Municipal Finance

Relevance for Clean Audit Outcomes

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ABSTRACT

The purpose of this article is to conceptually and theoretically analyse municipal finance and administration in South Africa, taking into account the need for clean audit outcomes which can be achieved through sound and effective municipal financial administration. The rationale for an analysis of municipal finance and the need for clean audit outcomes arose, firstly, from the fact that municipal finance covers the sources of revenue in the form of taxes that are then used by municipal government after intergovernmental transfers. Secondly, municipalities are faced with many challenges in trying to deliver services to the community. Discussion of municipal finance management and administration, and clean audit outcomes, has been on the government agenda for some time. However, the anticipated turn-around in the municipalities is not happening. In 2009, the national government initiated a programme called "clean audit programme", which is scheduled to be completed in 2014. However, the pace at which the municipal financial management issues are being attended to at the municipal levels leaves much to be desired. It is therefore doubtful whether all the municipalities will achieve the desired clean audit status by 2014. Hence, the objective of this study is to contribute to and promote discussion on the topic in academic circles and among people who have an interest in local government.

INTRODUCTION

Municipal finance deals with municipal governments' revenue and expenditure decisions. Municipalities cannot deliver services to the community without sufficient municipal finances, and have to raise income from taxes, levies, rates and service charges paid by ratepayers. South Africa's legislative requirements regarding local government's financial management functions are set out in the *Constitution of the Republic of South Africa,* 1996 and other legislation. Municipal managers, mayors, councillors and other municipal officials play an important role in sound financial management. A municipal budget must suit the community's needs and form a structure of municipal finance focusing on an operating and capital budget, income, and expenditure. Accountability is the cornerstone of financial reporting of local government, but municipalities experience financial management challenges which pose serious risks of lost opportunities that affect the poorest most, and result in municipal distress which cannot be easily resolved – the Auditor-General's audit outcomes for 2010/11 which was released in 2012 revealed profound municipal financial mismanagement and administrative problems.

This study is crucial because municipalities have a role to play in ensuring that legislative requirements are met to ensure sound financial management, budget control, monitoring and reporting. Municipal finance is about the revenue and expenditure decisions of municipal governments. Municipal finance also addresses issues around expenditures at a local level, and accountability for expenditure and revenue decisions, including the municipal budgetary process and financial management. No municipal administration can deliver services to its community unless it has enough money available to pay for its operational costs. The mayor, municipal manager, councillors, officials and council are all expected to play a role in the sound financial management of their municipality. These officials form an integral part of a public institution which provides services to communities – the responsibility of stewardship and accountability is theirs.

Every municipality compiles its budget each financial year, anticipating that once funds are made available, service delivery can follow. In a system of local government where appropriate organisational systems and internal controls are in place, financial reporting and auditing are fundamental in ensuring a municipality's sustainability. Accountability is the cornerstone of the financial reporting of a local government, based on the assumption that communities have a right to know and a right to receive openly declared facts.

Municipalities are faced with many challenges in trying to deliver services to the community. These challenges are overwhelming municipalities and deserve serious attention. They will require a turn-around strategy to correct, and this strategy should ideally come from the municipalities themselves. The urgent need for effective, efficient and sound financial management and achievable progress with regard to proper, clean audit outcomes, by all municipalities by 2014 in the system of municipal administration, cannot be overemphasised. Non-compliance with the relevant legislation results in a situation where consumer debts balloon, creditors remain unpaid until they go bankrupt, a lack of expenditure management results in unauthorised, irregular, fruitless and wasteful expenditure, audit committees fail to perform, or function ineffectively, expenditure is not contained within the approved budget, and monthly and quarterly reports are not submitted, etc. Such issues become sources of dissatisfaction and even suffering to members of the communities concerned. Above all, public confidence in municipalities and the government is affected by the fundamental perception that the anticipated service delivery is not taking place.

Discussion of municipal finance management and administration, and clean audit outcomes, has been on the government agenda for some time. However, the anticipated turn-around in the municipalities is not happening. In 2009, the national government initiated a programme called "clean audit programme", which is scheduled to be completed in 2014. However, the pace at which the municipal financial management issues are being attended to at the municipal levels leaves much to be desired. It is therefore doubtful whether all the municipalities will achieve the desired clean audit status by 2014. Hence, the objective of this study is to contribute to and promote discussion on the topic in academic circles and among people who have an interest in local government.

THE TERM MUNICIPAL FINANCE

Municipal finance refers to the decisions that municipal governments make about revenue and expenditure. These decisions cover the sources of revenue in the form of taxes used by municipal governments and intergovernmental transfers. They also include ways of financing infrastructure from operating revenues and borrowing, as well as charges on developers and public-private partnerships.

The need for municipal finance

Municipalities cannot deliver services to the community without sufficient finances, so they must generate money by raising taxes, levies, rates and service charges from the ratepayers within their municipalities (Van der Waldt and Du Toit 2009). This implies that no municipal institution can procure goods and services and in turn provide them to communities unless they have enough money available to pay for operational costs. If a municipality does not have a sustainable monetary income, that municipality cannot meet its commitments.

