# KwaZulu-Natal Provincial Treasury

# Municipal Budget Performance 2015/16
# Second Quarter Review

**Municipal Budget Performance 2015/16: Second Quarter Review Speech**

**Delivered by**

**Mrs B Scott,**

**MEC for Finance**

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## Introduction

Honourable Speaker, as mandated, I table the ***Municipal Budget Performance 2015/16 Second Quarter Review*** report at a time when our economy is facing numerous challenges. We are all aware that our economy contracted by 1.2 percent in the first quarter of this year, following 0.4 percent growth in the fourth quarter of last year, which was revised downward from 0.6 percent.

We are also aware that the current national unemployment stands at 26.7 percent, implying that 5.7 million out of 36.4 million people of working age in the country are unemployed - this rate is particularly alarming among young people.

We are further aware that business confidence, according to Stellenbosch University's Bureau of Economic Research (BER) is at its gloomiest level in seven years. This is in line with The South African Chamber of Commerce and Industry (Sacci) business confidence index (BCI), which plunged to 79.3 in May, down from 82.5 in April this year.

In its latest report released last month, Statistics South Africa showed that inflation is also on the upward trend. It has since bridged the upper limit of 3 and 6 percent targeted by the South African Reserve Bank (SARB), mainly due to the weaker rand compared to other currencies, higher food prices and the prevailing severe droughts facing the country.

As reported by the SARB earlier this month, our national gross reserves, which include gold and foreign exchange plummeted to $46.1 billion in May this year. The report indicates that, this decline was to a large extent due to currency valuations and foreign exchange payments made on behalf of government. Honourable Speaker, it must be noted that foreign exchange reserves are an important indicator of a country's ability to repay foreign debt in the short term and are used for currency defence. The house must be reminded that reserves are also one of the factors used to determine a country's credit rating.

Ladies and gentlemen, despite all these challenges, we must however applaud the excellent collective effort by National Treasury working in tandem with the business working group and labour organisations. It is through this much desired collective commitment that has led to the avoidance of downgrades by S&P, Moody's and Fitch Global Ratings over the past four weeks. These efforts have clearly demonstrated that, in spite of the economic challenges the country is faced with, we, as government remain committed to the fiscal discipline. However, much more still needs to be done before the agencies next reviews later this year, particularly given the fact that all three agencies have expressed concern about SA's low growth rate and rising political risks.

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## Municipal Budget Performance 2015/16 Second Quarter Review

Honourable Speaker, it is within the highlighted context of economic conditions that, I table the consolidated budget performance review, which covers the financial performance of municipalities in KwaZulu-Natal (KZN) as at the end of the second quarter of the current financial year. I must also emphasize that I table this report as per section 71(7) of the Municipal Finance Management Act (MFMA), No 56 of 2003.

The report provides the in-year financial performance of municipalities against their budgeted revenue and expenditure. It also includes the capital and operating budget performances as well as the debtors, creditors, conditional grants and compliance with the DoRA and MFMA reporting requirements. The assessment of the expenditure performance of municipalities assists in serving as a control and management tool. It also serves as an early warning signal for the identification of financial problems.

**Provincial Total Municipalities' Operating Revenue**

As at the end of December 2015, municipalities in KZN generated *operating revenue* amounting to R28.1 billion or 54 percent of the total budgeted revenue of R52 billion. *Service charges – electricity revenue* at R8.7 billion or 31.1 percent, contributed the most to total *operating revenue* generated, followed by *transfers recognised – operational* at R7.6 billion or 26.9 percent and *property rates (*which includes *penalties and collection charges)* at R5 billion or 17.9 percent. Unsurprisingly, bulk of this revenue was generated by eThekwini Metro at R15.2 billion, followed by uMgungundlovu and uThungulu Districts at R2.9 billion and R2.1 billion respectively.

As expected, compared to urban areas, actual revenue generated by rural municipalities such as Umkhanyakude, Harry Gwala and Zululand Districts is largely funded by grants at 85.2 percent, 67 percent and 65.3 percent respectively. Honourable Speaker, it is common knowledge that in rural municipalities, collection of revenue faces the triple challenge of unemployment, property valuation difficulties and tax administration capacities. As Provincial Treasury, we also share the view expressed by the FFC in its Division of Revenue submission for 2017/18, that in order to achieve "financial viability" in municipalities, concerted efforts must be made to increase or develop tax bases through local economic development.

