



Member of the Executive Council
for Finance
FREE STATE PROVINCE

MEC FINANCE ADDRESS TO THE FREE STATE LOCAL GOVERNMENT SUMMIT

STATE OF MUNICIPAL FINANCE & MFMA SUPPORT

6 NOVEMBER 2018

Hon. Premier

Members of the Provincial and Local Government political and management leadership

Our leadership and colleagues of SALGA

Ladies and Gentlemen

The financial landscape of Free State municipalities is probably one of the most discussed and debated subjects at various inter-governmental fora over the last 10 years. Let us remind ourselves where we were 10 years ago, specifically the audit outcomes of the 2008/09 financial year. For that financial year, the Free State municipalities produced 18 Disclaimers, 2 Adverse, 1 Qualified and 3 Unqualified audit opinions.

One of the significant features of the 2009 and 2014 electoral terms, was a concerted effort to improve the state of local government financial management through institutionalized programmes such as Operation Clean Audit, the Municipal Support Programme and the Back to Basics programme.

Provincial Treasury, COGTA and SALGA have undertaken extensive consultations and engagements with individual municipalities and the local government sector on a broad range of matters, including;

- budget preparation and analysis,
- revenue and expenditure trends,
- asset management
- valuation rolls
- all aspects relating to the preparation of annual financial statements and the audit process,
- support of organizational structure development and human resource management
- section 139 interventions in various municipalities and, more recently,
- the MSCOA process.

It took 7 years of slow but gradual improvement in audit outcomes to finally reach a stage where we had turned the 2008/09 audit outcomes around. For the 2015/16 financial year, Free State municipalities produced 1 Clean (Unqualified with No Finding), 16 Unqualified, 4 Qualified and 2 Disclaimer audit opinions. Although all of us were happy with the progress, we were very aware of a few hanging questions, namely;

- Was this progress sustainable without the substantial investment in financial and human resources through the various support initiatives?
- What would be the impact of the 2016 local government elections and

- have we fundamentally changed the prevailing financial management environment and culture within municipalities?

The audit outcomes of 2016/17 clearly provided answers to these questions as we saw the prior year gains being reversed substantially in a single financial year with an overall regression to no clean audit, 11 unqualified, 4 qualified, 5 disclaimers, 1 adverse and 3 outstanding audit opinions.

The answers to our questions were that indeed, our municipalities have not developed the institutional capacity to withstand the electoral shock, progress is not sustainable without substantial investment in support initiatives and we have not fundamentally changed the financial management environment and culture within municipalities. This necessitates us to critically analyse and evaluate our various municipal support programmes and initiatives, to identify and expand on the inherent strengths and to reconsider the shortcomings.

One fundamentally important lesson that we must take from this is to remind ourselves that the role of national and provincial government is summarized in Section 154(1) of the Constitution, namely that; *“The national government and provincial governments, by legislative and other measures, **must support and strengthen the capacity of municipalities to manage their own functions.**”*

This is consistent with Section 135 of the MFMA, which includes the following:

- *“(1) The primary responsibility to avoid, identify and resolve financial problems in a municipality rests with the municipality itself.*
- *(2) A municipality must meet its financial commitments.”*

Given these Constitutional and legislative requirements, let us reflect on the state of budgets and financial management in our municipalities as at the end of September 2018.

BUDGETS

- There is substantial work in progress between National Treasury, National COGTA and SALGA to review the current funding model of the local government sector. This work will not bring relief to the budget and financial position of municipalities in the short term.
- All municipalities tabled and adopted their 2018/19 budgets before the start of the financial year. However, only 4 (all 4 District Municipalities) out of 22 delegated municipalities’ budgets are funded.
- Majority of capital budgets are funded from conditional grants, with a few municipalities who are intending to use internally generated funds to finance capital projects, such as office furniture and equipment.
- The main sources of operating revenue for municipalities remain income from service charges at 44 percent and operating transfers at 29.2 percent. Property rates and other revenue contributes 11.4 percent and 14.5 percent respectively.

- Total Provincial Bulk Purchases projections amounts to R3.07 billion (R995 million for water and R2.08 billion for electricity) and has increased with 8 per cent from R2.8 billion (R840 million for water and R2 billion for electricity).
- Total Provincial projected sales on bulk utilities amounts to R3.88 billion (R1.4 billion for water and R2.4 billion for electricity) and has increased with 1.8 per cent from R3.81 billion (R840 million for water and R2 billion for electricity).
- The growth in purchases for bulk purchases and sales gives a picture that:
 - Municipalities are not planning to settle their arrears on the bulk purchases, which is currently accumulating interest and growing at a fast rate;
 - Tariffs may not be fully reflective of the costs;
 - Some municipalities might be providing more than the required free basic services to the indigents and
 - Municipalities are incurring extensive distribution losses, which could be due to mixture of reasons, ranging from dilapidating infrastructure, unmetered consumption and theft.