Key legislative requirements to drive sound municipal finance

Various legislative requirements are designed to direct municipalities in managing their revenue and expenditure. The 1996 *Constitution of the Republic of South Africa* grants the country's municipalities considerable income-generating powers, but subjects these powers to national legislation. The system of municipal finance must be based on the following basic principles: revenue adequacy and certainty, sustainability, effective and efficient resource use, accountability, transparency and good governance, equity and redistribution, development and investment, and macroeconomic management. In addition to the Constitution, for the purposes of this study, the following Acts are crucial as sources for the principles of sound financial and revenue management:

The *Local Government: Municipal Systems Act,* (32 of 2000) gives expression to the provisions of the Constitution and the policy developed in the *White Paper on Local Government,* 9 March 1998. The *Local Government: Municipal Systems Act,* (32 of 2000) provides for matters flowing from the constitutional imperatives. Sections 62(1), 64(1), and 96(b) of this Act regulate the collection and management of municipal revenue, a substantial portion of which is derived from the delivery of services.

The *Local Government: Municipal Finance Management Act,* (56 of 2003). The object of this Act is to secure sound and sustainable management of the fiscal and financial affairs of municipalities and municipal entities by establishing treasury norms and standards for the local sphere of government.

According to Section 153 of the Constitution, municipalities must structure and manage their administration, budgeting and planning processes to prioritise the community's basic needs and promote its social and economic development. According to the Municipal Demarcation Board (2010), there are 278 municipalities in South Africa, consisting of 8 metros (Category A), 44 districts (Category B) and 226 local municipalities (Category C) that constitute local governments structured to perform local government functions. These all need municipal finances to perform their functions and pay for services provided to them by other institutions and individuals.

The role of a mayor, municipal manager, councillors, officials and council

The mayor, municipal manager, councillors, officials and council are expected to play an important role in the sound financial management of their municipality. These officials form an integral part of a public institution which provides services to its community. To this end the mayor, municipal manager, councillors, officials and council have the responsibility of stewardship and accountability. Stewardship refers to a steward holding someone else's assets, which implies the acquisition, financing, maintenance and utilisation of such assets. Accountability means taking responsibility for a person's actions to someone else, for example, the actions of management, decisions taken and the extent to which local choice has been satisfied. To be accountable, a municipality has to demonstrate its stewardship and accountability by producing financial statements for the revenue and expenditure of that municipality (Fourie, Opperman and Scott 2007:414).

Of all these officials in a municipal administration, the municipal manager has the most distinct responsibilities to fulfil in the municipality, namely to ensure sound financial management and administration by accepting responsibility and accountability for all income and expenditure, asset management, the discharging of all liabilities, and proper and diligent compliance with legislation governing local government. Lastly, the *Local Government: Municipal Finance Management Act* (56 of 2003) requires municipal councils to oversee municipal finances in a way that allows them to ensure that the mandate to the people they serve can be fulfilled. Legislation thus gives a council a mandate to approve the budget and ensure that it is in line with integrated development planning.

STRUCTURE OF MUNICIPAL FINANCE

The municipal budget is constructed in the form of set rules called a municipal budget structure, which consists of an operating and a capital budget, income, and expenditure. The operating budget consists of an estimate of operating revenues which will accrue to the municipality and of operating expenditure which will be incurred by the municipality over the financial year to which the budget relates. The capital budget is an estimate of the capital expenditure which will be incurred over the relevant financial year, and the sources of finance from which expenditure will be funded (Fourie *et al.* 2007:96–97). Financial reporting and auditing also form a crucial part of the municipal finance structure.

Municipal budgets

Any municipal budget should be compiled in consultation with the community to meet certain standards. Once the budget has been compiled, it should be implemented to the benefit of service delivery and the community at large. The budget is the most immediate important mechanism that is used in giving effect to a municipality's service delivery strategies. In terms of the *Local Government: Municipal Finance Management Act* (56 of 2003), municipalities must work on three-year operating and capital budget cycles. The Medium Term Strategic Framework (MTREF) is a three-year capital and operating budget that takes into account, and is linked to, a municipality's current and future development priorities in accordance with the Integrated Development Plan and other finance-related policies such as those relating to the provision of free basic services. Municipal budgets are based on accrual accounting, which means that transactions must be accounted for in the financial year in which they occur, irrespective of whether cash is paid or received in respect of such transactions during the financial year. There is a difference between an operating budget and a capital budget. These terms are discussed below.

Operating budget

An operating budget normally provides for the day-to-day expenditures of a municipality, for items such as salaries, wages, benefits, heat, water, maintenance of buildings and infrastructure.

Capital budget

A capital budget plans for the acquisition or rehabilitation of capital assets. It is thus used to record the financing sources and expenditures for the acquisition, rehabilitation or replacement of the capital assets of the municipality. Generally, capital assets refer to the buildings, equipment and infrastructure required by the municipality. This includes items such as municipal buildings, arenas, trucks, graders, roads, and water/sewerage systems.

Operating income

The revenue or operating income is the principal fund applicable to all municipalities into which the main sources of financing available to a municipality flow, such as taxation revenue, electricity, water, sewage, and refuse removal tariffs, government and other grants, interest on investments, traffic fines, minor tariffs, charges and fees, licensing fees and property rates. This fund also records the municipality's everyday operating expenditures. The revenue side initially records most of the sources of financing that are eventually transferred to the capital fund and the reserve funds. According to Table 1, during the first quarter of 2012/13 metropolitan municipalities achieved 24,5% or R40,3 billion of their billed and other revenue of the total adopted revenue budget of R164,8 billion (National Treasury 2012b:2).

