council will have to budget more for the writing off of bad debt. This effect can be seen in the next discussion.
5.3.6 Gross Consumer Debtors versus Net Consumer Debtors

Net consumer debtors have been relatively low at R15 million and below and recorded an average annual increase of 10% during the period of study. Following high increases in core (rates, electricity and water) revenue sources that were mainly driven by high tariff increases, gross consumer debtors had nonetheless increased substantially in 2011 to 2013 with a slight decrease being observed in 2014. It is also noted that the rate of increase in debtors was more pronounced in 2012 and this is also confirmed by the drop in collection rate from 100% in 2010 to 96% in 2012. This could be an indication that tariff increases are becoming unaffordable and that CAM should strive to align its future increases closer to that of the inflation rate in order to prevent increases in defaulting customers due to affordability issues.

Whilst CAM made sufficient provision to cover debtors older than 90 days from 2009 to 2013, the provision for 2014 was inadequate as it was only 64% at the end of June 2014. The municipality should consider aligning its policy on provision for bad debts to the national
guidelines of providing for all outstanding debtors for more than 90 days, and ensuring the consistent provision thereof even though debt collection levels are high. The negative trend of increasing gross consumer debtors and the inadequate provision for bad debt is shown in **Graph 5** below.

**Graph 5: Gross Consumer Debtors versus Bad Debt**

![Graph 5: Gross Consumer Debtors versus Bad Debt](image)

**Source:** CAM AFS (2003 – 2014)

### 5.3.7 Consumer Debtor Type

Consumer debtors from electricity dominate the outstanding consumer debtors and represented 39% of total debtors at the year ending 30 June 2014. Rates represented 17% and are the second largest debtors by type, while water amounts to 16%, refuse 8%, sewerage 5% and other debtors at 15%. The representation of the debtors by type in terms of percentages above is closely linked to the revenue streams from those services as a percentage of the total income.
In terms of the composition of debtors per age analysis, there has been an evolvement over the years. While the debtors older than 90 days represented about 50% of the total consumer debtors early in the study (until 2008), the composition has changed in the last six years with outstanding debtors for more than 90 days constituting a lower portion of 43% on average as at 30 June 2014. Current debtors have been increasing and this can be ascribed to an increase in billings to consumers on a yearly basis. As at 30 June 2014, 53% of CAM’s gross consumer debtors fell under current debtors of 30 days.

It is the view of the researcher that this phenomena can be explained by the fact that CAM has done relatively well with the provision of low-cost housing over the latter part of the period of the study. This explains the increase in consumers, but these consumers are not necessarily able to pay for services rendered. The beneficiaries of low-cost housing are households that must earn less than R3 500,00 per month in terms of the National Housing Policy, meaning that they are the first to be negatively affected by higher tariff increases. These are also new homeowners who are not accustomed to receiving a municipal bill for monthly services rendered. So firstly, they may not necessarily have the means to pay due to their income status and secondly they need to get accustomed to the fact that they now have to pay for services. Experience has shown that the consumers in this group tend to ignore the municipal bills until they are contacted by the municipality. Then they would apply for an indigent grant and most of them would qualify. This then creates a situation where there is an increase in current debtors and if the debt is irrecoverable it would ultimately lead to an increase in debt older than 90 days.

5.4 STATEMENT OF FINANCIAL PERFORMANCE

5.4.1 Net Operating Surplus Margin

The ratio assesses the extent to which a municipality generates operating surpluses. The norm is equal or greater than 0%. Municipalities should at least recover operation costs for services being delivered. In addition a ratio which is greater than 0% will enable a municipality to generate a surplus which will assist to contribute towards its capital funding requirements.
Total revenue grew by 320% while Total Expenditure grew by 319% over the period of study. **Graph 6** below shows that CAM has kept its expenditures at slightly lower levels than the total revenue.

**Graph 6: Total Revenue versus Total Expenditure**

[Graph showing Total Revenue and Total Expenditure from 2003/04 to 2013/14]


A positive performance was noted in 2006/07 to 2009/10 with a slight widening of the curves resulting in higher surpluses posted during the same period. In 2010/11 a small accounting deficit was posted before recovery in the performance in the next two financial years. Total income includes both capital and operational conditional grant funding from National and Provincial Government – which may not be used for standard operational expenses or for the repayment of external loans – and therefore the true growth in revenue is escalating at a slower pace. This level reflects the level from which CAM can gear external borrowing.

The CAM’s ability to generate operational surpluses during the period of study is based on the following methodologies:

**Total Accounting Surplus/Deficit**
This ratio measures whether revenue from all sources exceeds total expenditures. This calculation however includes earmarked operational and capital conditional funding received as well as accounting changes. On this basis CAM posted healthy surpluses year-on-year except for 2010/11 in which an accounting deficit of R3.3 million was recorded as mentioned earlier. However it managed to recover, and posted the second highest surplus of R12.44 million in 2013 before recording a relatively low surplus of R6.89 million as at the end of the financial year on 30 June 2014.

**On a cash basis**

Once all non-cash items have been removed from the operational expenditure CAM has indicated strong capacity to post cash operational surpluses, with the exception of 2010/11 where a cash deficit of R15.50 million was posted. The largest surplus of R67.46 million was posted in 2006.

In order to improve both accounting and cash operating activities the municipality needs to consider the rationalisation of its operating spending activities, which is crucial in enabling it to generate sufficient operating margins.

In order to understand the financial performance of a municipality fully, one needs to have insight into the main revenue streams and key expenditure drivers that exist. In the following discussion the main contributors to revenue sources as well as the key expenditure items will be explored.

### 5.4.2 Contribution per Revenue Source

The five main income sources to be discussed are: Equitable Share, Conditional Operations Grants, Property Rates, Electricity, Water and Interest earned from Investments.

Although the contribution percentage of main revenue drivers may vary slightly from one year to the next, the order of importance with regard to the magnitude of contributions has broadly remained the same through most of the period of the study. Cape Agulhas Municipality generated most of its income from electricity services, property rates and water
with the percentage contributed being 34%, 19% and 8% respectively; this made up a total of 61% of operational income as at 30 June 2014. This information is reflected in Table 6 below.

### Table 6: Analysis of Surplus

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Operating Surplus/(Deficit)</strong></td>
<td>2.88</td>
<td>4.06</td>
<td>2.49</td>
<td>7.74</td>
<td>8.93</td>
<td>14.52</td>
<td>7.34</td>
<td>(3.30)</td>
<td>7.21</td>
<td>12.44</td>
<td>6.89</td>
</tr>
<tr>
<td><strong>Cash Operating Surplus/(Deficit)</strong></td>
<td>7.89</td>
<td>18.07</td>
<td>67.46</td>
<td>13.98</td>
<td>15.77</td>
<td>9.53</td>
<td>13.62</td>
<td>(15.58)</td>
<td>6.59</td>
<td>7.76</td>
<td>11.91</td>
</tr>
</tbody>
</table>

**Source:** CAM AFS (2004 – 2014)

The annual increases in electricity services remained stable at 10% from 2004 to 2007 while considerably higher increases were recorded from 2009 to 2012. This is a result of the relatively high tariff increases levied by ESKOM and is also linked to high increases in the municipality’s revenue over the same period.

The contribution of equitable shares to operating revenue ranged from 4% to 10% over the period of the study while conditional operating grants contributed significantly in the last five years ending 30 June 2014, averaging 17% to total operating revenue. This can be linked directly to the increase in housing delivery where more grants were received for the roll-out of the projects. Income contribution from property rates remained stable between 17% and 19% of the last five years of the study. What is interesting about the income contribution from property rates is that it actually decreased after the implementation of the MPRA, 2004 on 01 July 2009. The implementation of this Act effectively broadened the tax base of municipalities as it legislated the taxation of all properties, including farms and state-owned land, within the boundaries of the municipality, albeit at a lower rate. Previously these properties were not taxed by a local municipality. It is the view of the researcher that the
broadening of the tax base should have culminated in an increase in tax revenue and thus an increase, and not a decrease, in the contribution of rates to the total revenue should have been realised. The annual increases per revenue source are indicated in Table 7 and Table 8 below.

**Table 7: Contribution per Revenue Source**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>ES</td>
<td>4%</td>
<td>5%</td>
<td>6%</td>
<td>7%</td>
<td>10%</td>
<td>8%</td>
<td>8%</td>
<td>9%</td>
<td>8%</td>
<td>8%</td>
<td>9%</td>
</tr>
<tr>
<td>COG</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>17%</td>
<td>14%</td>
<td>23%</td>
<td>23%</td>
<td>16%</td>
</tr>
<tr>
<td>PR</td>
<td>25%</td>
<td>26%</td>
<td>24%</td>
<td>24%</td>
<td>25%</td>
<td>21%</td>
<td>19%</td>
<td>19%</td>
<td>17%</td>
<td>17%</td>
<td>19%</td>
</tr>
<tr>
<td>Electricity</td>
<td>36%</td>
<td>34%</td>
<td>33%</td>
<td>29%</td>
<td>30%</td>
<td>34%</td>
<td>31%</td>
<td>34%</td>
<td>33%</td>
<td>32%</td>
<td>34%</td>
</tr>
<tr>
<td>Water</td>
<td>14%</td>
<td>13%</td>
<td>13%</td>
<td>11%</td>
<td>11%</td>
<td>10%</td>
<td>9%</td>
<td>9%</td>
<td>8%</td>
<td>8%</td>
<td>8%</td>
</tr>
<tr>
<td>Interest</td>
<td>6%</td>
<td>5%</td>
<td>5%</td>
<td>6%</td>
<td>9%</td>
<td>8%</td>
<td>4%</td>
<td>3%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
</tr>
</tbody>
</table>