**Provincial Total Municipalities' Operating Expenditure**

The analysis of expenditure shows that the overall spending by municipalities in KZN was R24 billion or 45.8 percent of the total approved budget of R52.5 billion. This percentage is moderately lower compared to 47.1 percent achieved in the second quarter of the previous financial year.

Honorable members, it is tormenting that 40 out of the 61 municipalities in the province have not reported on debt impairment. Furthermore, no municipality within the Ugu District reported any expenditure against debt impairment whilst a debtors balance of R553.7 million was reported as at the end of the second quarter of 2015/16 financial year. In addition to the above, it was noted that numerous municipalities within the Ugu District did not reflect expenditure against depreciation and asset impairment.

**Capital revenue and expenditure**

Capital sources of finance and expenditure recognised by municipalities in KZN amounted to R5 billion or 35.5 percent as at the end of December 2015. This is much lower compared to 42.9 percent recognised over the same quarter in the 2014/15 financial year.

***Capital Revenue***

As a trend nationally and across provinces, the district overview reflects that the municipalities in KZN are to a large extent dependent on grants to fund their capital expenditure. It is therefore not surprising that *transfers recognised – capital* constitutes 74.1 percent or R3.7 billion of the R5 billion spent as at the end of the second quarter. This is followed by *internally generated* funds at 22.7 percent or R1.1 billion. *Borrowing* and *public contributions & donations* make up a marginal contribution of 2.4 percent and 0.7 percent respectively.

Four districts utilised *borrowings* as a source of capital funding to the value of R121.4 million in total. The largest amount of R59.2 million or 48.8 percent of the total borrowed funds was utilised by Amajuba District Municipality, followed by the uThungulu, iLembe and uMgungundlovu district municipalities with R38.1 million, R14.1 million and R10 million respectively.

Only four districts received *public contributions and donations* to fund their capital expenditure and this amounted to R35.6 million. The ILembe district received a significant R29 million (82.7 percent) of those *public contributions and donation*s. The remaining three districts which received *public contributions and donations* were uThungulu (R6.1million), Harry Gwala (R51 000), and Zululand (R23 000).

***Capital Expenditure***

As at the end of the second quarter of the 2015/16 financial year, municipalities in the province spent R5 billion or 35.5 percent of their *capital budgets*, which is significantly below the 50 percent straight line projection expected at mid-year. The district with the largest percentage of capital expenditure against its budget was Zululand with 54.5 percent. This high expenditure in the Zululand district was mainly attributed to Abaqulusi Municipality, which reported incorrect capital expenditure of 133.5 percent or R86.9 million of the capital budget of R65.1 million. All other districts did not perform well, as they achieved capital expenditure rates of less than 50 percent.

**Debtor Age Analysis - Provincial Total**

Fellow members of the house, debtor age analysis is one of the useful tools in managing outstanding amounts owed by customers. The total amount of debt owed to all municipalities in KZN was R14.2 billion as at 31 December 2015, with an amount of R11.2 billion or 79.3 percent of debtors in the *over 90 days category.* The *debtors age analysis* by customer group, indicates that a considerable portion of debt is owed by *households* at 56 percent or R7.9 billion, followed by *commercial* at 28.4 percent or R4 billion. Disturbingly, a sizable amount of R1.3 billion or 9.2 percent of total debts is owed by various national and provincial departments of government.

Subsequent to these high debts, R16.4 million has been written off as bad debts as at 31 December 2015. Majority of the debt written off is for *households* at 50.6 percent or R8.3 million followed by *commercial* at 43.2 percent or R7.1 million and *organs of state* at 3.9 percent or R645 000.

Honourable Speaker, it should be noted that the Vulamehlo, Ezinqoleni, uMshwathi, and Abaqulusi Municipalities did not report any debtors for the period under review. As a result, the debtors figure may be understated.

