

# Leadership in local government: building globally competitive cities

**Financial Statements: The basis of sound city finance**

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**national treasury**

Department:  
National Treasury  
REPUBLIC OF SOUTH AFRICA

# Audit outcomes – 2009/10 financial year

- Audit outcomes for 2006/07 to 2009/10

39 per cent or 110 municipalities have totally unacceptable audit findings!

To what degree does this impede effective, efficient service deliver?

2009/10	
No.	%
7	2%
53	19%
50	18%
120	42%
7	2%
46	16%
<b>283</b>	<b>100%</b>

Source: National Treasury Local Government Database and Auditor-General Consolidated Report 2009/10

- There is a clear improvement in audit outcomes
  - No. of adverse opinions and disclaimers has decreased
  - No. of unqualified opinions has increased from 19% in 2006 to 42% in 2009/ 10
- **BUT** an unqualified audit report is NOT an indicator of the absence of financial problems in a municipality because the audit report does not assess:
  - The adequacy of the funding of the municipal budget
  - The allocative efficiency of the municipality's spending priorities
  - The quality of the municipality's revenue management capabilities
  - The effectiveness of municipal spending
  - The sustainability of the municipality's debt burden

# Persistence of municipalities' negative or unknown end of month cash balances

	Section 71 Reports			
	30-Sep-10	31-Dec-10	31-Mar-11	30-Jun-11
<b>Metropolitan Municipalities (6)</b>				
No. of municipalities with negative or unknown cash balances over the last 6 months	1	0	0	0
No. of municipalities whose cash balance was negative or unknown over the last 6 months:				
less than 2 months of the previous 6 months	1	0	0	0
between 2 and 3 months of the previous 6 months	0	0	0	0
for more than 3 months of previous 6 months	0	0	0	0
<b>Secondary Cities (21)</b>				
No. of municipalities with negative or unknown cash balances over the last 6 months	9	5	6	7
No. of municipalities whose cash balance was negative or unknown over the last 6 months:				
less than 2 months of the previous 6 months	2	2	1	3
between 2 and 3 months of the previous 6 months	5	0	2	1
for more than 3 months of previous 6 months	2	3	3	3
<b>Other Local Municipalities (210)</b>				
No. of municipalities with negative or unknown cash balances over the last 6 months	122	96	97	104
No. of municipalities whose cash balance was negative or unknown over the last 6 months:				
less than 2 months of the previous 6 months	35	29	21	26
between 2 and 3 months of the previous 6 months	63	35	36	31
for more than 3 months of previous 6 months	24	32	40	47
<b>District Municipalities (46)</b>				
No. of municipalities with negative or unknown cash balances over the last 6 months	23	14	11	16
No. of municipalities whose cash balance was negative or unknown over the last 6 months:				
less than 2 months of the previous 6 months	12	7	4	7
between 2 and 3 months of the previous 6 months	8	4	3	4
for more than 3 months of previous 6 months	3	3	4	5
<b>All Municipalities (283)</b>				
No. of municipalities with negative or unknown cash balances over the last 6 months	155	115	114	127
No. of municipalities whose cash balance was negative or unknown over the last 6 months:				
less than 2 months of the previous 6 months	50	38	26	36
between 2 and 3 months of the previous 6 months	76	39	41	36
for more than 3 months of previous 6 months	29	38	47	55

# Vulnerable cash position of municipalities – cash coverage

	Audited Outcome				YTD: 2010/11
	2006/07	2007/08	2008/09	2009/10	
<b>Metropolitan Municipalities (6)</b>					
No. of munics for which cash data is unavailable	0	1	1	0	0
No. whose cash coverage is					
more than 3 months of operational expenditure	2	1	1	0	0
between 1 and 3 months of operational expenditure	1	3	1	3	2
less than 1 month of operational expenditure	3	1	3	3	4
<b>Secondary Cities (21)</b>					
No. of munics for which cash data is unavailable	1	14	13	0	2
No. whose cash coverage is					
more than 3 months of operational expenditure	3	0	0	3	4
between 1 and 3 months of operational expenditure	7	2	3	6	5
less than 1 month of operational expenditure	10	5	5	12	10
<b>Other Local Municipalities (210)</b>					
No. of munics for which cash data is unavailable	181	154	154	4	28
No. whose cash coverage is					
more than 3 months of operational expenditure	3	10	6	50	30
between 1 and 3 months of operational expenditure	3	7	12	58	38
less than 1 month of operational expenditure	23	39	38	98	114
<b>District Municipalities (46)</b>					
No. of munics for which cash data is unavailable	29	28	28	0	4
No. whose cash coverage is					
more than 3 months of operational expenditure	6	6	3	15	9
between 1 and 3 months of operational expenditure	4	2	3	13	6
less than 1 month of operational expenditure	7	10	12	18	27