**Source:** CAM AFS (2004 – 2014)

**Table 8: Annual Increase per Revenue Source**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>ES</td>
<td>53%</td>
<td>38%</td>
<td>44%</td>
<td>49%</td>
<td>-5%</td>
<td>15%</td>
<td>28%</td>
<td>10%</td>
<td>14%</td>
<td>7%</td>
</tr>
<tr>
<td>COG</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>-11%</td>
<td>104%</td>
<td>7%</td>
<td>-27%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>PR</td>
<td>24%</td>
<td>7%</td>
<td>23%</td>
<td>8%</td>
<td>-2%</td>
<td>15%</td>
<td>8%</td>
<td>14%</td>
<td>7%</td>
<td>13%</td>
</tr>
<tr>
<td>Electricity</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
<td>7%</td>
<td>32%</td>
<td>16%</td>
<td>16%</td>
<td>25%</td>
<td>4%</td>
<td>7%</td>
</tr>
<tr>
<td>Water</td>
<td>12%</td>
<td>14%</td>
<td>10%</td>
<td>0%</td>
<td>9%</td>
<td>12%</td>
<td>6%</td>
<td>16%</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>Interest</td>
<td>10%</td>
<td>14%</td>
<td>48%</td>
<td>41%</td>
<td>10%</td>
<td>-38%</td>
<td>-33%</td>
<td>-26%</td>
<td>-26%</td>
<td>32%</td>
</tr>
</tbody>
</table>

**Source:** CAM AFS (2005 – 2014)
5.4.3 Contribution per Expenditure Item

As in the discussion on revenue contributions, the percentage of contributions of key expenditure drivers may vary slightly from one year to the next and the order of importance with regard to the magnitude of contributions has broadly remained the same over the study period. The municipality’s expenditure structure is, as is the case for the majority of municipalities in the country, broadly rigid, as it does not offer flexibility in terms of significant budget cuts which are truly needed to support operating margins. As a result, expenditure items such as staff costs and bulk electricity purchases represent a large proportion of 61% of total operating expenditure, followed by repairs and maintenance and depreciation at 5% and 4% respectively for the year ending 30 June 2014.

5.4.4 Net Surplus/Deficit Electricity and Water

The ratio measures the extent to which a municipality generates a surplus or a deficit on rendering electricity and water services. The purpose thereof is to determine the contribution made by the provision of these services, which are classified as basic and are core functions of a municipality. The norm for electricity range is between 0% and 15%, while the norm for water is equal or greater than 0%. The results must be within the range to ensure that services are sustainable and that all costs associated with the service are at least recovered with a margin for future growth to allow funding to be availability for capital assets related to each individual service.

CAM derives substantial profits from the provision of electricity services. During the period of study, electricity services were provided at a bulk cost of R233.96 million while the revenue generated was R376.64 million. On average over this period, the ratio amounts to 37.88%. In terms of water, this was provided at a bulk cost of R105 million while the revenue amounted to R142, resulting in an average ratio of 26% over the same period. These ratios are excessive as they are way above the prescribed NT norms. It is important for the municipality to regulate tariff increases on these services so that they can remain affordable to consumers, and that the municipality are able to collect all revenue owed to them for the provision of
these services on a regular basis. However, it could not be established whether the expenditure figures for these items include all expenditure items, such as, for instance those of salaries, overtime, maintenance and repairs and other overhead costs. The CAM should ensure that the tariffs for all services are reflective of all costs associated with the delivery of these particular services.

Graph 7: Electricity Net Surplus/Deficit


Graph 8: Water Nett Surplus/Deficit

5.4.5 Remuneration as a percentage of Total Operating Expenditure

The largest expenditure item for CAM is salaries and wages, contributing 36% to the total expenditure in 2014, with the highest level of 38% recorded in 2011. These levels are at the higher end of the NT norm of 25% to 40%. Although the associated increases were higher and above the Consumer Price Index (CPI) figures in 2009 to 2011, the municipality was able to contain salary increases to about 8%, in the last three years of the study period.

It will be beneficial for the municipality to continue monitoring this expense item as it has a direct impact on operating costs and consequently on financial sustainability. However, the annual increases for salaries in the local government sector are negotiated nationally and individual municipalities have little or no control over which percentage increase will eventually be agreed upon. Although municipalities are permitted to apply for exemption from implementing the negotiated increases, this is very seldom approved and can be quite a tedious process. The municipality does however have control over the staff establishment and should endeavour to approve an organisational design that has been developed taking the most effective and efficient use of each staff member into account.

5.4.6 Other costs as a percentage of Total Operating Revenue

Electricity costs are the second largest expense and constituted an annual average of 23% of CAM’s operational expenditure in the last four years of the period of study. Year-on-year increases for bulk electricity were also high between the periods 2009 to 2012, before the substantial reductions in the last two financial years in the study. A worrying factor however is that of repairs and maintenance. This expenditure item was historically kept at so-called healthy levels, but this contribution has declined considerably in the last three years and averaged 4% while the NT norm is 8%.

A ratio below the norm, as is the case for CAM, is an indication that insufficient funds are being utilised for repairs and maintenance. This has the effect of an increase in impairment of useful assets, as assets are not maintained. It should however be mentioned that any spending
must be informed by a credible asset maintenance plan in order to ensure that the funds are in fact utilised for the purposed that they were budgeted for and that they can be easily tracked. The contribution per expenditure item as well as the annual increases per expenditure item is shown in Table 8 and Table 9 below.

Table 9: Contribution per Expenditure Item

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Salaries</td>
<td>41%</td>
<td>37%</td>
<td>35%</td>
<td>32%</td>
<td>33%</td>
<td>37%</td>
<td>37%</td>
<td>38%</td>
<td>34%</td>
<td>33%</td>
<td>36%</td>
</tr>
<tr>
<td>Electricity</td>
<td>21%</td>
<td>20%</td>
<td>18%</td>
<td>16%</td>
<td>17%</td>
<td>19%</td>
<td>18%</td>
<td>21%</td>
<td>23%</td>
<td>23%</td>
<td>25%</td>
</tr>
<tr>
<td>Water</td>
<td>13%</td>
<td>12%</td>
<td>12%</td>
<td>9%</td>
<td>8%</td>
<td>7%</td>
<td>6%</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>R&amp;M</td>
<td>5%</td>
<td>9%</td>
<td>12%</td>
<td>8%</td>
<td>8%</td>
<td>6%</td>
<td>5%</td>
<td>11%</td>
<td>4%</td>
<td>4%</td>
<td>5%</td>
</tr>
<tr>
<td>Depreciation</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>5%</td>
<td>4%</td>
<td>3%</td>
<td>3%</td>
<td>3%</td>
<td>4%</td>
</tr>
<tr>
<td>Interest Paid</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>


Table 10: Annual Increase per Expenditure Item

|--------|------|------|------|------| |------|------|------|------| |------|------|
| Salaries | 6%   | 11%  | 6%   | 9%   | | 42%  | 27%  | 19%  | 7%   | | 10%  | 8%   |
| Electricity | 10%  | 4%   | 7%   | 7%   | | 30%  | 19%  | 27%  | 23%  | | 9%   | 10%  |
| Water | 11.8% | 16.3% | 11%  | 0%   | | 9%   | 12%  | 1.2% | 15%  | | 5.3% | 4.7% |
| R&M | 115% | 55%  | −19% | −1%  | | −1%  | 8%   | 131% | −55% | | 15%  | 17%  |
| Depreciation | 0%   | 0%   | 0%   | 0%   | | 0%   | 15%  | −11% | 21%  | | 13%  | 21%  |
| Interest Paid | −19% | −18% | −17% | −19% | | −19% | −23% | −2%  | −22% | | −54% | 307% |

5.4.7 Electricity Distribution Losses

The purpose of this ratio is to measure the percentage loss of potential revenue from electricity services through electricity units purchased and generated but not sold, as a result of losses incurred through illegal connections, non- or inaccurate metering or wastage as well as distribution losses. The norm is between 7% and 15%. A ratio below the norm indicates that electricity losses are well managed. If the ratio is above the norm it could indicate various challenges such as poor maintenance and management of the electricity networks and associated infrastructure as well as high levels of illegal electricity usage.

The CAM has managed to keep electricity distribution losses consistently below the norm as can be seen in Graph 9 below. Even though these losses are below the norm they still add up to a considerable amount of revenue lost, and therefore council should monitor them and continuously work towards keeping these losses as close to the percentage at the lower end of the norm. Electricity losses will never be 0% as there are always inevitable network losses.

Before the implementation of the GRAP Standards in 2008/09 it was not a requirement to disclose electricity and water distribution losses and therefore the information in this regard is only available from 2009. Graph 9 below shows the electricity losses against the norm and indicates a downward trend. This downward trend must be maintained.

Graph 9: Electricity Distribution Losses

Source: CAM AFS (2009 – 2014)
5.4.8 Water Distribution Losses

As is the case with electricity, the purpose of this ratio is to determine the percentage loss of potential revenue from the water service through kilolitres of water purchased but not sold, as a result of losses incurred through illegal connections, non- or incorrect metering or wastage as a result of ageing infrastructure. The norm is between 15% and 30%. According to NT a ratio within the norm indicates that water losses and water infrastructure are well managed. Once again, when the ratio is above the norm it could indicate challenges regarding proper maintenance and poor infrastructure management as well as illegal water use. The ratios for CAM over the period depicted in Graph 10 below are also well within the norm but the trend is increasing in the negative. The municipality should put more stringent measures in place to kerb this increasing trend. Once again, it is the view of the researcher that, in a water scarce country like South Africa, even the NT norms are too lenient and do not really encourage municipalities to implement more stringent measures to ensure effective water conservation. These norms should be well below 10%, however the norm was probably set at this level due to the reality of water losses currently being high in the majority of municipalities in the country.

Graph 10: Water Distribution Losses

Source: CAM AFS (2009 – 2014)
5.4.9 Repairs and Maintenance as a Percentage of Property, Plant and Equipment

This ratio measures the level of repairs and maintenance to ensure adequate maintenance so as to prevent breakdowns and interruptions to service delivery. Repairs and maintenance of municipal assets are required to ensure the continued provision of services. The norm is 8% and a ratio below the norm reflects that insufficient monies are being spent on repairs and maintenance to the extent that this could increase impairment of useful assets.