CASH POSITION

- Generally, municipalities are required to have cash coverage for at least three (3) months. At the end of September 2018, (i.e. the end of the first quarter) 10 Municipalities reported closing balances below R10 million, which could lead to the non-payment of salaries and

creditors. (Xhariep, Letsemeng, Kopanong, Masilonyana, Tokologo, Mafube, MAP, Dihlabeng, Mantsopa & Metsimaholo).

- Three municipalities, in fact, closed the first quarter of the 2018/19 financial year with negative bank balances. (Dihlabeng R8,8 million, Mantsopa R20,4million and Metsimaholo R49 838 million)

OUTSTANDING CREDITORS

In its analysis of Municipal Financial Performance for the end of the fourth quarter of the 2017/18 financial year on 30 June 2018, National Treasury reflected that;

“Municipalities in the Free State have the highest percentage of outstanding creditors greater than 90 days at 87.5 per cent, followed by North West at 71.1 per cent, Northern Cape 70.3 per cent and Mpumalanga at 65.6 per cent. The year-on-year increase in outstanding creditors could be an indication that municipalities are experiencing liquidity and cash challenges and consequently are delaying the settlement of outstanding debt owed.”

We have to ask ourselves how do we support local economic development and the SMME sector when we are unable to adhere to the 30 day payment requirement and what does this mean to translate our commitment to radical economic transformation into practice?

As at 30 September 2018, the position in respect of outstanding creditors of Free State municipalities (including Mangaung) reflected as follows;

- Consolidated outstanding creditors amounted to R12.3 billion. This debt includes the following;
 - Bulk Water – R3.2 billion (The 3 largest contributors are Matjhabeng R 2 372 933; Kopanong R251 825m and Mafube R203 721m) Sedibeng Water is owed R2.5 billion and Bloemwater R931.2 million)
 - Bulk Electricity – R7.8 billion (The 3 largest contributors are Maluti-A-Phofung R3 383 373; Matjhabeng R2 010 814 and Ngwathe R1 065 407)
 - Pension / Retirement deductions – R218.4 million
 - Trade Creditors – R365.1 million
 - PAYE – R136.3 million
 - VAT – R23.5 million
 - Loan Repayments – R40.1 million
 - Auditor-General Fees – R24.4 million

DEBTORS

- An analysis of the outstanding debtors shows:
 - Total debt owed to municipalities amounts to R15,6 billion. Debt relating to water services contribute the most to the total outstanding debt amounting to R5, 6 billion (35 percent), whilst electricity amounts to R1.7 billion (11.1 percent).
 - Households owe 70,5 percent (R11,006 billion) of the total outstanding debt.
 - Businesses contribute 16, 9 percent (R2.6 billion) of the total debt.

- Organs of state contribute 9,4 percent (R1,4 billion) of the total outstanding debt
 - It should be noted that the outstanding debt of R15,6 billion includes debt older than 90 days (historic debt which accumulated over a long period), interest on arrears and other recoveries
- The collection rate of debt at municipalities remains a challenge, with 9 municipalities collecting below 50%:

MUNICIPALITY	COLLECTION RATE (%)
Masilonyana	29.4
Tokologo	31.2
Nala	48.2
Ngwathe	33.1
Mafube	39.3
Mantsopa	46.0
Setsoto	32.7
Nketoana	26.3
Maluti-A-Phofung	46.0

National Treasury reflected that the average year-to-date national collection rate at 30 June 2018 was 79.4 % compared to the adjusted budget collection rate of 90.2 %.

We need to reverse the existing practice in some of our municipalities that have resulted in artificially inflated budgets, supported by unrealistic projected collection rates, being adopted and implemented.

INSTITUTIONAL ARRANGEMENTS (INTERNAL AUDIT AND RISK)

- Out of the 22 delegated municipalities, 19 have appointed Heads of Internal Audit. Based on the assessment of functionality of the internal audit activity, 19 municipalities were assessed to be having functional internal audit activity.
- Audit Committees have been established at 20 of the 22 delegated municipalities. However, 17 Audit Committees were assessed to be functional.
- In terms of risk management, 16 municipalities have appointed Risk Officers whilst the function is performed by internal audit at 2 municipalities. In 3 of the municipalities, the position of Risk Officer is being occupied in acting capacity and in 1 municipality the position is vacant.
- The Risk Management Committees have been established at 19 of the 22 delegated municipalities. However, upon assessment only 14 Risk Management Committees were assessed to be functional.

UNAUTHORIZED, IRREGULAR, FRUITLESS AND WASTEFUL EXPENDITURE

I will not deal with the unauthorized, irregular, fruitless and wasteful expenditure as I am sure the Office of the Auditor-General will be dealing with this aspect.