# Growth in consumer debtors

	Audited Outcome				YTD 2010/11
	2006/07	2007/08	2008/09	2009/10	
<b>Metropolitan Municipalities (6)</b>					
<b>No. whose debtors grew</b>	0	2	4	4	5
<b>No. whose debtors increased by</b>					
less than 10% over period show n	0	1	1	1	1
betw een 10% and 20% over period show n	0	1	0	2	3
more than 20% over period show n	0	0	3	1	1
<b>Secondary Cities (21)</b>					
<b>No. whose debtors grew</b>	0	16	14	18	17
<b>No. whose debtors increased by</b>					
less than 10% over period show n	0	4	2	3	0
betw een 10% and 20% over period show n	0	7	6	5	8
more than 20% over period show n	0	5	6	10	9
<b>Other Local Municipalities (210)</b>					
<b>No. whose debtors grew</b>	0	17	39	78	126
<b>No. whose debtors increased by</b>					
less than 10% over period show n	0	4	6	15	20
betw een 10% and 20% over period show n	0	4	9	14	31
more than 20% over period show n	0	9	24	49	75
<b>District Municipalities (46)</b>					
<b>No. whose debtors grew</b>	0	5	12	18	19
<b>No. whose debtors increased by</b>					
less than 10% over period show n	0	1	2	3	3
betw een 10% and 20% over period show n	0	1	2	1	2
more than 20% over period show n	0	3	8	14	14

# Creditors as a percentage of cash and investments

	Outcome				Section 71			
	2006/07	2007/08	2008/09	2009/10	Q1: 30 Sep 10	Q2: 31 Dec 10	Q3: 31 Mar 11	Q4: 30 Jun 11
<b>Metropolitan Municipalities (6)</b>								
<b>Total Cash and Investments</b>	9,873	9,618	5,238	9,745	7,872	10,755	14,996	11,396
<b>Total Creditors</b>	4,657	6,949	8,413	7,620	5,759	5,788	5,187	10,890
Creditors as a % of Total Cash and Investments	47%	72%	161%	78%	73%	54%	35%	96%
<b>No. whose Total Creditors are</b>								
less than 25% of their Cash and Investments	1	1	2	2	1	1	2	0
between 25 and 50% of their Cash and Investments	2	3	1	0	1	1	2	2
more than 50% of their Cash and Investments	3	2	3	4	4	4	2	4
<b>Secondary Cities (21)</b>								
<b>Total Cash and Investments</b>	1,653	488	617	327	2,409	2,864	3,826	3,134
<b>Total Creditors</b>	1,115	1,053	1,238	1,899	2,212	1,678	1,857	2,591
Creditors as a % of Total Cash and Investments	67%	216%	201%	580%	92%	59%	49%	83%
<b>No. whose Total Creditors are</b>								
less than 25% of their Cash and Investments	8	17	16	12	6	10	8	9
between 25 and 50% of their Cash and Investments	4	0	1	1	3	2	3	1
more than 50% of their Cash and Investments	9	4	4	8	12	9	10	11
<b>Other Local Municipalities (210)</b>								
<b>Total Cash and Investments</b>	716	432	438	2,008	2,519	3,475	4,525	2,260
<b>Total Creditors</b>	224	284	807	1,438	2,056	2,556	2,076	1,934
Creditors as a % of Total Cash and Investments	31%	66%	184%	72%	82%	74%	46%	86%
<b>No. whose Total Creditors are</b>								
less than 25% of their Cash and Investments	203	197	189	153	139	141	146	134
between 25 and 50% of their Cash and Investments	2	3	6	9	16	16	20	17
more than 50% of their Cash and Investments	5	10	15	48	55	53	44	59
<b>District Municipalities (46)</b>								
<b>Total Cash and Investments</b>	2,217	365	569	2,495	2,530	2,923	3,971	1,854
<b>Total Creditors</b>	44	134	422	721	550	695	778	843
Creditors as a % of Total Cash and Investments	2%	37%	74%	29%	22%	24%	20%	45%
<b>No. whose Total Creditors are</b>								
less than 25% of their Cash and Investments	44	42	41	29	31	29	37	28
between 25 and 50% of their Cash and Investments	1	3	0	4	3	10	3	5
more than 50% of their Cash and Investments	1	1	5	13	12	7	6	13