An increasing expenditure trend may be indicative of high asset usage levels, which can prematurely require advanced levels of repairs and maintenance or a need for asset renewal or replacement. Should an increasing expenditure trend suddenly drop to lower levels without an increase in the fixed asset value, it may be indicative of challenges in spending patterns. This may also indicate that the municipality is experiencing cash flow problems and is therefore unable to spend at appropriate levels on its repairs to existing assets or the purchase of new assets, thus impacting negatively on service delivery.

CAM performed well in this regard from 2003/04 to 2007/08. However, as a direct result of the revaluations to align with the accounting practices of GRAP standards, the value of Property, Plant and Equipment increased from R30.88 million and totalled R335 million at the end of June 2014. Provision for repairs and maintenance only increased slightly during the same period.

The percentage of repairs and maintenance to maintainable assets remained at 3% for the last three years of the study, as shown in Table 11, and remained lower than the norm of 8% after the revaluation of the property, plant and equipment with the implementation of GRAP standards in 2009. The municipality should review the levels for repairs and maintenance in accordance with the growing levels of fixed assets.


5.5 CASH FLOW STATEMENT

CAM historically managed to keep positive levels of working capital components prior to 2009/10. This situation has however changed from 2010/11, where larger increases in debtors that were not collected, whilst in the same year significant payments to creditors, can be noted. This resulted in a cash outflow of almost R15 million which can be directly correlated as the reason that CAM posted a cash operating deficit of R15.58 million in that particular year. At the end of the financial year on 30 June 2014, CAM’s working capital improved from a deficit of R5.6 million in 2013 to a deficit of R3.8 million.

The data indicates that for the last four years of the period of study, the municipality has had cash operating deficits although the situation has improved year-on-year from 2011. The ideal situation should be where, in terms of working capital, a surplus is realised. This will enable the municipality to contribute towards its Capital Replacement Reserve (CRR) to fund future projects and to ensure that it stays liquid, thus contributing towards more stable and predictable cash flows in the future.
CHAPTER 5: DATA ANALYSIS AND DISCUSSION

Graph 11: Interest Received versus Interest Paid


5.5.1 Investment Income versus Investment Paid

Graph 11 above indicates that with the decrease in cash and investment balances, interest received decreased substantially. Interest paid also declined as no new borrowings were taken up by the municipality. However, it is still positive to note that the municipality received more interest from investments as compared to interest paid on loans. The limited usage of own funds for capital expenditure in the 2013 budget resulted in a less pronounced decrease in interest received and was at R2.6 million as at 30 June 2014.

5.5.2 Funding Sources Utilised to Fund Capital Expenditure

CAM had invested R285 million into capital expenditure over the period of study. As no external borrowings were utilised during the study period, capital spending was limited to own funds and grants received. The capital program was funded from cash reserves and funds (60%), capital grants (37%) and to a lesser degree from the sale of fixed assets.

Despite the tremendous growth in operating revenue, CAM kept capital expenditure at low levels as can be seen in Graph 12 below. What is positive though is that these levels gradually increased. This is due to the fact that the municipality does not make use of external
borrowing, and capital expenditure is limited to cash reserves and grants as mentioned earlier. The high spending level in 2005/06 is considered an anomaly and could be linked to the fact that 2006 was also an election year. It could not be confirmed but experience has shown that councils tend to spend considerably more on capital projects in an election year than is the case in years where there are no elections.

Whilst CAM was very conservative with regard to the usage of debt towards the funding mix of capital expenditure, as mentioned previously this was achieved through the continuous depletion of the municipality’s cash reserves, which were reduced to R21 million as at 30 June 2014, from the highest level of R73 million recorded in 2008. Operating income for the financial year ending 30 June 2014 amounted to R205 million reflecting a large gap of R174 million from the corresponding capital expenditure level.

Despite the fact that capital expenditure had been kept at relatively low levels since 2007 the municipality was not able to translate the benefits of this to high liquidity levels due to the depletion of the cash reserves to fund capital works. Table 12 below gives a snapshot of the capital funding sources over the period of study as well as the total amounts spent at the end of the study.

**Graph 12: Growth in Total Operating Revenue versus Capital Expenditure**

![Graph showing growth in total operating revenue versus capital expenditure](image)

***Source:*** CAM AFS (2004 – 2014)
5.5.3 Net Change in Cash and Investments

As at 30 June 2014, CAM had an annual average decrease in cash and investments of R3, 1 million since 2009. Between 2005 and 2008 the annual change in cash and investments reflected the municipality’s approach to increase its cash and investment balances. Subsequently the municipality made use of the cash operational surplus generated and further supplemented its capital expenditure through the use of cash reserves between 2009 through to 2013 and, to a lesser extent, in 2014.

Table 12: Capital Funding Sources

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Grants</td>
<td>5.29</td>
<td>10.75</td>
<td>8.07</td>
<td>10.70</td>
<td>12.33</td>
<td>7.23</td>
<td>8.02</td>
<td>8.59</td>
<td>23.71</td>
<td>15.44</td>
<td>112.98</td>
</tr>
<tr>
<td>Sale of Assets</td>
<td>0.68</td>
<td>0.29</td>
<td>2.03</td>
<td>0.35</td>
<td>0.80</td>
<td>-</td>
<td>0.17</td>
<td>0.37</td>
<td>0.16</td>
<td>0.23</td>
<td>6.76</td>
</tr>
<tr>
<td>Financing</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>0.73</td>
<td>0.44</td>
<td>0.17</td>
<td>0.94</td>
</tr>
<tr>
<td>Cash Reserves</td>
<td>15.06</td>
<td>57.50</td>
<td>4.16</td>
<td>8.20</td>
<td>12.02</td>
<td>15.47</td>
<td>18.74</td>
<td>13.39</td>
<td>9.78</td>
<td>14.73</td>
<td>170.92</td>
</tr>
</tbody>
</table>


Specifically in 2011 the large decrease in cash and investments was influenced by the municipality’s decision to pay a significant amount of R9.6 million at once to creditors, while in the same period, it suffered a negative cash flow impact of R4.2 million due to an increase in gross consumer debtors. The situation was further compounded by R19 million taken out of cash reserves as the main contributor towards the capital expenditure funding mix in the same year. Over the period of the study there has in essence been no growth in the cash and investments balance as the net effect over this period is a reduction of R7.93 million.
5.5.4 Cash and Investment Balances

The economic crisis in 2009 also had a negative effect on the local economy in the Cape Agulhas Municipal area. This resulted therein, that due to certain consumers finding it difficult to honour their commitments towards the municipality, the revenue collection level dropped from 99% in 2008 to 97% in 2009. The situation was further aggravated by relatively high electricity tariff increases in the same year resulting in a significantly low cash operating surplus of R2.1 million, compared to the previous year’s R8.9 million.

Despite all these negative trends the municipality, as mentioned previously, still kept to their strategy of using own cash and investments to fund capital expenditure. However the municipality still managed to maintain robust cash reserves from 2008 to 2010 before the cash and investment balances deteriorated further to the weakest level of R21.4 million in 2014.

5.5.5 Minimum Liquidity Requirement

Throughout the period of the study the municipality has never been able to achieve minimum liquidity required and could only record the most improved shortfall of R16 million in 2010 as shown in Table 13. This follows the relatively better conditions that led to a 100% revenue collection from the previous year’s 97% with a consequent rebounce of cash and operating surplus to R8.5 million in 2010, from R2.2 million in 2009. After the improved shortfall in 2010, the municipality’s minimum liquidity shortfall has since widened significantly in the last four years and totalled R31 million in 2014, once again, due to the historic depletion of the cash reserves.

It is a statutory requirement that the items listed below must be cash-backed:

- Unspent conditional grants
- Earmarked funds, reserves and trust funds
- Capital Replacement Reserve, Housing Development Fund and Insurance Reserve
- Short term Provisions such as Employee Benefit Liabilities
During this period, CAM was not in a position to cover these statutory requirements as shown in Table 13. It is however positive to note that CAM has reduced its unspent conditional grant liability at the end of each respective year since the start of the period of study and recorded a relatively small value of R5.5 million as at 30 June 2014 indicating an improved capacity to spend against conditional grants received.