Table 1: Metros' aggregated revenue for the first quarter ended 30 September 2012

R Thousand	Main appropriation			First Quarter 2012/13			Year to date: 30 September 2012					First Quarter 2011/12				Q1 of 2011/12 to Q1 of 2012/13
	Operating Budget	Capital Revenue	Total	Operating Revenue	Capital Revenue	Total	1st Q as % of Main Appr.	Operating Revenue	Capital Revenue	Total	Total Revenue as % of Main Appr.	Operating Revenue	Capital Revenue	Total	Total Revenue as % of Main Appr.	
							%				%				%	%
Buffalo City	3 966 637	749 097	4 715 735	1 704 045	38 431	1 742 475	37,0	1 704 045	38 431	1 742 475	37,0	1 483 058	36 993	1 520 051	34,4	14,6
Cape Town	23 901 656	5 926 610	29 828 266	6 053 866	620 978	6 674 844	22,4	6 053 866	620 978	6 674 844	22,4	5 533 833	354 886	5 888 718	21,8	13,3
Ekurhuleni Metro	22 368 169	2 650 708	25 018 877	6 526 120	147 480	6 673 600	26,7	6 526 120	147 480	6 673 600	26,7	5 677 399	186 037	5 863 435	26,4	13,8
eThekwini	23 662 218	5 308 715	28 970 933	6 159 314	596 821	6 756 135	23,3	6 159 314	596 821	6 756 135	23,3	5 457 524	614 665	6 072 189	22,9	11,3
City of Johannes-burg	33 414 387	4 261 567	37 675 954	8 961 849	227 416	9 189 265	24,4	8 961 849	227 416	9 189 265	24,4	7 828 995	314 777	8 143 773	24,6	12,8
Mangaung	4 374 349	753 667	5 128 016	1 356 594	116 278	1 472 872	28,7	1 356 594	116 278	1 472 872	28,7	960 359	92 165	1 052 524	22,4	39,9
Nelson Mandela Bay	7 246 752	1 079 076	8 325 828	1 923 971	145 739	2 069 709	24,9	1 923 971	145 739	2 069 709	24,9	1 502 524	126 366	1 628 890	21,0	27,1
City of Tshwane	20 795 035	4 353 047	25 148 081	5 224 464	500 622	5 725 085	22,8	5 224 464	500 622	5 725 085	22,8	4 804 011	365 946	5 169 957	24,1	10,7
Total	**139 729 202**	**25 082 487**	**164 811 689**	**37 910 222**	**2 393764**	**40 303 986**	**24,5**	**37 910 222**	**2 393 764**	**40 303 986**	**24,5**	**33 247 703**	**2 091 835**	**35 339 538**	**24,0**	**14,0**

Source Adapted from National Treasury 2012b:2 -First Quarter Local Government Section 71 Report September 2012

Operating expenditure

Local government expenditure consists of the day-to-day necessities of the operations of the local government and the delivery of services. The operating expenditure of a municipality is one of the crucial components which must be carefully overseen in order to achieve a clean audit and maintain sound financial management. Operating expenditure relates to expenditure incurred in connection with the provision of services, or the provision of benefits which are immediately consumed, such as the salaries, allowances and remunerative benefits of employees, general expenses such as bulk electricity and water, rentals, telecommunications, insurance, transport costs, legal costs, repairs and maintenance of fixed assets, the depreciation of assets, finance charges, contributions to provisions for bad debt and accrued leave entitlements, and the appropriation of revenues to capital and operating reserves.

Financial reporting and auditing

Financial reporting and auditing are fundamental to a municipality's sustainability. Accountability is the cornerstone of financial reporting by local government. Accountability is predicated on the assumption that communities have a right to know and to receive openly declared facts. The facts would normally come out of the financial statements and reports of the organisation. For the purposes of this article, accountability means a state of being accountable or responsible for actions taken, and the liability to be called upon to account for or answer questions regarding such actions. According to Meredith and Williams (2003:7), the task of financial management involves the monitoring of an organisation's financial position and the task may be divided into three main functions, namely, the organisation's financial position, managing the firm's asset structure, and managing the firm's financial structure. The fundamental objective underpinning the *Municipal Financial Management Act* (56 of 2003) is the development of sound financial management governance in municipalities. Unquestionably, financial management governance is built around the responsibilities of accountability and regular reporting (Presidency 2012).

The *Municipal Financial Management Act* (56 of 2003) therefore requires regular and accurate financial reporting to the municipal council to facilitate an environment in which potential or real financial problems are reported in time and in an appropriate manner to allow the council to remedy the situation. Financial audits are specifically designed to detect problems in the system of internal financial control, any failure to comply with accounting principles and standards, or with the reporting requirements set out by the central or provincial/state government, and misappropriations of funds (Fourie *et al.* 2007:212).

Responsibility for internal control

The internal control function is vital in any municipal environment. The responsibilities of the various stakeholders for internal control imply that management is ultimately responsible for the implementation, compliance and ownership of the system of internal control. The members of legislative bodies, in their capacity as representatives of taxpayers, exercise governance, guidance and oversight. The Auditor-General plays a role in making recommendations when any weaknesses in internal control are identified. The audit committee should be able to identify and act on instances where management may override internal control or otherwise seek to misrepresent reported financial results; hence, the independence of the audit committee from management, the extent of the committee's involvement with and scrutiny of activities, and the appropriateness of its actions will strongly influence the control environment in a municipality.