# Underspending of original capital budgets

	Audited Outcome				S71
	2006/07	2007/08	2008/09	2009/10	YTD: 2010/11
<b>Metropolitan Municipalities (6)</b>					
<b>Total Original Capital Budget</b>	13 241	17 559	22 471	23 444	19 215
<b>Total Underspending of Original Capital Budget</b>	2 215	2 439	49	3 363	2 848
Underspending as % of Original Capital Budget	17%	14%	0%	14%	15%
Number of municipalities w ho underspent by					
less than 10% of their capital budget	0	0	1	1	2
betw een 10 and 30% of their capital budget	4	4	0	2	3
more than 30% of their capital budget	1	0	0	1	1
<b>Secondary Cities (21)</b>					
<b>Total Original Capital Budget</b>	4 853	6 117	7 630	8 635	6 685
<b>Total Underspending of Original Capital Budget</b>	1 778	1 927	1 743	2 757	2 968
Underspending as % of Original Capital Budget	37%	31%	23%	32%	44%
Number of municipalities w ho underspent by					
less than 10% of their capital budget	1	5	1	2	2
betw een 10 and 30% of their capital budget	7	3	4	5	5
more than 30% of their capital budget	9	10	8	11	14
<b>Other Local Municipalities (210)</b>					
<b>Total Original Capital Budget</b>	7 508	9 213	9 428	10 925	10 729
<b>Total Underspending of Original Capital Budget</b>	3 362	4 172	3 882	4 553	3 965
Underspending as % of Original Capital Budget	45%	45%	41%	42%	37%
Number of municipalities w ho underspent by					
less than 10% of their capital budget	12	15	16	12	15
betw een 10 and 30% of their capital budget	24	32	30	38	43
more than 30% of their capital budget	119	105	110	99	111
<b>District Municipalities (46)</b>					
<b>Total Original Capital Budget</b>	3 485	5 077	6 565	6 942	5 617
<b>Total Underspending of Original Capital Budget</b>	2 085	2 851	3 183	3 101	2 581
Underspending as % of Original Capital Budget	60%	56%	48%	45%	46%
Number of municipalities w ho underspent by					
less than 10% of their capital budget	1	0	4	4	5
betw een 10 and 30% of their capital budget	4	7	9	7	8
more than 30% of their capital budget	29	27	24	24	26

# Key issues identified as part of the 2011 LGBER

Quality of leadership and governance is critical to performance

- Incompetent and corrupt leadership undermines service delivery
- Management appointments are often more political than competency based
- Instability in senior management cadre detracts from continuity

Municipal budgets must be funded and realistic

- Depleted cash reserves – operating at the absolute margin
- General under-pricing of municipal services – bankrupting municipalities
- Revenue projections are unrealistic – not based on requirements of the MFMA
- Operating expenditures are too high – driven by non-priority spending
- Capital budgets are too ambitious

Maintenance of existing assets needs urgent attention

- Lack of key technical skills – qualified managers, engineers and technicians
- Weak asset management systems
- Spending on repairs and maintenance inadequate to maintain assets
- Maintenance spending is reactive, and so is more costly than planned maintenance

Own funding of capital budgets needs to increase

- Increased grant reliance, and reduced own funding of the capital budget
- Tariffs and operating budgets not making provision to fund capital
- Municipalities (other than metros) not adequately leveraging private finance to fund economic infrastructure

Reconceptualise approach to combat poverty

- New housing developments are located on the periphery far from economic opportunities and services
- Municipalities are not using labour intensive approaches to deliver services
- Current modes of service delivery are too expensive and unsustainable, especially for poor households in rural areas