**Table 13: Minimum Liquidity Requirements**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Unspent Conditional Grants</td>
<td>60.00</td>
<td>50.70</td>
<td>41.40</td>
<td>29.91</td>
<td>27.02</td>
<td>11.31</td>
<td>6.93</td>
<td>2.84</td>
<td>6.21</td>
<td>5.53</td>
</tr>
<tr>
<td>Short Term Provision</td>
<td>1.97</td>
<td>2.45</td>
<td>5.73</td>
<td>5.84</td>
<td>2.39</td>
<td>6.28</td>
<td>7.48</td>
<td>7.89</td>
<td>9.22</td>
<td>13.30</td>
</tr>
<tr>
<td>Funds, Reserves and Trusts (Cash Backed)</td>
<td>40.72</td>
<td>45.18</td>
<td>53.68</td>
<td>58.62</td>
<td>60.00</td>
<td>55.00</td>
<td>31.00</td>
<td>20.50</td>
<td>16.50</td>
<td>15.75</td>
</tr>
<tr>
<td>Total</td>
<td>102.69</td>
<td>98.33</td>
<td>97.73</td>
<td>94.37</td>
<td>89.59</td>
<td>72.59</td>
<td>45.41</td>
<td>31.23</td>
<td>31.93</td>
<td>34.58</td>
</tr>
<tr>
<td>Unencumbered Cash Equivalents</td>
<td>45.93</td>
<td>55.89</td>
<td>65.71</td>
<td>73.29</td>
<td>70.80</td>
<td>67.71</td>
<td>33.38</td>
<td>26.58</td>
<td>24.56</td>
<td>21.41</td>
</tr>
<tr>
<td>Cash Coverage Ratio (excl Working Capital)</td>
<td>0.45</td>
<td>0.57</td>
<td>0.67</td>
<td>0.78</td>
<td>0.79</td>
<td>0.93</td>
<td>0.74</td>
<td>0.85</td>
<td>0.77</td>
<td>0.62</td>
</tr>
<tr>
<td>Working Capital Provision (1 month Opex)</td>
<td>4.96</td>
<td>5.80</td>
<td>6.76</td>
<td>7.08</td>
<td>8.99</td>
<td>11.60</td>
<td>13.30</td>
<td>15.95</td>
<td>17.81</td>
<td>17.81</td>
</tr>
<tr>
<td>Cash Coverage Ratio (incl Working Capital)</td>
<td>0.43</td>
<td>0.54</td>
<td>0.63</td>
<td>0.72</td>
<td>0.72</td>
<td>0.80</td>
<td>0.57</td>
<td>0.56</td>
<td>0.49</td>
<td>0.41</td>
</tr>
<tr>
<td>Minimum Liquidity Requirement</td>
<td>107.65</td>
<td>104.14</td>
<td>104.48</td>
<td>101.45</td>
<td>98.58</td>
<td>84.19</td>
<td>58.71</td>
<td>47.18</td>
<td>49.74</td>
<td>52.40</td>
</tr>
<tr>
<td>Cash Surplus/(Shortfall)</td>
<td>−61.72</td>
<td>−48.24</td>
<td>−38.77</td>
<td>−28.16</td>
<td>−27.78</td>
<td>−16.48</td>
<td>−25.33</td>
<td>−20.60</td>
<td>−25.18</td>
<td>−30.99</td>
</tr>
</tbody>
</table>

**Source:** CAM AFS (2005 – 2014)
NT prescribes that in addition to holding cash for the above items, cash resources need to be available for working capital requirements and this should equate to at least three months of operational expenditure. However, looking at the figures in Table 13 above it is evident that CAM’s cost coverage ratio decreased significantly as at 30 June 2014, from the previous years since 2010. In fact the municipality’s cash reserves were very low and do not even cover one months’ operational expenditure as it was at 0.41:1 as at 30 June 2014. The municipality must prioritise the stabilisation of cash reserves in order to accommodate all the statutory accounts listed above and in addition, cover at least one month’s operational expenditure.

5.6 OBSERVATIONS REGARDING THE RATIO FINANCIAL ANALYSIS

The municipality has invested extensively in Property, Plant and Equipment (PPE) over that period of study and the revaluations of the assets in terms of the GRAP standards have also resulted in a considerable jump in the value of the assets. As the valuations are an attempt to show the real value of assets at a certain point in time the negative is that the provision for repairs and maintenance should also increase to the norm of 8% as prescribed by the NT.

The revaluation of PPE resulted therein that the instead of allowing for 8% of PPE amounting to R31 million in 2008, the municipality now needs to provide for repairs and maintenance of 8% on PPE valued at R191 million in 2009. This revaluation alone can be the reason why provision for PPE as a percentage of maintainable assets fell from 22% in 2008 to 4% in 2009.

This can also be the reason why the provision has stayed low at an average of 3.8% over the last five years of the study. CAM should review the level of provisions for repairs and maintenance in accordance with the growing levels of fixed assets as this would ultimately result in insufficient and improper maintenance of specifically basic infrastructure, which may result in a breakdown in service delivery.
The liquidity ratios which measure the liquidity position of the municipality have also deteriorated over the ten year study period from a high of 8.80:1 in 2006 to a low of 1.77:1 in 2014, and the trend is downwards. This ratio needs to be monitored closely as even though collection ratios have increased in the last two years of the study, the minimum liquidity needs are deteriorating, which may impact negatively on the future liquidity situation of the municipality.

The municipality was able to generate operating surpluses within the norm for most of the period of this study, except for 2010/11 when a small accounting deficit was posted. However as the total revenue includes conditional and unconditional grants, the true growth in revenue is seen to be escalating at a slower pace. Between 2008 and 2014 the gap between total revenue and true revenue has widened. As at 30 June 2014 grants made up a total of 25%, down from 31% in 2013, of the revenue and the municipality will have to monitor this situation closely as even though there is a decline in the last two years of the study, it points to the fact that it becomes increasingly dependent on grants from either National and Provincial government.

Income from the provision of electricity has constantly remained the main source of revenue for the municipality over the eleven years of the study averaging 34%, followed by grants (25%), property rates (19%) and water (8%). On the expenditure side, salaries and wages were the highest (36%), followed by electricity (25%) as at 30 June 2014. Although the expenditure on salaries and wages is still within the NT norm (between 25% and 40%) the municipality should put stricter control measures on this expenditure item.

The annual increases on these two expenditure items (salaries and electricity) were also above the CPI, ranging between 42% (2009) and 6% (2005) for salaries and 30% (2009) and 4% (2006) for electricity. Although some of these increases are regulated and not within the control of the municipality, (electricity increases are regulated by NERSA and the wage
increases are negotiated nationally) care should be taken that increases are done responsibly so that tariffs do not become unaffordable, leading to further growth in debtors.

Since 2010/11 the municipality experienced more cash outflows for the following three years due to more cash being held up as debtors and more payments being made to creditors at the same time. In future, debtors’ and creditors’ cycle policies should be closely aligned so that there is a balance between cash collected from debtors and cash paid to suppliers in order to maintain smooth operations. Working capital should be effectively managed as large swings either way negatively impact on the operational performance of the municipality.

The municipality made minimal use of external borrowings for capital expenditure which was limited to own funds and grants received. This resulted in the non-growth of cash and investments balances and the net effect over the ten-year period of assessment is that there has been an actual reduction of R7.93 million. The municipality must explore the possibility of long term external funding to fund infrastructure with a long lifespan, as this assessment shows that it uses short term cash to fund long term expenditure, thus resulting in the decline in cash and investments.

5.7 ANALYSIS OF DATA OBTAINED FROM INTERVIEWS

This section presents the data collected from the sample interviewed to ascertain their perspective on the factors that contributed or hindered the financial sustainability of CAM municipality. As discussed in the previous chapter, semi-structured interviews were conducted with the EM and the leader of the opposition party in council to get a political perspective on the financial management and financial sustainability in the municipality. Then the same was done with the CFO and the Internal Auditor so as to get an administrative perspective. Interviews were conducted by using ten open ended questions and concluded with the respondents being afforded the opportunity to add any information that might have been missed and that they felt might be important.
Both the EM and opposition councillor have been in council for more than ten years respectively and include tenures during the period of study. They have both been councillors since the local government elections in December 2000, and previously held management positions in the South African Defence Force and at Denel respectively, where they had to manage people and their own budgets. They thus have a fairly good understanding of public financial management although this experience was gained before the advent of the major public financial management reforms after democracy. They are thus both the most experienced councillors currently in council and the most appropriate ones in terms of their former knowledge of public financial management; they were also senior councillors, one being a member of the executive, during the period, from 2000 up to the end of the study, when most of the major reforms were implemented in local government.

Does the internal audit committee make recommendations to council that are informed by the ratios?

The politicians were both of the opinion that the Internal Audit Committee (IAC) recommendations are taken into account when making budgetary decisions. The views of the IAC are important as all municipalities in South Africa are required to appoint an IAC in terms of section 166 Of the MFMA, 2003. The purpose of the IAC as an independent advisory body to the municipal council is to advise council, the political office-bearers as well as the municipal manager and management staff on the following matters;

- Internal financial control and internal audits
- Risk management
- Accounting policies
- The adequacy, reliability and accuracy of financial reporting and information
- Performance management
- Effective governance
- Compliance with the MFMA, 2003, the annual DoRA and any other applicable legislation
- Any other issues referred to it by the municipality.
Furthermore it must review the annual financial statements to provide council with an authoritative and credible view of the municipality on its financial position, its efficiency and effectiveness and the level of compliance to local government legislation. The IAC must also respond to the council on any issues raised by the AG in the audit report and implement, conclude and make recommendations to council on any investigations into the financial affairs of the municipality.

In order to achieve this, the IAC must have access to all financial and any other records in order for it to carry out its work. The fact that the IAC must review the annual financial statements and provide council with its views on it implies that it plays a vital role in terms of providing council with credible information to make informed decisions on the financial management of the municipality.

The councillors also expressed their views on the ability of the members of the IAC to fulfil their roles and provide recommendations that are credible and authoritative. The current chairperson of the IAC has been a member over the period of the study while the other members are either retired or working as senior financial officials in the private sector. According to both councillors, they trust the ability of the IAC to fulfil its legislative mandate and that council takes their recommendations seriously when decisions are made on the finances of the municipality.

The two officials concurred with the views of the councillors in this regard but added that even when this is the case, they are of the opinion that politics still influences the final decision-making process. This is specifically true before an election and directly after an election. Their view is that this is done deliberately in an effort to solicit votes before, and then to placate voters after, an election.
Is the financial position considered when making budgetary decisions?

The EM and the DA leader within council both confirmed that the financial position of the municipality is taken into account when making budgetary decisions. However they both expressed their dissatisfaction with the quality of the information provided to them by the officials during the budget planning process. Their general view is that the information provided specifically for the capital infrastructure projects is not informed by hard evidence and proper costing principles, thus resulting in either over or under-expenditure, the non-achievement of predetermined objectives and goals as well as requests for significant changes and shifting of funds when an adjustment budget is annually considered.

The DA councillor specifically expressed that he feels that the EM is not very transparent in his handling of the public participation processes during the budget drafting process. He is of the opinion that the EM must give more specific information about projects to the community. An example that he cited was that of the upgrading of roads. When the EM explains this item to the community he must be specific on which roads are planned to be upgraded, and this must be informed by some sort of scientific method, otherwise the budget will not be spent on those roads that require the most pressing attention. It also makes his job as a ward councillor difficult, as his constituents confront him about the budget not being spent on the roads that they have identified that need upgrading.