MUNICIPAL FINANCIAL MANAGEMENT AND ADMINISTRATION: SOME CHALLENGES

Municipalities face many challenges in trying to deliver services to the community. At present, for most South African municipalities, these challenges are overwhelming and need a radical turn-around strategy to correct problems. This strategy has to emanate, in the first instance, from the municipalities themselves. The financial management challenges in particular have an effect on service delivery to urban and rural populations regarding water, electricity, sanitation, and housing and refuse collection.

Financial management

Municipal financial management takes into account interconnected management aspects such as enhancing the developmental mandate of local government, planning and budgeting, a transparent and participatory trajectory, continuous capital investment, setting aside money for that capital investment, maintenance of and repairs to existing infrastructure, generating revenue, debt collection, managing cash and expenditure within the applicable limits. Procurement, asset management, reporting and oversight form part of financial management. Without effective and efficient application of those processes, municipal challenges may become overwhelming. It is crucial to overcome any apparent lack of ethical leadership from senior financial managers in order to achieve both proper development and sound financial management. At this juncture, South African municipalities face a myriad of financial management challenges, some examples of which are discussed below.

The *Division of Revenue Act* (6 of 2011) originally allocated R65,6 billion to local government. This sum was to be divided equitably to local government with a share of R34,1 billion, and R31,5 billion was allocated for both direct and indirect grants. These allocations were adjusted in December 2011 to reflect all additional in-year allocations, new allocations, re-allocations, rollovers and technical adjustments to the local government spheres (National Treasury 2012a:3). The adjustment increased the total baseline for the local government conditional grant allocations from R24,7 billion to a revised total of R24,8 billion. Of this, R22,6 billion was transferred by the national departments responsible for administering local government conditional grants against an allocation of R24,8 billion for both direct and indirect conditional grants. This constitutes 91,1% of the total conditional grants allocated for the 2011-12 financial year (National Treasury 2012a:4).

Municipalities receiving direct conditional grants reported an average expenditure of 78,5%, or R15,8 billion, of the R20,1 billion allocated directly to municipalities (National Treasury 2012a:4). This represents an underperformance of R4,3 billion (20,4%) for the municipal financial year. The main contributor to underspending was the Public Transport Infrastructure and Systems Grants reflecting expenditure of R2,3 billion (48,7%) from the allocated amount of R4,8 billion, which accounts for 23,9% of the direct allocation to municipalities. Reporting on performance against unspent committed funds that were rolled over by municipalities from the 2010-11 allocation to 2011-12 financial year was very weak (National Treasury 2012a:4). In June 2012, the aggregate expenditure for roll-over funds was R360,3 million (14,8%) of the R2,4 billion that was approved by the National Treasury to be spent in the 2011-12 financial year (National Treasury 2012a:4).

Over- and under spending of the operating budget

National Treasury (2012a:4), concedes that over- and underspending of operating budgets by municipalities signal challenges regarding financial managers' capacity and leadership in executing programmes within their budget and on time. The status of operating budget implementation has been projected as follows:

- aggregate net overspending of R4,3 billion (1,6%);
- aggregate overspending of the adjusted operating budget – R4 billion (1,8%);
- aggregate net underspending of R35,2 billion (13,3%) of municipalities' total budgets;
- aggregate underspending of the adjusted operating budget – R22,3 billion (10,2%); and

- aggregate overspending of the adjusted capital budget – R2,2 billion (4,9%).

Under spending of the capital budget

According to National Treasury 2012a:2), capital budget performance leaves much to be desired in that aggregate underspending of the adjusted capital budget was R14,8 billion (32,3%) during the in year reporting period. The aggregate adjusted capital budget for all municipalities in the 2011/12 financial year was R46 billion, of which only R33,2 billion (72,5%) was spent by 30 June 2012. The aggregate adjusted capital budget for metros in the 2011/12 financial year was R22 billion, of which metros spent R17,5 billion (79,5%) by 30 June 2012, reflecting some of the challenges of planning capital project implementation.

Under-/overspending of conditional grants

Municipalities tend to either under- or overspend the conditional grants made available for specific purposes. It is further observed that on aggregate, during the in year reporting period, municipalities overspent conditional grants by R0,8 billion (3,8%), and underspent conditional grants by R5,1 billion (25,3%) (National Treasury 2012a:2).

Table 2: National collection rates

Description	2011–2012	Budget year 2012–13		
R Thousand	**Audited Outcome**	**Original Budget**	**Q1 Sept Actual**	**YTD Actual**
Collection Rate	100,62%	92,34%	84,14%	84,14%
Property rates	167,07%%	86.,34%	73,73%	73,73%
Service charges	79,80%	94,6%	89,59%	89,59%
Service charges – electricity revenue	81,33%	94,31%	88,60%	88,60%
Service charges – water revenue	78,25%	89,08%	86,62%	86,62%
Service charges – water sanitation	97,84%	87,36%	72,25%	72,25%
Service charges – refuse revenue	51,95%	96,87%	72,65%	72,65%
Service charges – other	101,61%	(216,94)%%	(144,38)%	(144,38)
Interest earned – outstanding debtors	79,19%	71,49%	38,14%	38,14%

Source Adapted from National Treasury 2012b:13 Press Release: Local Government Revenue and Expenditure: First Quarter Local Government Section 71 Report for the Period: 1 July 2012 – 30 September 2012.