# Potential policy responses include ...

## Focus on leadership

- Bring mayors and councils into the Outcomes monitoring system
- Depoliticise senior management appointments
- Appoint competent MMs, CFOs and senior managers
- Highlight difference between political leadership and management roles

## Creating fiscal space

- Get back to basics in all aspects of revenue management and cash management
- Ensure tariffs are cost-reflective – including maintenance and capital spending
- Make more innovative use of opportunities to leverage private finance
- Ensure value-for-money in procurement and contract management
- Eliminate non-priority spending

## Focussing on sustainable human settlements

- Use spatial planning, development approval and location of bulk infrastructure to guide private investment decisions
- Effective development control to ensure poor households are located close to economic opportunities
- Ensure co-ordination of infrastructure and housing investments

## Ensuring fiscally sustainable choices in service delivery

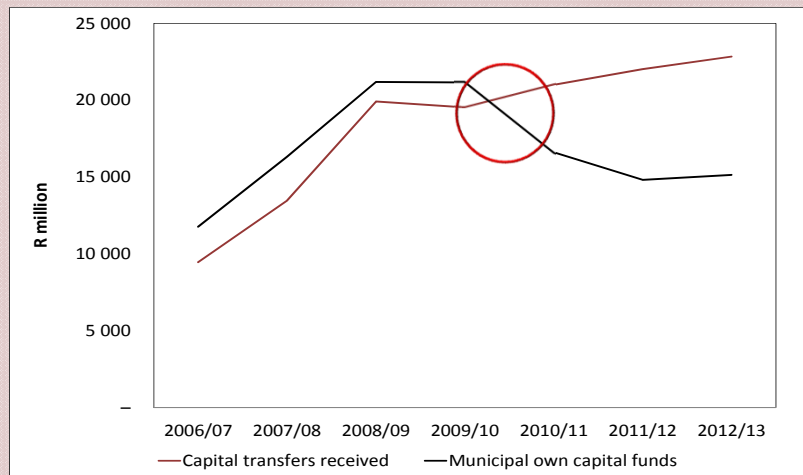
- Increase funding for repairs and maintenance
- Ensure indigents policy is appropriately structured and properly implemented
- Use appropriate service standards and technologies, especially in rural areas
- Use labour intensive service delivery methods

## Adopting a differentiated approach towards municipalities

- Better coordination of financing with the allocation of powers and functions
- Devolving of functions, especially housing and transport, based on municipalities' management capacity
- Structuring the local government fiscal framework around municipalities' fiscal capacity
- Targeting support to municipalities where assistance is needed and there is a willingness to co-operate

# Municipalities continue to face important fiscal challenges

Municipal own contribution to capital spending



**Municipal own contribution to capital expenditure, 2006 to 2012**

*Municipal own contributions are now less than 50% of total capital spending*

Pay attention to revenue management

- Get the basics right to ensure revenue value-chain is complete
- Integrity of billing information, accuracy of billing systems and ability to collect

High outstanding consumer debts

- In December 2010, municipalities were owed a total of R62.3 billion. This represents an increase of 10.8% from the same month in 2009

Under-pricing of services

- Municipalities not following the Systems Act principles for tariff setting
- On average, tariffs must reflect the cost of rendering the service