The officials also confirmed that council does take the financial position of the municipality into account when making budgetary decisions, but only to a certain extent. However their opinion differed from that of the councillors in the sense that there is a difference in the understanding of the financial position between the councillors and officials. They state that councillors are mostly of the opinion that officials are too cautious in their interpretation of the financial information and would therefore want to rather build the cash reserves of the municipality than to spend it on the provision of much needed services.
CHAPTER 5: DATA ANALYSIS AND DISCUSSION

Debt collection remains a challenge for most municipalities. Is this true for CAM and what procedures and methods does the municipality use to ensure effective debt collection? Councillors and officials were both of the opinion that debt collection remains a challenge for the CAM. The councillors were both supportive of the fact that council is doing well in addressing the issue of debt owed by the indigent. The so-called Masakhane division within the financial department of the municipality works specifically with the indigent and poor families within the municipal boundaries and makes recommendations to a committee of council with regard to the treatment of their municipal debt.

All were basically of the belief that the debt collection methods of the lawyers who are currently appointed are not yielding the intended results. In fact the debt situation has actually worsened for the individual debtors as well as for the municipality. This is due to legal fees being added to the existing debt thus increasing it. Furthermore there is no apparent incentive for the lawyers to have outstanding debt settled, other than enriching themselves at the expense of the council.

Council has already resolved to appoint another service provider where they will only receive payment as a percentage of the actual debt collected. The service provider is better incentivised in this manner as they will be paid more only when they collect more. Furthermore, there are no legal fees payable by the municipality, as the fees will be paid by the defaulter and will not reflect on the debt register of the municipality. All were in agreement that this method of debt collection will not only benefit the municipality but also the defaulters. This remains to be seen however, as the service provider will only start on 01 September 2015.

Payment levels have however been above the norm of NT (95%) for the majority of the period of study which they felt were positive but with the year-on-year increase in debt it was felt that a new approach to debt collection was needed and thus the reason for the appointment of the new service provider. Another positive action towards addressing the increasing debt
situation in the municipality which all these interviewees mentioned was the fact that council had written off debt that was classified as non-recoverable towards the end of the 2014/15 financial year. This falls outside the period of scope of this study but, according to the CFO, it is a step in the right direction in order to address the broad issue of increasing municipal debt. Previous write-offs were done as far back 2006 and the need exists to annually review the outstanding debtors in terms of the ability to recover this, before a decision is taken by council to write it off. It would also mean that council will have to budget every year to fully fund the write-offs.

Do you think that ESKOM tariff increases have an impact on CAM?

All respondents were of the view that the double digit increases from ESKOM since 2008 negatively impacted on the revenue-raising ability of the municipality. Revenue from electricity sales were and still remain a major contributor towards the total revenue of any municipality. In fact, it was felt that these increases contributed towards the increasing debt situation within the municipality.

One of the respondents stated that these increases from ESKOM affect the poorest of the poor more than the other ratepayers because they result in the fact that electricity, which is a basic service, becomes unaffordable to this sector of users. The result of this is that the poor slip deeper into poverty as more of their already meagre dispensable household income is required to fulfil their energy requirement needs.

The CFO is of the view that the fact that the National Energy Regulator of South Africa (NERSA) constantly approved increases for municipalities that are less than the ESKOM approved increases for certain users within a municipality, affects the ability of municipalities to remain sustainable in future. This basically results in a situation where municipalities are compelled to subsidise the difference between the rates approved for ESKOM and those approved for municipalities.
The CFO states that the result will be obvious. When approved tariff increases on the purchase of bulk electricity are higher than those approved on electricity sales, it is inevitable that a point will be reached where expenditure will surpass revenue. The obvious response is to increase electricity tariffs to make up for this negative trend.

This is not sustainable as it will also reach a point of saturation and users of the service will then look at more sustainable ways of providing their own energy. In the case of CAM there are no large industrial and business users, resulting in the municipality being more vulnerable to the electricity increases as the majority of users are residential, in the view of the CFO.

Is the financial reporting adequate to support oversight and control?

Council has several measures in place to ensure effective budgetary control. Section 71 of the MFMA, 2003, requires the accounting officer to provide monthly budget reports to council and both the provincial and national treasuries. All respondents confirmed that these reports are submitted to the EM and the full council. The method of reporting is also prescribed by NT for all municipalities thus ensuring that there is uniformity in the reporting of all municipalities.

The CFO confirmed that all operational departments also report monthly to the EMC and council on the expenditure of their respective capital projects in the manner of a percentage of the budget spent. The councillors conceded that they specifically track under- and over-expenditure in these reports and require reasons and motivations from the relevant departments for material deviations. It is their opinion that these measures of budgetary control are sufficient and serve the purpose for which they are intended.
What are your views on capital financing?

In terms of the capital funding linkage to the reasonable lifespan of capital projects, there was a marked difference between the views of the councillors and officials. The officials agreed with the NT and general financial practice norm as stated regarding the funding of capital projects in the long term. Adhering to this practice not only frees up essential capital funds within a financial year but it also makes financial management sense that the financial burden for the repayment of financing be spread to the future users of the services as well. The impact on the cash reserves of the municipality is also less pronounced as the project will not be funded from the reserves, thus allowing municipalities to strengthen their reserves.

The councillors, by contrast, were however of the opinion that although they agree with the principle in general, they are not in favour of long term loans as a funding mechanism. They stated that a municipality should rather fund all projects from its own reserves so that it does not place an additional burden on the future operational budgets. This being the reason why the municipality has funded most of its infrastructure projects, which could not be funded from grants, from its own reserves over the period of study. The DA councillor however agreed with the principle of future users of the infrastructure paying for its use, but still remained adamant that the funding for this infrastructure be from the municipality’s own resources.

Do Financial Ratio’s inform or play a role in the financial decision-making?

Council does not consider financial trends and ratios when performance indicators are identified for senior managers and they are thus not included in the performance agreements. The IA stated that even though it might be easy to include the ratios specifically as a performance measure, the difficulty lies in the fact that in almost all cases the specific senior manager does not have control over the decisions that might influence the outcome of a ratio. It would then be unfair of council to expect a senior manager to reach a target without giving him or her full control to influence the decisions that will contribute to reaching the target.
An example of this would be that council cannot expect the senior manager responsible for technical services to spend 8% of the department’s operational budget on repairs and maintenance, as is prescribed as a norm by NT, if sufficient budget is not allocated by council to the department to actually reach this target. The DA councillor shared this view and stated that these measures could be better used by council itself in making future budgetary and financial management decisions.

**Do you think councillors require financial management training?**

In terms of assistance needed by council regarding financial management, all respondents indicated that there is a definite need for training to councillors in the basics of financial management as well as the meaning and purpose of financial ratios and trends. The councillors felt that even though there is councillor induction done by SALGA after every local government election, the time spent on financial management issues is not enough. This is also a once-off training session for councillors and the recommendation from the respondents was that training or skills development for councillors should be done on a more regular basis and must be specific to financial management.

This will assist councillors and council in general to understand and use financial information so as to contribute sensibly towards any decisions that are required to be taken. The councillors also emphasised that the financial information provided to them should be in a format that is easily understandable and that some councillors sometimes feel overwhelmed by the sheer amount of numbers that is presented to them, not just during the budgeting process but also with the monthly reports.

The councillors are of the opinion that this information must be simplified and that training should specifically focus on which figures in the reports and financial statements must be scrutinised and tracked regularly. Only when they are able to understand and interpret
financial information, will councillors be able to make a meaningful contribution, not only towards effective and credible budgeting, but also towards executing their oversight role effectively.

There was general consent amongst all respondents that the NT norms and standards are conducive to financial viability. This means that interpreting the ratios and trends generated and staying within the set limits of the norms can act as an effective means of control to manage the finances of the municipality. However, due to the lack of understanding of the purpose of the financial ratios and norms, they are not always used when making financial decisions.

5.8 SUMMARY

The information obtained from the respondents of the interviews shows clearly that there is generally trust and respect for the internal audit committee and that their recommendations are taken seriously regarding the financial management and financial sustainability of the municipality. The members of the internal audit committee are capable and competent to execute their duties as they have the necessary experience and the majority have served on the committee for more than one term.

Although there is a difference in opinion between the officials and the councillors regarding the consideration of the financial position when making budgetary decisions, there is agreement that the financial position is taken seriously. The difference is basically in the actual application of the information, where the officials take a more prudent approach while the councillors, and therefore council, are more risky in their approach, especially before elections.

Debt collection is managed well at the municipality and this statement is supported by the findings from both the interviews and the analysis of the financial statements. The payment ratio, which has a norm of 95%, has been above the norm during all years within the period of the study and a 100% ratio was achieved at the end of June 2014. However, the findings
indicate a concern regarding the growth in outstanding debtors over the same period with a more pronounced growth from 2011 to 2014. This increase could be linked to the high increases in core revenue sources (rates and electricity) that were mainly driven by high tariff increases. The year-on-year growth of consumer debtors are also exacerbated by the fact that the municipality did not allow for sufficient funding within the respective annual budgets to write off irrecoverable debt. The norm is that municipalities must make provision for all debtors outstanding for more than 90 days. At the end of the 2014 financial year the provision only constituted 64% of all outstanding debtors above 90 days.

The findings from both the interviews as well as the financial analysis indicate that the double digit increases from ESKOM definitely have a negative effect on the revenue realised from electricity sales in the municipality. The respondents were in agreement that these tariff increases and the fact that NERSA does not allow municipalities to recover the full increase from its customers, with their approval of municipal tariffs, does not make common and financial sense. If this methodology from NERSA and ESKOM is not curbed or contained within the near future, it could culminate in a situation for municipalities where expenditures on the electricity service will surpass the revenues realised.