Revenue collections

Table 2 shows the status of revenue collection by municipalities on 30 September 2012. The table shows that the collection rate was 100,62% (audited figure) in the 2011–12 financial year, compared to the 2012–13 first quarter figure, which in aggregate stood at 84,14%, indicating underperformance for this quarter. However, electricity revenue increased from 81,33% (audited outcome) in 2011–12 to 89,59% for the same quarter in 2012–13, and water increased from 78,25% (audited outcome) to 86,62% for the first quarter of 2012–13.

An analysis of the collection rates indicates that although municipalities budgeted for a 92,3% collection rate, the aggregate actual collection performance against the billed revenue was 84,1%. The fact that some municipalities bill yearly property rates in July distorts this analysis. The metros budgeted for a 93,6% collection rate and collected 90,9%, whereas the secondary cities appear to be collecting billed revenue at a lower rate of 81,9% (National Treasury 2012b:2).

Consumer debts

The multiple effects of municipal consumer debt are a matter of public finance and intergovernmental fiscal concern. In order to address the problem, municipalities and local government policy-makers need to understand the extent of this debt and how to manage the related challenges and risks better. Municipal consumer debt encompasses late payments for property rates, service and other municipal charges, as well as amounts that are deemed irrecoverable, according to the Fiscal and Financial Commission (FFC 2012:155). The aggregate municipal consumer debts amounted to R87,2 billion on 30 September 2012. This gloomy picture is a clear indication that municipalities are facing a serious challenge because they fail to collect all billed revenue. Underperformance in respect of collections is a significant risk, as it has a direct impact on cash and cash equivalents (National Treasury 2012b:2). Table 3, below, shows the state of debts on 30 September 2012.

For debtors (by income group) of over 90 days, bills for water amount to R18,3 billion (80,2%) of the amounts billed of debts of R22,8 billion), for electricity to R7,4 billion (44,4% of R16,6 billion) for property rates to R14,2 billion (68,7% of R20,7 billion, for sanitation to R6,5 billion (78,5% of R8,2 billion, and for refuse removal to R5,2 billion (81,8% of R6,4 billion). Other outstanding payments amounted to R11,7 billion (94,0% of R12,4 billion). The average with regards to debtors by income group of over 90 days is R63 billion or (72,6% of R87 billion).

Debtors (by customer group) of over 90 days are government at R3,2 billion (67,3% of R4,8 billion), business at R9,9 billion (52,7% of R18,9 billion),

Table 3: National debtors' age analysis at the end of the first quarter ending on 30 September 2012

R Thousand	0 – 30 Days		31 – 60 Days		61 – 90 Days		Over 90 Days		Total		Debt Written Off	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Debtor Age Analysis by Income Source												
Water	2 252 702	9,9%	1 228 071	5,4%	1 027 846	4,5%	18 267 727	80,2%	22 776 346	26,1%	162 463	0,7%
Electricity	6 082 545	36,6%	2 086 097	12,6%	1 071 108	6,5%	7 365 189	44,4%	16 604 940	19,1%	119 766	0,7%
Property Rates	3 675 377	17,8%	1 127 747	5,5%	1 664 600	8,1%	14 200 020	68,7%	20 667 744	23,7%	115 116	0,6%
Sanitation	9 20 058	11,2%	469 782	5,7%	374 983	4,6%	6 451 719	78,5%	8 216 542	9,4%	81 587	1,0%
Refuse Removal	5 51 118	8,6%	313 840	4,9%	302 853	4,7%	5 238 363	81,8%	6 406 174	7,3%	70 456	1,1%
Other	(63096)	-0,5%	343 799	2,8%	462 371	3,7%	11 744 382	94,0%	12 487 456	14,3%	252 724	2,0%
Total by Income Source	13 418 704	15,4%	5 569 335	6,4%	4 903 761	5,6%	63 267 401	72,6%	87 159 201	100,0%	802 111	0,9%
Debtor Age Analysis by Customer Group												
Government	510 988	10,7%	308 970	6,5%	734 516	15,4%	3 202 250	67,3%	4 756 724	5,5%	30 828	0,6%
Business	5 843 329	31,0%	1 930 700	10,2%	1 146 132	6,1%	9 932 470	52,7%	18 852 632	21,6%	181 444	1,0%
Household	6 666 836	12,0%	2 901 228	5,2%	2 487 136	4,5%	43 417 707	78,3%	55 472 907	63,6%	504 740	0,9%
Other	3 97 564	4,9%	428 464	5,3%	535 978	6,6%	6 714 973	83,1%	8 076 980	9,3%	85 099	1,1%
Total by Customer Group	13 418 718	15,4%	5 569 363	6,4%	4 903 763	5,6%	63 267 401	72,6%	87 159 244	100,0%	802 111	0,9%

Source Adapted from National Treasury 2012b:11 Press Release: Local Government Revenue and Expenditure: First Quarter Local Government Section 71 Report for the Period: 1 July 2012 – 30 September 2012