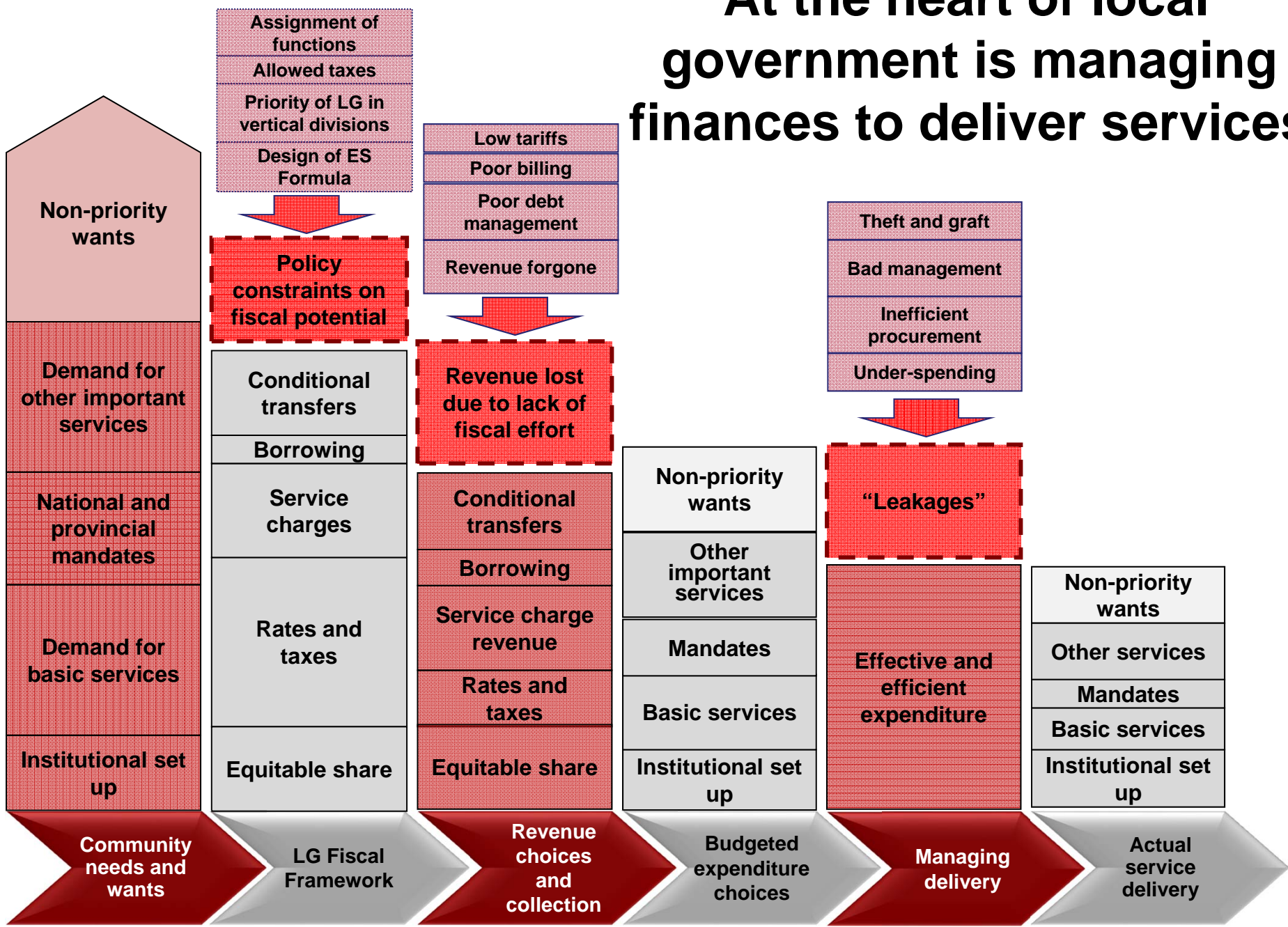
Inadequate spending on repairs and maintenance

- Cutting spending on maintenance is not seen as politically sensitive, but will have a disastrous impact on the reliability of services