The findings indicate that the contribution of electricity to total revenue remained steady at an average of 32% over the period of study while, on the expenditure side, the average for the period was 20%. However since 2011 the contribution of electricity as an expenditure item has increased steadily from 18% in 2010 to 25% in 2014, thus confirming the fact that the gap between revenue and expenditure on electricity has been narrowing resulting in less expendable revenue from electricity sales. Another concern is the significant growth in electricity debtors over the period of study. Average annual growth rate in electricity debtors in the last six years up to 30 June 2014 amounted to 15%. Both trends are expected to continue should there be no change in the manner in which electricity tariff increases are treated currently since 2009.
The findings regarding budgetary control are that sufficient measures are in place to provide council and the senior managers with timely and accurate information. Effective budgetary control relates to the process of ensuring that council and senior management receive timely and accurate reports on the implementation of the budget. One of the measures of budget control is to ensure that no material under- or over-expenditure occurs. The prevalence of this can either be ascribed to weaknesses in the budget planning process, for example the costing of a project may not have been done properly, or the forecasting for revenue or expenditure might have been under- or over-stated. Budgetary control not only assists in tracking revenue and expenditure in terms of the approved budget, but it also acts as an early warning system that can inform council to make the necessary adjustments to the budget so as to align it to the current reality.

The findings indicate that the municipality complies with the legislative requirements and that the information generated from these reports is used to inform annual adjustments to the original approved budget. The IA stated that due to more effective budgetary control, unauthorised expenditure declined from R25 million in 2013 to R12 million in 2014 and he is of the opinion that the figure is currently less than R1 million.

He also mentioned that, in his view, this decline is due to the measures that the CFO has introduced as well as effective political oversight by the Mayor. These reports are also presented in a format that is prescribed by NT for all municipalities in terms of the Municipal Budget and Reporting Regulations, (MBRR) 2009, and forms part of the financial management reforms as contemplated in the MFMA, 2003.

The findings indicated a difference of views concerning the financing of capital projects. It was found that the municipality invested a substantial amount of their own reserves in capital funding. This reality is confirmed by all respondents in the interviews but also by the information generated from the financial analysis. As alluded to earlier, the capital reserves of the municipality have declined significantly from a high of R70 million in 2009 to R21.41
SOG (MADMIN. DEGREE)  JANUARY 2016

CHAPTER 5: DATA ANALYSIS AND DISCUSSION

million at the end of June 2014. Common financial practice as well as NT maintains that capital funding be linked to the reasonable lifespan of the infrastructure to be funded. This can be achieved by accessing external funding instruments from the commercial and so-called development banks.

The councillors were of the opinion that they do not like this particular method of funding as it encumbers the municipality with the redemption of loans for many years after the completion of the project and is thus the reason why they would rather use the municipality’s own funds for this purpose. The IA did not agree with the politicians and stated that “it will come back and bite us.” He is of the opinion that these funds were spent to “buy” votes and cites the fact that R30 million of the reserves was spent before the 2011 local government election; he is worried about the little that council invests in the upgrading of existing and old infrastructure.

The findings indicate that CAM financial trends and ratios are not considered when performance indicators are identified for senior managers and therefore not included in the performance contracts. The respondents felt that in order to influence trends and ratios, a collective effort between council for policy direction and approval, and the administration, for policy implementation is needed. Therefore the responsibility cannot be that of any one person only.

The respondents opinionated that it would be unfair to include this in individual performance contracts if the ability to influence the outcome is not vested within the influence sphere of the specific individual. All of them also agreed that the NT norms in general are conducive to financial viability. The EM felt that these norms provide a guide for municipalities and if a municipality stays within the parameters of this guide, it could ensure its financial health in future.
CHAPTER 6: CONCLUSIONS AND RECOMMENDATIONS

6.1 INTRODUCTION

This chapter provides the conclusions and recommendation stemming from the data collected and the subsequent findings derived therefrom. The research question: *What are the factors that constrain or contribute to the financial performance and financial sustainability of the municipality?* was set to guide the research. The research was a longitudinal study spreading over an eleven-year period from 2003 until 2014.

To operationalise the research a number of objectives were set. The primary objective of the study was to assess the financial performance of the Cape Agulhas Municipality over a period of eleven years. A secondary objective set was to identify factors that constrain or facilitate financial performance in municipalities that may have an influence on their future financial sustainability.

A number of specific objectives were set:

1. To determine what are the constraints or enablers regarding financial sustainability
2. To perform a literature review of the relevant legislation and analyse financial data of Cape Agulhas Municipality from 2003 to 2014
3. To outline the ratios/theory as assessment tools
4. To analyse the data/findings with a view to identify factors that constrain or facilitate the financial performance and viability of Cape Agulhas Municipality
5. To draw conclusions and make recommendations with regard to the impact for financing service delivery.

Chapter 2 provided an international perspective and theoretical framework on financial management and explored the reforms that were implemented internationally to improve financial management in order to enhance financial performance in the public sector. The
discussion in Chapter 2 attempted to provide a linkage between the theories of NPM and NFPM to the specific reforms in financial management and focussed on the four essential components thereof, being budgeting, accounting, auditing and reporting.

The financial legislative reforms of South Africa were discussed in Chapter 3. Financial reforms in South Africa were only instituted in the beginning of the twenty-first century, whilst those in the USA, UK, some countries in Europe, and Australia already occurred either in the second half and more towards the end of the twentieth century. South African reforms were driven by legislation, whilst the reforms internationally were driven either by a need to transform, for instance the need to rebuild the countries that participated in the Second World War or as a consequence of the global economic recession in the 1970s. Governments needed to work smarter and achieve more with fewer resources in order to satisfy the needs of the people who they served.

Chapter 4 explained the research methodology used in the study. Qualitative research methods were used and consisted of semi-structured open-ended questionnaires and the desktop analysis of information from the financial statements of the municipality over the period of study. Research design, validity and sampling methods were also considered in this chapter.

In Chapter 5 the financial data obtained from the annual financial statements of the municipality was analysed by using the general and internationally accepted financial ratios and norms to assess the financial performance, financial position and cash flow statements of the CAM. The data obtained from the interviews were also discussed here and the chapter concluded with a summary of the findings obtained from the financial assessment.

Chapter 6 is the concluding chapter and, based on the findings with regard to the financial position of the CAM, makes recommendations towards the facilitation of financial performance and financial sustainability in future.
6.2 OBSERVATIONS AND LESSONS LEARNT FROM THE RESEARCH

The study started with a clear objective of analysing the financial information of the municipality over the long term, and specifically a period of eleven years. This was done in order to specify the financial ratios and identify the trends that would enable the researcher to make recommendations on financial decisions that need to be taken by council to ensure the financial sustainability of the municipality. The audited annual financial statements over the period of study were used to gather the information.

From the data gathered and analysed the following can be observed:

The lack of medium and long term financial planning as shown by the findings is a major hindrance to financial sustainability. This statement is supported by the LGA which states in its definition of financial sustainability that the long term financial performance and position of a council is sustainable where infrastructure levels and standards in the long term are met without unplanned increases in rates or disruptive cuts to services (LGA 2012:3). Cangiano, Curristine and Lazare (2013:2) observed that there is a significant shift in terms of PFM from expenditure management to financial management. This shift indicates a widening scope from a narrowly defined budget to all aspects of public resource management including a focus on medium to long term budget planning.

The above authors are of the opinion that NFPM progressed from its historic focus of compliance and control to providing information for the purposes of financial analysis and future policy-making in an effort to ensure future financial sustainability. CAM municipality, in contrast, has an annual financial planning approach informed by its budget approach. This type of short term financial planning, though important, must take place in relation to medium and long term financial planning to ensure financial sustainability.
The findings support the view that the political leadership, in their decision making, ignore financial ratios. In this regard they ignored the warning signs stemming from the financial ratios in their financial decision making. The declining liquidity ratio from a high of 9.22:1 in 2006 to 1.77:1 in 2014 is an indication that the municipality is currently, and will in future, be experiencing liquidity tensions. The payment ratio is at 100% as at 30 June 2014, improving from 96% in the two preceding financial years. Consumer debtors increased from 2011 and the provision for debtors older than 90 days was inadequate over the whole period of the study. The provision for the 2014 financial year was significantly inadequate as it only covered only 64% of the total debtors older than 90 days.

Electricity debtors have increased since 2008 at an average rate of 15% annually and represented a six-year average of 39% to total debtors by the year ending 30 June 2014. This is followed by rates at 17%, water at 16% and refuse and sewerage at 8% and 5% respectively. The composition of consumer debtors per age analysis has evolved over the years, changing from the majority of debtors older than 90 days from 2005 to 2008, to current debtors from 2009. Current debtors represented 53% of gross consumer debtors as at 30 June 2014.

Electricity sales were the highest contributor to the total revenue of the municipality, averaging at 32% over the period of study and 34% as at 30 June 2014, followed by property rates at 19% and water at 8%. In total these sources accounted for 61% of the operational income at the end of the period of the study. Overall, the municipality managed to post cash operational surpluses for the majority of the study period, but posted a cash operating deficit of R15 million in 2011.

On the expenditure side, salaries, wages and allowances were the largest expenditure item contributing 36% to total expenditure in 2014, followed by electricity at 25% and water at 5%. The above percentage contribution per expenditure item remained more or less the same over the period of study.

The municipality still realised a healthy profit of 24% on electricity sales in 2014 although it is lower than the 37% recorded from 2009 to 2012. This downward trend is expected to
continue into the future as NERSA approved tariff increases have consistently been less than those approved for ESKOM. The result of this is that the municipality actually subsidised the negative difference between the tariffs approved for ESKOM and the indigent and low users of electricity. For example NERSA approved a tariff increase of 12.68% for ESKOM in 2014 while the approved increase for municipalities was on average just 7%.

The municipality was also able to record profits for the provision of water, averaging 14.83% over the period of study. The average for the last seven years of the study climbed to 21.50% with a percentage profit of 29.02% recorded as at 30 June 2014.