I must therefore emphasize that, debt collection efforts must be concentrated on the long outstanding debts. However, some of these long outstanding debtors may need to be written off as they arose as a result of incorrect billing of indigents amongst others. Nonetheless, it has come to my attention that, there are a number of municipalities who are currently performing data cleansing exercises with the aim of ensuring that reported debtors are reflected accurately.

**Creditors Age Analysis – Provincial Total**

The total credit accumulated by municipalities in KZN amounted to R3.5 billion as at 31 December 2015, with creditors due within *0-30 days* category being R2.1 billion or 61.2 percent. The bulk of the outstanding creditors relate mainly to *loan repayments* of R1 billion or 29 percent, followed by *bulk electricity* of R979.8 million or 27.9 percent and *trade creditors* of R617.3 million or 17.6 percent. Creditors not paid within 30 days accounted for R1.4 billion or 38.8 percent of total creditors.

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Of the *bulk electricity* outstanding balance, R46.7 million is in the *over 90 days* category. This is mainly due to the fact that Ulundi Municipality owed Eskom R41.4 million (over 90 days) for unpaid electricity. A task team, of which the Provincial Treasury is a part of, has been set up to support the municipality. A repayment plan was entered into whereby Eskom will no longer be charging interest as per the agreement between them and Ulundi Municipality.

Provincial Treasury has closely monitored payments to Eskom on a monthly basis to ensure that the municipality adheres to its repayment plan. The municipality defaulted on the repayment plan in June 2015, July 2015 and September 2015 which has resulted in the revision of the payment plan in February 2016.

In most cases unpaid invoices and creditors over the *30 days* category are due to disputes with suppliers, however in other cases, it could be an indication of cash flow challenges being faced by municipalities. Non-payment of creditors within *30 days* is of serious concern to us as KZN Provincial Treasury. This is mainly to the fact that, municipalities could be liable for penalties and interest incurred as a result thereof, which results in fruitless and wasteful expenditure.

**National Conditional Grants**

In terms of the Division of Revenue Act (DoRA) of 2015 including any adjustments, direct allocations to all 61 municipalities in KZN amounted to R8.8 billion, while allocations in-kind amounted to R878.7 million, totalling R9.7 billion overall. Of the direct allocations of R8.8 billion, R4.7 billion or 53.1 percent had been transferred to municipalities as at the end of quarter two. Municipalities have reflected spending of R3.1 billion or 65.5 percent against the total transferred.

Disturbingly, of the eighteen direct allocations to municipalities, only six conditional grants reflected expenditure of 50 percent or more against the total available DoRA allocations for 2015/16. This is indeed a concern as it is crucial that, municipalities appropriately utilise capital conditional grants, particularly, given the fact that, under spending is inherently detrimental to infrastructure development.

**Non-compliance with the DoRA and MFMA Reporting Requirements**

The non-compliance with the DoRA and MFMA reporting requirements is reported bi-annually, via a Provincial Treasury Circular from my office to Mayors of all delegated KZN municipalities. The issuing of the non-compliance circular bi-annually is over and above the weekly schedules which are sent to municipalities regarding their outstanding MFMA reports and returns.

Despite these efforts, a number of municipalities did not fully comply with all reporting requirements according to the National Treasury report reflecting the outstanding MFMA returns and reports as at the first of February 2016.

By the same date, 15 municipalities did not submit all monthly reports, while 5 municipalities did not report on certain conditional grant expenditure, 49 municipalities did not submit their annual returns and 25 municipalities did not submit their quarterly returns. Further to this, 38 municipalities did not submit the relevant return pertaining to the minimum competency levels for the first half of 2015/16 financial year, which was due on 30 January 2016. I also note with grave concern that 26 municipalities had not submitted their MFMA Implementation Plans, which were required by the end of January this year.

I finally commend the hard work by committed municipal and community leaders, Provincial Treasury, sister departments, civic organisations and other stakeholders. It is through such collaboration and hard work that the Auditor-General has reported that a total of 18 KZN municipalities have received unqualified audit opinions with no other matters for the 2014/2015 financial year. This is indeed a significant improvement compared to the total of 13 municipalities that received unqualified audit opinions with no other matters in the preceding financial year.

I thank you.