Table 4: Creditor age analysis

R Thousand	0 – 30 Days		31 – 60 Days		61 – 90 Days		Over 90 Days		Total	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Eastern Cape	588 499	76.3%	75 966	9.8%	6 107	0.8%	100 847	13.1%	771 420	5.3%
Free State	234 114	17.7%	149 387	11.3%	86 015	6.5%	853 854	64.5%	1 323 370	9.0%
Gauteng	5 962 910	95.5%	125 367	2.0%	29 140	0.5%	126 930	2.0%	6 244 346	42.6%
KwaZulu-Natal	1 916 676	68.8%	46 068	1.7%	174 751	6.3%	646 562	23.2%	2 784 058	19.0%
Limpopo	262 679	28.8%	15 881	1.7%	389 964	42.8%	242 749	26.6%	911 273	6.2%
Mpumalanga	345 562	36.2%	93 401	9.8%	1 133	0.1%	515 652	54.0%	955 748	6.5%
Northern Cape	95 700	54.4%	16 129	9.2%	6 383	3.6%	57 761	32.8%	175 974	1.2%
North West	363 594	34.9%	117 355	11.3%	107 623	10.3%	453 680	43.5%	1 042 252	7.1%
Western Cape	391 728	89.6%	19 070	4.4%	17 428	4.0%	9 033	2.1%	437 259	3.0%
Total	**10 161 462**	**69.4%**	**658 626**	**4.5%**	**818 542**	**5.6%**	**3 007 069**	**20.5%**	**14 645 699**	**100.0%**

Source Adapted from National Treasury 2012b:13. Press Release: Local Government Revenue and Expenditure: First Quarter Local Government Section 71 Report for the Period: 1 July 2012 – 30 September 2012 households at R43,4 billion (78,3% of R55,5 billion) and others at R6,7 billion (83,1% of R8,1 billion).

Creditors and accounts payable

In terms of the principles as articulated in the *Local Government: Municipal Finance Management Act*, when a municipality owes money for goods and services purchased, the municipality must settle such outstanding amounts within 30 days of the date of the invoice or statement, unless it is prescribed otherwise. The payment of creditors or accounts payable must be reconciled monthly, according to the statements received from the service providers.

Table 4 below reflects the creditors' age analysis on 30 September 2012. It shows that R14,6 billion was owed by municipalities and shows an overall decrease of R1,3 billion owed compared to the R15,9 billion reported in the fourth quarter of 2011-12. The Free State had the highest percentage of creditors outstanding for more than 90 days, at 64,5% of the total outstanding municipal creditors, followed by Mpumalanga (at 54%) and North West (at 43,5%) (National Treasury 2012b:2).

Auditor-General audit outcomes 2010-11: Challenges

The Auditor-General of South Africa (2012) highlighted fundamental municipal finance management and administration problems of interest to the general public. These problems need to be addressed to improve public confidence in local government systems.

Annual financial statements audited

The essence of the report (Auditor-General of South Africa 2012:17–54) regarding the state of the financial statements is the following:

According to the Auditor-General of South Africa (2012:17), the significant aspects of the 2010–11 audit outcomes was centred around the overall audit outcomes, submission of financial statements and annual performance reports, opinions on financial statements, reporting on predetermined objectives, non compliance with laws and regulations, supply chain management contraventions, human resources management and risks related to the use of information. For the purposes of this article, supply chain management contraventions, human resources management and risk related to the use of information, will not be discussed. The financial reports and accounts and in particular financial statements represent published reports and accounts of municipalities prepared by Chief Financial Officers and their accountants. The data so presented have to comply with relevant legislative requirements, accounting standards and reporting practices and other listing requirements if appropriate and thus will qualify for clean audit outcomes (Broadbent and Cullen 2003:12). The analysis with regards to the overall audit outcomes painted the following picture (Auditor-General of South Africa, 2012:17-18).

Overall audit outcomes

The following information was analysed:

- Only 52 (17%) auditees improved on their 2009-10 audit outcomes, while 38 (13%) regressed.
- Less than half of the auditees, 129 (46%), retained a financially unqualified audit opinion but made no further progress towards clean audit reports for the 2010-11 audit period.
- The rate of timely submission of financial statements (80%) and annual performance reports (86%) for audit did not improve significantly, compared to 2009-10.
- The non-submission or late submission of financial statements was the highest in the North West (61%) and Northern Cape (34%). Neither province had a clean audit report.
- Of the auditees, 38 (10%) did not submit annual performance reports for audit, and 15 (4%) submitted their annual performance reports after the legislated deadline.
- The number of financially unqualified audit opinions increased by only four auditees to reach 50%. KwaZulu-Natal (87%), Gauteng (76%) and the Western Cape (76%), continued to have the highest number of financially unqualified audit opinions.
- The Eastern Cape and Free State recorded an increase of 13% and 11% respectively in financially unqualified audit opinions.
- The majority of audit opinions were recorded in the provinces of Limpopo and North West. However the auditees were financially qualified because the number of financially unqualified audit opinions decreased to 13% in Limpopo and to 9% in North West and the prevalence of material misstatements in the financial statements audited increased from 85% to 91% of auditees.