In terms of provision for repairs and maintenance against maintainable assets, the municipality has constantly recording less than half (3,88%) of the norm of 8% since 2009 and recorded 3% at 30 June 2014. PPE was restated in 2009 due to the implementation of the GRAP standards which resulted in a significant increase in the value thereof from R31 million in 2008 to R191 million in 2009. The low provision for repairs and maintenance could result in a situation where the infrastructure of the municipality could deteriorate to such a level that it must be rebuilt or totally replaced due to inadequate maintenance thereof.

The working capital of the municipality was at positive levels until 2010, and a deficit of R15 million was recorded in 2011. The situation however remained the same although some improvement was recorded since 2011 and a deficit of R3.8 million was recorded as at 30 June 2014, improving from R5.6 million in 2013. This negative situation is mainly due to the fact that the municipality used its own cash and cash equivalents to fund its capital expenditure programme during the whole period of study albeit to a lesser extent in the last two years.

Due to the abovementioned manner of funding capital expenditure the revenue from investments also declined from a high of close on R9 million in 2009 to R2.6 million being recorded at 30 June 2014. An amount of R170.92 million, out of a total of R285.29 million of total capital expenditure, was funded from the municipality’s own cash reserves and funds. This amount equates to almost 60% of the capital funding mix over the period of study while the rest was made up of capital grants and sales from fixed assets.
On the positive side the interest paid remained steady at below R1 million during the period of study. This situation existed as the municipality did not take up any external loans to fund capital expenditure as well as no short term loans or overdrafts for operational expenditure during this period. However this conservative approach of the municipality towards debt resulted in the continuous depletion of the cash reserves as shown earlier.

The gap between operating revenue and capital expenditure grew since 2007 and this difference amounted to R174 million as at 30 June 2014. However this positive trend could not be translated to high liquidity levels due to the depletion of own cash reserves for capital expenditure.

The municipality managed to reduce unspent conditional grants considerably since 2005 when this item was an amount of R60 million. The amount for unspent conditional grants recorded at 30 June 2014 was R5.5 million, indicating an improved capacity by the municipality to spend against conditional grants received.

The minimum liquidity requirements of the municipality were below the NT norm of 1:1 for all the years during the period of study but also decreased year-on-year since 2010 when a ratio of 0.80:1 was recorded to a low of 0.41:1 at 30 June 2014. The manner in which the municipality approached the funding of its capital budget in the past has specifically contributed to the precarious financial liquidity position it finds itself in at present.

Even though information from the IAC regarding financial trends as well as the financial position of the municipality are taken into account when council makes budgetary decisions, the data from the assessment of the annual financial statements reflects a different picture.

All respondents were of the view that the municipality is doing well with debt collection and this statement is corroborated by the findings of the financial assessment which shows that debt collection levels have improved to 100% in 2014.

The perception of the respondents was that the double digit increases from ESKOM have a negative impact on the revenue from sales and that they would have an influence on the future financial sustainability of the municipality. This perception finds resonance in the findings of
the financial assessment where it was found that this was indeed the case as profit from
electricity sales has declined. Furthermore, electricity revenue made up just more than a third
of the total revenue of the municipality over the period of study. Revenue from electricity is
thus an important contributor towards the financial sustainability, and a significant decline in
this revenue source would lead to a decline in total revenue and therefore negatively influence
future financial sustainability.

All respondents agreed that the budget reporting requirements of the MFMA, 2003, as
regulated in the MBRR, 2009, are used by council to exercise control over the municipal
budget. Reports are tabled monthly, bi-annually and annually as part of the annual report.
This control seemed to produce positive results as unauthorised expenditure was reduced
significantly over the last quarter of the period of study. However, it was stated that even
though budget control is in place, the real issue that needs to be addressed is that of costing
the budget before its approval, specifically that of the capital budget. Tighter costing measures
must be utilised to ensure that the costing of projects for budgetary purposes is done
effectively to avoid over- or under-expenditure or a project change of scope in the
implementation phase.

The councillors confirmed council’s conservative approach to the use of long term debt as a
tool for funding capital expenditure and thus their decision to use their own cash resources for
this purpose. Although they made their “aversion” to debt very clear, they were not as aware
as the officials of the effect that this approach had on the liquidity position of the
municipality, which deteriorated to a ratio of 0.41:1 as at 30 June 2014. Essentially, this
means that the council should ensure that it effectively collects all revenue due to it within the
month that it is billed otherwise it will not be able to honour expenditure commitments for
the same month. If this not done, council will in effect not be able to pay all of its creditors
within the 30 day period legislated in the MFMA, 2003.

Council does not consider financial trends and ratios when considering the performance
indicators of senior managers. The reason cited for this is that these managers are not able to
influence financial trends and ratios as individuals. This is true to some extent, but it does not
deter council, as an autonomous body that can make its own decisions, approve tariffs and
budgets, to, while being aware of the financial situation of the municipality, set reasonable
targets and indicators, in order to improve the financial situation over a reasonable period. The implication is thus that a council should be aware of the historic financial performance of the municipality, use this information to make informed decisions of what the future position should be, and then develop a plan with specific indicators and targets to reach the planned future position. For example, the targets could be the NT ratios and norms, and the indicators could be incremental annual improvements on the current situation in terms of these ratios and norms, to reach the target.

Councillors need to be up-skilled to specifically understand financial ratios, identify and understand trends and to make reasonable assumptions as to the direction of these trends. Only when there is a common understanding of the financial data between councillors, officials and the provincial and national treasuries, will they be able to effectively address the issue of current financial management and its impact on future sustainability with the decisions that they take.

In general, there was agreement between all respondents that the NT norms are or could be conducive to the future financial viability of municipalities. NT by its own submission, Circular 71, 2014, states that the ratios and norms will aid municipalities in long term financial planning and assist in tracking progress over a number of years. They should also not be used in isolation of one another as this could lead to distortions in interpretation. Besides the obvious advantages of producing data that technically makes allowance for the assessment of the financial health and performance of municipalities, another advantage is that when the information from the audited annual financial statements is used – and without manipulating the accounting figures – the data generated are valid and free from bias.

The NT uniform financial ratios and norms were also regulated to remove ambiguity and misinterpretation, which enabled comparisons of financial data with that of other municipalities. The point to be made here is that because of this, councils would have no valid reason to doubt the validity of the data and should then take the responsibility and be held accountable for decisions taken in disregard of the financial data provided.
6.3 FACTORS THAT CONSTRAIN OR ENABLE FINANCIAL SUSTAINABILITY

The research showed that financial management in municipalities is influenced by a number of factors that either constrain or enable financial sustainability. Some of these are within the control of the municipality to influence and others are not. The fact that tariff increases for electricity are influenced by the high ESKOM increases and that individual municipalities have very little control over the approval of these tariffs is a case in point. If future tariff approvals to ESKOM are done in the same manner as they have been done since 2009 and the fact that they may then become unaffordable, this would definitely constrain financial sustainability as revenue from electricity sales is the largest contributor to total revenue in the municipality.

Another constraining factor is that of increases in salaries, wages and allowances. These increases are collectively bargained at a national level. Individual municipalities have little or no influence on the subsequent outcome of wage increases. Although the prevalent inflation rates are used as a guideline, experience has shown that the final increase is usually above this rate. This coupled with the rather rigid labour legislation, the collective agreements negotiated nationally and the fact that salaries, wages and allowances are the largest expenditure item on the municipalities budget means that even moderate increases for this expenditure item translate to a high monetary value.

Lack of technical financial skills is a constraining factor. The reality that the majority of decision makers in local councils do not have the technical skills to interpret and understand financial information limits their ability to foresee financial problems and to forecast accordingly. This is not only true of the politicians but the senior management staff as well. Financial management is a highly technical skill and the current reality is that municipalities rely heavily on consultants to fulfil this role. Without proper up-skilling of the relevant role players, the situation will continue and councillors will either make politically motivated or the wrong financial decisions. This reality constrains financial sustainability.

A major constraining factor is the huge service delivery backlogs that are experienced by almost every municipality in the country. These backlogs and the pressure and demands from both politicians and the community force municipalities to spend beyond their means in order to satisfy these pressing needs. These needs are politically prioritised above infrastructure
maintenance. This then creates a situation where existing infrastructure is not maintained properly and in some instances it is neglected beyond repair. An environment is then created where infrastructure needs to be replaced at a higher cost, thus putting more pressure on an already overextended budget and drawing the municipality into further financial distress. The fact that in general, municipalities are not budgeting sufficiently for repairs and maintenance, compounds this issue.

Red tape is stifling financial sustainability. A general view prevails that municipalities are over legislated and that in some cases this may lead to a focus on compliance rather than effective service delivery. As stated previously, municipalities rely heavily on consultants to ensure compliance. An example of this is the use of financial consultants to produce MFMA and GRAP compliant annual financial statements. Another example is the use of environmental consultants to prepare documentation for the approval of environmental impact assessments. Non-compliance may have adverse consequences for a municipality, however if one takes the cost of compliance into account, it also put additional strain on the budget. Residents and councillors fail to comprehend the necessity of these expenditures and do not easily support their inclusion in the budget. However, in terms of financial management, the study has shown that these legislative changes are indeed much needed and ultimately will contribute towards financial sustainability. Given the history of local government development in the country, the legislative implementation and compliance timing thereto with regard to the overwhelming needs of the citizens, might be too soon.

The study also identified factors that enhance financial sustainability. Financial planning is an important contributing factor to financial sustainability. Planning allows the municipality to take into consideration economic trends and design strategies to ensure financial sustainability. The importance of relevant, reliable and up-to-date information to assist the municipal council decision making cannot be sufficiently underscored. This information can be obtained by using the ratios and norms identified and regulated by the NT. The fact that the annual financial statements of municipalities are audited independently by the AG ensures that any manipulation of financial information can be verified quite easily. The same financial ratios and norms are to be applied in the same manner to all municipalities in the country, which ensures uniformity and enables comparisons between municipalities of the same size.
In order to be able to plan and forecast effectively, municipalities need to have insight into historical financial information. The study has shown that a long term retrospective analysis of the financial information can provide them with important information to plan ahead. This information can be used to forecast future budgetary requirements and this in return must inform financial policy and long term budget planning. The study showed, for example, that the liquidity ratios have been declining consistently and are an indication that serious cash flow problems might be encountered in the near future. This data must inform the financial strategy of the municipality. The strategy of council should then be to stabilise this decline and investigate and implement ways to bring this ratio into acceptable levels and maintain these levels in future.