WHY DO CHALLENGES CONTINUE TO EXIST

Given the picture painted by these statistics, we need to ask ourselves why we continue to face these persistent challenges in the financial management environment of our municipalities. Numerous political and administrative factors can be outlined that contribute to this situation these include;

- **Lack of stability and capacity**
 - Instability in Top Management of Municipalities (Constant changes in positions such as MM's, CFO's, Technical)
 - Lack of Capacity (Budget & Treasury Office & Asset Management, etc)
 - Critical vacancies not timeously filled, resulting in continuous rotational acting)
 - Excessive reliance on service providers for routine / daily operational tasks, such as meter readings, verification of movable assets, etc. Non-reviewal and monitoring of other work done by service providers
- **Bloated organizational structures.** Organisational structures are not reviewed and adapted regularly. Headcounts are not / not consistently performed. In some instances, municipalities have become employment agencies and their quarterly salary bill even exceed their quarterly equitable share allocation. In other instances, municipalities succumb to undue pressure from workers and do not terminate contract employments as such become due but attempt to “absorb” contract workers whilst a new intake of contract workers (such as EPWP) is also accommodated.

- **Control Environment deficiencies**

- Lack of Policy Implementation, including failure to review and update policies
- Non-Compliance to laws and Regulations, such as incorrect usage of contracts entered into by other organs of State (SCM Regulation 32), deviations (SCM Regulation 36), etc.
- Non-implementation/submission of reports on the 5 Key Controls to Provincial Treasury (*daily disciplines consisting of reconciling cash receipts, deposit and payments and filling of documents; monthly reconciliations and disciplines are done and performed; confirmation of monthly assets count and assets reconciliations to the mayor (this should include progress on the infrastructure); monthly feedback to the mayor on revenue and expenditure linked to the performance targets (service delivery)*)
- Lack of internal controls / standard operating procedures
- Non-implementation of Fraud Management Strategies
- None implementation/compilation and submission of Audit action plans

- **Unrealistic Budgets**

- Unrealistic Budget Projections, i.e. yearly incremental budgeting without considering actual past performance resulting in unfunded budgets
- Over-estimation of revenue collection and/or poor revenue collections due to non-implementation of credit control policies where appropriate as well as high levels of unemployment
- Lack of revenue base
- Indigent registers not updated. This is also linked to the entrenched culture of non-payment of services.

- No or minimal **consequence management**. What does it suggest that even on clear conflict of interest cases such as procurement awards to employees and/or close family members, no action is taken?
- **Political interference** in financial management and administration, including irregular appointments and/or suspensions, supply chain management, decisions on the payment of service providers and preventing the implementation of credit control measures.

WAY FORWARD

It was indicated earlier that we need to analyse and evaluate the various support programmes and initiatives that have been developed and implemented to determine the extent to which we need to review and adjust to the changing circumstances we have found ourselves in.

At a political level, we need a commitment to the following;

- Political ownership to achieve and sustain improved financial governance
- Consequence management must be implemented
- Political management must be coordinated between the key political office-bearers in the municipality. There has to be effective and timeous intervention, as and when challenges arise.
- Strategic and realistic decision making in respect of resource allocations

- Reverse institutionalized informalization, including planning, monitoring & oversight, formalised monthly and quarterly performance reviews & meetings of oversight bodies must take place.
- Meaningful meetings with stakeholders, including public participation
- Review of the current demarcation model that has resulted in financially unviable municipalities

We have in the past relied almost entirely on section 139(1) interventions in instances where the financial position in a municipality was deemed to have reached critical levels. An evaluation of section 139(1) interventions implemented throughout the country has indicated that it seldom achieves the desired effect on a sustainable basis.

An emerging narrative that has been discussed extensively in the national Budget Council lekgotla, the Budget Forum (where National and Provincial Treasuries, national and provincial COGTA and SALGA meet) and the Budget Council seeks to achieve a shift away from section 139(1) interventions to section 139(5) interventions. The section 139(5) intervention is in response to serious financial problems - *material breach of financial obligations or ability to provide basic services*. These are mandatory interventions and must be further considered in the context of the MFMA Chapter 13 Interventions.

The MFMA distinguishes between “serious financial problems” which may lead to a discretionary provincial intervention based on sections 137 and 138 of the MFMA and a “financial crisis” which would require a mandatory provincial intervention in terms of section 139(5) of the Constitution and sections 139 and 140 of the MFMA.

The MFMA requires mandatory interventions under s139(5) to be undertaken through the Municipal Financial Recovery Service of National Treasury. In National Treasury's preliminary assessment of municipalities, 13 municipalities in the Free State were deemed to have serious financial problems and meets the MFMA s138 criteria. Of those 13 municipalities, 5 municipalities are deemed to meet the MFMA s140 criteria and if the Constitution and legislation are strictly applied, a section 139(5) mandatory intervention should be activated.

A further process of engagement and consultation between national, provincial and local governments as well as SALGA will be unfolding over the next few months. It would be realistic to expect that significant developments with regard to discretionary and mandatory interventions will be unfolding during 2019.

We must be clear that the current fiscal position of our country does not leave options for the financial bail-out of municipalities. We need to find solutions for these challenges through creativity and innovation, through dedication and commitment.

In conclusion Chairperson, as long as our Constitution, legislation, Manifestos and policies must be translated into credible action that brings about real, meaningful and tangible change in the lives of our people.

And so, perhaps most importantly, there is a lesson for us in the words of James Frick, a former vice-president of the University of Notre Dame, when he said; "Don't tell me where your priorities are. Show me where you spend your money and I'll tell you what they are."