## Comparison of Metro's

Description of financial indicator	City of Johannesburg	City of Cape Town	eThewini Metro	Ekurhuleni Metro	City of Tshwane	Nelson Mandela Bay Metro	Mangaung Metro	Buffalo City	Metro Average	Msunduzi LM
	<b>2011/12 Financial Year</b>									
<b>BUDGET AND FUNDING</b>	R'000	R'000	R'000	R'000	R'000	R'000	R'000	R'000	R'000	R'000
Total Operating Revenue	29,371,287	21,981,235	21,285,904	19,824,807	18,231,501	6,366,954	3,843,525	3,653,289		3,339,196
Total Operating Expenditure	28,266,482	22,141,875	21,219,412	20,908,641	18,218,844	6,621,119	3,691,530	3,926,991		3,339,106
Employee Related Costs	6,868,127	7,091,648	5,337,350	4,333,687	4,904,395	1,866,226	886,816	983,308		657,096
Employee Related Costs as % of Opex Exp	24.3%	32.0%	25.2%	20.7%	26.9%	28.2%	24.0%	25.0%	<b>25.8%</b>	19.7%
Debt impairment expense as a % of total billable revenue	7.4%	6.0%	2.5%	9.7%	6.4%	6.2%	6.0%	7.2%	<b>6.4%</b>	7.3%
<i>Operating Surplus/(Deficit)</i>	1,104,805	(160,840)	66,491	(1,083,834)	12,658	(254,165)	151,995	37,039		90
<b>ASSET MANAGEMENT</b>										
Total Depreciation and Asset Impairment	1,590,011	1,392,823	1,639,561	2,101,119	859,810	689,301	200,299	473,248		124,712
Depreciation as % of Asset Value	4.2%	5.3%	4.9%	4.5%	4.2%	5.5%	3.6%	3.7%	<b>4.5%</b>	1.9%
Total Operational Repairs and Maintenance	1,929,121	1,798,911	2,238,066	2,215,461	1,960,183	458,471	216,941	242,036		99,214
% of Capital Exp on Renewal of Assets	35.4%	38.7%	58.0%	34.3%	61.1%	73.6%	45.5%	10.0%	<b>44.6%</b>	37.1%
Renewal of Existing Assets as % of Depreciation	82.9%	141.3%	113.8%	38.7%	226.5%	48.5%	187.1%	1.9%	105.1%	1.5%
R&M as a % of PPE	5.1%	6.8%	6.7%	4.7%	9.5%	3.7%	3.9%	1.9%	5.3%	1.5%
<b>BORROWING MANAGEMENT</b>										
Borrowed Funding of 'own' Capital Expenditure	98.0%	63.2%	69.4%	97.0%	79.8%	0.0%	43.8%	0.0%	<b>56.4%</b>	100.0%
<b>LIQUIDITY AND CASH MANAGEMENT</b>										
Annual Debtors Collection Rate (Payment Level %)	89.4%	97.7%	97.3%	89.8%	96.7%	94.2%	88.1%	130.9%	98.0%	74.8%
Outstanding Debtors to Revenue	21.3%	19.7%	30.3%	9.1%	23.0%	15.8%	13.9%	18.9%	19.0%	24.5%
Current Ratio	0.9	1.5	1.6	0.9	1.3	1.0	1.2	2.4	135.6%	2.9
Liquidity Ratio	0.2	0.6	0.6	0.4	0.5	0.3	0.4	1.2	52.6%	0.5
Cash Coverage	0.8	2.3	2.5	1.3	1.3	1.1	0.1	3.2	<b>155.5%</b>	1.3
Cash/cash equivalents at year end	1,635,853	3,233,856	4,013,788	1,609,876	1,825,960	458,748	11,155	774,572		238,509
<b>PERFORMANCE &amp; ANNUAL GROWTH</b>										
% increase in Operating Revenue	11.6%	13.1%	14.8%	14.7%	19.1%	11.4%	24.5%	23.9%	16.6%	39.8%
% increase in Operating Expenditure (Nominal)	12.3%	13.7%	14.7%	12.9%	20.7%	19.1%	23.5%	20.7%	17.2%	39.8%
% increase in Operating Expenditure (Real)	7.3%	8.7%	9.7%	7.9%	15.7%	14.1%	18.5%	15.7%	12.2%	34.8%
Headline CPI Inflation	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%

# At the heart of local government is managing finances to deliver services



# Leading Financial Management underpinned by three lines of enquiry!



**national treasury**

Department:  
National Treasury  
REPUBLIC OF SOUTH AFRICA

# 1. Are finances planned effectively to deliver on priority spending?

Is spending in line with Constitutional priorities?

Is the budget a “balanced budget” or a “funded budget”?

Is adequate provision made for asset renewal; repairs and maintenance?

Is the revenue value chain working effectively to ensure accurate billing?

Is value for money achieved?

## **2. What is the understanding of costs and performance efficiencies?**

**Are tariffs for trading services cost reflective?**

**If so, are indirect costs considered?**

**Does cost management and efficiencies inform planning?**

**Is the municipality billing for ALL services and collecting ALL money due?**

### **3. Is financial reporting timely, reliable and does it add value?**

**How accurate are the section 71 and 72 reports?**

**Is the Municipal Budget and Reporting Regulations effectively utilised ?**

**Is reporting driven by compliance?**

**Are reporting outcomes regularly reviewed and does it inform decision making?**

**Are reports meeting stakeholder requirements?**



Thank you