A point in case is that the consumer debtors increased steadily over the period of study. A strategic response of the municipality should be to investigate its debtor account so as to determine what portion of this debt is irrecoverable and to provide sufficient funding in the budget to write off irrecoverable debt. Lastly, to improve debt collection by strengthening the debt collection unit or make use of dedicated service providers for this function. The point made is that the liquidity ratios, if used correctly, could inform the financial strategies of the municipality in its endeavour to become financially sustainable.

In order to realise the above however, councillors and officials need to be empowered to understand the importance of financial viability and the impact their decisions have taken or still need to take on municipal finances in future. An enabling factor in this regard would be to up-skill the relevant councillors and officials in financial management.

Finally it is important that effective public participation and communication is done. When the public is informed about the financial position of the municipality and the reasons for budget decisions it may enable financial sustainability. It is important that once a long term financial plan has been approved – supported by a well-defined budget plan – this information be shared with the community. It is equally important not to deviate from these plans without informing the public. This will assist in managing the expectations of the community but it will enhance the trust relationship and the credibility of the municipal council if they can show that they remain committed to executing the adopted plans and improve the financial health of the municipality.
6.4 CONCLUSION

The study has revealed that the fundamentals of financial management: budgeting, accounting, reporting and auditing, are fully entrenched within the South African local government legislation. Local public financial management reforms followed those that were implemented in developed countries (UK, USA, Europe, Australia and New Zealand) late in the previous century. Financial reforms in local government in South Africa started with the promulgation of the MFMA, 2003, effective from 01 July 2004. It was shown that the financial information generated from the actions resulting from these reforms is useful in establishing the financial performance of a municipality.

This study indicated that unless some drastic measures are implemented soon, the municipality will experience serious cash flow constraints in the very near future thus impacting negatively on its financial sustainability. This in turn will impact negatively on the municipality’s ability to provide much needed and quality services. When considering annual tariff increases, council needs to ensure that the approved increases are as close as possible to the prevalent inflation figures, because the study has shown that when tariffs are increased far above the prevalent inflation rate, customers find it difficult to afford them which results in an increase in debt and a decrease in payment levels.

It is understood that increases coupled to the inflation rate will not always be possible, especially when tariffs for a specific service do not reflect the full cost of providing such a service. In such cases, council will have to do extensive public participation so as to inform the public about the reasons for the increases or they will need to consider a lower level of service; for example, if the municipality is currently removing refuse from residences twice a week, it may consider doing so only once a week.

Expenditure should be limited to only those that are necessary for municipal service delivery as allowed for in the Constitution. As resources are becoming more limited, municipalities
need to implement austerity measures. This means that expenditure on items such as new office accommodation, overseas trips, catering, the appointment of so-called political staff and events that are not directly linked to service delivery must be avoided.

Budget provision for repairs and maintenance must be increased to the levels as prescribed in the NT norms in order to prolong the useful life of infrastructure and avoid service delivery disruptions. However the budget for repairs and maintenance should ideally be linked to, and informed by, a well-defined infrastructure maintenance plan. This plan would not only assist the administration in motivating for higher budget allocations to maintenance and repairs but would also ensure that expenditure for this item can be tracked and controlled against set targets stipulated in the infrastructure maintenance plan.

Municipalities need to continuously assess their organisational structure so as to ascertain whether the functionality of each position is aligned to the municipality’s constitutional mandate and contributes towards the reaching of its strategic objectives and goals. Expenditure on salaries and wages has been, and is expected to remain, the largest expenditure by type for a municipality and although a council has little control over the annual salary increases, it does have control over the approval of an organisational structure that is closely linked to its Constitutional mandate, development goals and strategic objectives.

The study highlights the deterioration of the financial health of the municipality which has happened gradually over the period of study. The cash reserves were noticeably reduced from 2006, as they were used for the purpose of capital expenditure funding. Cash reserves are needed to ensure liquidity, and the study has shown the negative effect of the current capital funding strategy on the liquidity situation of the municipality. The municipality must explore alternative means of funding capital expenditure, other than specifically relying on its own cash reserves.
Finally it must be stressed that the road to financial recovery and sustainability is not one that is quick or easy. The turn-around of the current financial situation to one where future financial sustainability is achieved, will not be a speedy process and the results will not be immediate. It will require political will and the development and implementation of long term financial planning, with specific targets and objectives that are measurable, achievable, and realistic and timed in such a manner that the pre-determined objectives are achieved both on the revenue as well as the expenditure budgets.

6.5 RECOMMENDATIONS FOR IMPROVING FUTURE FINANCIAL SUSTAINABILITY AT CAM

The following actions are recommended to the CAM in support of ensuring future financial sustainability.

The municipality must stabilise the decline in its current assets and put measures in place to improve the current ratio from the current 1.77:1 to at least 2:1. One of the measures should be to stop the utilisation of cash reserves and explore the use of long term loans as a funding source for capital expenditure in future. Another measure would be to monitor the expenditure on salaries, wages and allowances as currently at 36%, it is not far away from the upper limits of the NT norm of between 25% and 40%. This trend is upwards over the last three years of the study and should ideally be below the 30% mark. Another measure, where the municipality is currently performing well, is the payment level. As at 30 June 2014 the payment level was 100% up from 96% in the previous financial year. This payment level must be maintained in order for the municipality to honour its current expenditure commitments in the short term.

The municipality must align its annual tariff increases closer to that of inflation with a view to prevent increases to the consumers who are not paying due to service affordability issues. This alignment must be informed by the accurate costing for the provision of a service to ensure cost reflective tariffs therefore the municipality investigates, identifies and apportions all costs related to a specific service. The municipality must also make sufficient provision for the writing off of debt older than 90 days to curb the increasing trend in this category of debtors.
The municipality appointed a new service provider to assist with the collection of outstanding debt. It is recommended that this contract be closely monitored to ensure that all debt that can be collected, is indeed collected and that debt that is considered irrecoverable is written off. Debt on electricity represents an average of 39% to total debtors over the last six years of the study, clearly making this consumer debtor type the most dominant one.

The municipality should streamline its operating spending activities with a view to improve cash operating surpluses, which is crucial in enabling the municipality’s ability to generate sufficient operating margins. Expenditure items such as salaries, wages and allowances as well as electricity, which make up 36% and 25% respectively of total expenditure, should be monitored closely so as to keep year on year increases at a minimum.

The municipality must strive to increase the allocation of funding towards repairs and maintenance of existing infrastructure to reach the NT norm of 8%. However in order to effectively and efficiently manage the expenditure of this item, it needs to be informed by a comprehensive infrastructure maintenance plan. It is recommended that the municipality first develop and adopt an infrastructure maintenance plan and then budget accordingly.

The municipality should prioritise the stabilisation of cash reserves with a view to accommodating all statutory accounts such as unspent conditional grants, CRR and short term provisions, as well as further covering one month’s operating expenditure, in the short to medium term. The cash coverage ratio (including working capital) of CAM has been less than the NT norm range of one month to three months in all the years of the period of study, ending with 0.41:1 at the end of June 2014. The closest the municipality came to the lower end of the range was 0.80:1 in 2010 and the trend since then was negative up to the lowest ratio of 2014.

Finally, it is recommended that the input from the treasuries on a proposed budget must be solicited and obtained before the public participation process starts. National and provincial treasuries have a role to play in assessing and ensuring that a municipality’s budgets are credible and fully funded. This is done at present but the inputs from the two treasuries are
only received after the public participation process for budget input has been concluded. This means that if major changes, that impact on changes in the proposed tariffs to a specific budget are proposed, the municipality would need to repeat the public participation process.
REFERENCES


REFERENCES


http://www.ffc.co.za/index.php/reports/chapters


REFERENCES


REFERENCES


APPENDICES

APPENDICES

APPENDIX 1

Semi-structured interview questionnaire

1. Does the internal audit committee make recommendations to council that is informed by the ratios?

2. Is the financial position considered when making budgetary decisions?

3. Debt collection remains a challenge for most municipalities. Is this true for Cape Agulhas Municipality and what procedures and methods does the municipality use to ensure effective debt collection.

4. Did the double digit increases on bulk electricity from ESCOM over the last five years have any impact on the revenue realised from electricity sales in the municipality? If yes, what was the impact and how will it influence the future financial sustainability of the municipality.

5. What measures does council have in place to ensure effective budgetary control in order to ensure that no material over or under-expenditure occurs.

6. NT maintains, and it is common financial practice that capital funding be linked to the reasonable lifespan of the infrastructure to be built. How did council finance its capital projects over the last ten years?

7. Does the council consider financial trends and ratios when performance indicators are identified for the performance contracts of the senior managers?

8. Is there any assistance needed by council in terms of financial management? If yes, what kind of assistance?

9. Do you think the NT norms in general are conducive to financial viability?

10. Is there something that you feel I might have missed that may be important?
APPENDIX 2

Interview schedule

<table>
<thead>
<tr>
<th>Interviewee</th>
<th>Date</th>
<th>Time Taken</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive Mayor</td>
<td>13 August 2015</td>
<td>26 minutes</td>
</tr>
<tr>
<td>Leader of Opposition</td>
<td>14 August 2015</td>
<td>41 minutes</td>
</tr>
<tr>
<td>Chief Financial Officer</td>
<td>12 August 2015</td>
<td>01 hour 19 minutes</td>
</tr>
<tr>
<td>Internal Auditor</td>
<td>11 August 2015</td>
<td>43 minutes</td>
</tr>
</tbody>
</table>

Transcripts of the interviews are available on request with the permission of the interviewees.