Quality of the financial statements submitted for audit

The Auditor-General reported that as in prior years, many auditees submitted financial statements that contained material misstatements in one or more areas and only 26 (9%) auditees submitted financial statements that required no material adjustments as compared to 49 (15%) auditees in the 2009/10 financial year (Auditor-General Consolidated general report on the audit outcomes of local government 2010–11:2012:17–18). The report further revealed the following challenges:

- Almost half, 147 (49%) auditees, could achieve a financially unqualified audit opinion because they used the opportunity provided by the Auditor-General of South Africa to correct all misstatements identified during the audit.
- Of the 127 (42%) auditees to receive disclaimed, adverse or qualified audit opinions, 29% regressed from the previous year and 80 (63%) remained disclaimed, adverse or qualified.
- Of the auditees, 31 (10%) received disclaimed or adverse audit opinions for the past six years – the Eastern Cape (seven), Free State (eight) and Northern Cape (seven) account for 71% of such auditees.
- Of the auditees that received financially unqualified audit opinions, 60% engaged consultants to assist them with accounting-related services and/or the preparation of financial statements.
- Of the auditees with qualified, adverse or disclaimed opinions, 85% got assistance from consultants.
- The number of auditees with findings on their reporting on predetermined objectives (PDOs) decreased from 274 (84%) in the previous year to 210 (70%). All provinces' levels of PDO findings decreased, except the Free State and Northern Cape's. Gauteng remained unchanged and is still the province with the lowest level of PDO findings.
- Non-compliance with PDO-related legislation decreased by 30%. Of the auditees, 60% included findings on the usefulness and reliability of the information in their annual performance reports.

Non-compliance with laws and regulations was high: 90% of auditees had findings on material non-compliance with laws and regulations. The Auditor-General reported that non-compliance deteriorated in KwaZulu-Natal, North West, Mpumalanga and the Northern Cape, and other provinces such as Limpopo, Western Cape, Free State, Gauteng and Eastern Cape showed no major improvement. In this regard, unauthorised, irregular, fruitless and wasteful expenditure was incurred by 86% of auditees and 84% of the auditees took no reasonable steps to prevent such expenditure.

Non-compliance with legislation

An inadequate performance management system has serious implications for the implementation of budgets and programmes in municipalities, because it may affect a municipality's capacity for sound financial management and administration (Auditor-General Consolidated general report on the audit outcomes of local government 2010–11:2012:42). Failure to adopt and implement a performance management system was reported for 37% of auditees. There were no mid-year budget and performance assessments by 30% of auditees, and 20% of auditees omitted reports on performance against predetermined objectives, indicators and targets from annual performance reports. Moreover, in these reports, 30% of municipalities did not disclose the measures taken to improve performance. The Auditor- General expressed concern that no performance audit committee was in place for 27% of auditees, and that for 20%, the performance audit committee did not function as prescribed in legislation. Furthermore, internal audits by 37% of auditees did not include performance measures.

Unauthorised, irregular, fruitless and wasteful expenditure

It was reported that the accounting officers of 84% of auditees did not ensure that reasonable steps were taken to prevent this type of expenditure. Lovemore and Brümmer (2003:7), maintains that managers plan, organise, direct and control activities to achieve the goals; both financial and non-financial information; required. In the light of the above, financial objectives are established as an offshoot of the organisation's overall objectives, either as part of a cohesive plan, or arising from implied understanding of the organisation's overall purpose. To this end, such financial objectives can be established by management only with sound, relevant and timely information. The extent of this expenditure and non-compliance by the accounting officers is indicative of an environment where incurring unauthorised and irregular expenditure has become the norm, rather than the exception. A total of 234 auditees incurred R11 billion as unauthorised and irregular expenditure. Alarmingly, a R2 billion decrease in the amount of unauthorised expenditure does not signify an improvement, because the decrease was mostly achieved by the fact that Gauteng's unauthorised expenditure decreased by R1,7 billion, because R1,5 billion of the 2009-10 unauthorised expenditure was an exception relating to the 2010 World Cup expenses. The North West's unauthorised expenditure decreased by R1,3 billion, since fewer auditees were reported on because of outstanding financial statements. The number of auditees that incurred unauthorised expenditure remained the same, at 55% of auditees, which is a further indication that there was little improvement overall. R3,8 billion (88%) of the unauthorised expenditure was incurred due to overspending of the budget as a result of weak budgetary controls, which was also identified as a prevalent and material non-compliance finding (Auditor-General Consolidated general report on the audit outcomes of local government 2010-11:2012:48–52). Table 5, below reflects the unauthorised, irregular, fruitless and wasteful expenditure.

To this end, the overall amount for overspending decreased, but only as a result of the Gauteng and North West anomalies. The biggest over spender was the Free State, at R1,3 billion. The highest incidence of overspending was found in the Northern Cape (86%), Free State (77%) and Eastern Cape (59%). Auditees

Table 5: Unauthorised, irregular, fruitless and wasteful expenditure

Financial years	2009–10	2010–11
Unauthorised expenditure	**R6,3 billion**	**R4,3 billion**
Identified during audit		R2,2 billion
Identified by auditee		R2,1 billion
Irregular expenditure	**R4,7 billion**	**R10 billion**
Identified during audit		R1,9 billion
Identified by auditee		R4,8 billion
Limitation		R3,3 billion
Fruitless and Wasteful expenditure	**R253 million**	**R260 million**
Identified during audit		R152 million
Identified by auditee		R108 million

Source Auditor-General of South Africa 2012:51: Consolidated general report on the audit outcomes of local government 2010–11

tended to fare better in detecting unauthorised expenditure, as is evident from the financial statements and budget reporting, but 48% of unauthorised expenditure was identified by the auditors. Unauthorised expenditure invariably means that money for some programmes was diverted to fund others, which ultimately affects service delivery in terms of the performance objectives set for a given year (Auditor-General of South Africa 2012:54).

Fruitless and wasteful expenditure continued to increase. It was incurred by half the auditees and across all provinces. The worst lawbreaker was the Free State, at R115 million. Late payment of creditors, which was raised as a material and prevalent form of non-compliance, caused the most fruitless and wasteful expenditure. The audits showed that this stemmed from weak internal controls and insufficient care given to protecting public money.

Cross-cutting problems of non-compliance with laws and regulations

The Auditor-General of South Africa's (2012) audit outcomes report noted problems regarding non-compliance with legislation in municipalities. Table 6 reflects cross cutting challenges.

Table 6 shows the following transversal issues in municipalities or auditees (Auditor- General of South Africa 2012:48-49)

- Unauthorised, irregular, fruitless and wasteful expenditure nationally averages 84% (Northern Cape 95%, Eastern Cape 94%, North West 91%, Free State 89%, Limpopo 87%.)

Table 6: Cross cutting issues on non-compliances with regulations and laws

Province	Unauthorised, irregular as well as fruitless and wasteful expenditure	Submitted financial statements required material adjustments	Procurement and contract management	Other expenditure management issues	Strategic and performance management	Audit commitees	Other annual financial statement, performance report and annual report issue	Budgets
Eastern Cape	94%	85%	72%	70%	57%	46%	56%	61%
Free State	89%	93%	81%	78%	63%	78%	52%	67%
Gauteng	69%	74%	48%	29%	14%	7%	7%	10%
KwaZulu- Natal	85%	71%	60%	19%	32%	26%	21%	15%
Limpopo	87%	83%	83%	67%	37%	57%	43%	47%
Mpumalanga	70%	65%	70%	60%	25%	30%	30%	35%
Northern Cape	95%	95%	90%	57%	95%	81%	71%	71%
North West	91%	100%	91%	64%	73%	45%	64%	55%
Western Cape	78%	44%	78%	7%	37%	30%	52%	26%
Total	**84%**	**77%**	**70%**	**46%**	**43%**	**40%**	**39%**	**38%**

Source: Auditor-General of South Africa 2012:48: Auditor-General Consolidated general report on the audit outcomes of local government 2010-11

- Submitted financial statements requiring material adjustments nationally average 77% (North West 100%, Northern Cape 95%, Free State 93%, Eastern Cape 85%, Limpopo 83%).

- Procurement and contract management nationally averages 70% (North West 91%, Northern Cape 90%, Limpopo 83%, and Free State 81%).
- Other expenditure management issues nationally average 46% (Free State 78%, Eastern Cape 70%, Limpopo 67%, and North West 64%).
- Strategic and performance management issues nationally average 43% (Mpumalanga 95%, North West 73%, Free State 63%, Eastern Cape 57%).
- Lack of performance by audit committees and the nationally averaged 40% (North West 91%, Free State 78%, Limpopo 57%, Eastern Cape 46%).
- Other annual financial statement, performance report and annual report issues showed that national was average 39% (Northern Cape 71%, North West 64%, Eastern Cape 56%, Western Cape and Free State 52%).
- Budgets and expenditure management issues nationally average 38% (Northern Cape, 71%, Free State 67%, Eastern Cape 61%, North West 55%).

CONCLUSION

The financial resources available in any municipality are limited, but have to provide as many as possible of the services required by the local community, despite financial constraints. The revenue and expenditure management, particularly the sound financial management capacity of a municipality, determine its ability to contribute to poverty reduction and economic development. Thus, any weaknesses in financial management are likely to be reflected in the emergence of other long-term governance challenges in the municipality which may lead communities to complain of a lack of adequate delivery of services.

The challenges indicated in this study pose a number of potential risks related to the current state of municipal finances – bulk services, contractors and suppliers may not be paid on time; repairs and maintenance are invariably amongst the first expenditures cut, placing service delivery at risk, with severe implications for future revenue or income; procurement opportunities that could be exploited through the implementation of bulk services and contractor/supplier partnerships could be lost; staff morale may be affected if salaries are not paid on time and strikes may ensue; outstanding payments could result in resources being lost that could be used to improve the living conditions of the poorest of the poor; and a greater need for greater cross-subsidisation from wealthier households and business may arise, potentially overburdening the existing tax base. When the legal framework for the preparation and submission of annual financial statements is disregarded, the quality of the information presented is poor, which is both offensive and injurious to the general public.

The work done by the National Treasury and the Auditor-General is commendable, but these two institutions cannot work alone, if they do, they are unlikely to achieve much, despite their excellent efforts to improve the local government environment. South Africa needs the national department dealing with local government to ensure that the performance management of municipal managers and the chief financial officers and other senior managers is tightened up considerably to turn financial management and the state municipal finance around and to keep them going in the right direction. It would be most appropriate if government can enact a legislation to commit councillors, audit committees, oversight committees to sign performance contracts to prevent poor financial performance and service delivery in various municipalities.

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