treasury

Department:
Treasury
PROVINCE OF KWAZULU-NATAL

SALGA KZN MUNICIPAL FINANCE & GOVERNANCE CONFERENCE

"Fit for the Future – Local Government mSCOA Reform"

Delivered by

Ms BF Scott

MEC for Finance

03 March 2016

SPENDING YOUR MONEY WISELY

UKUSETSHENZISWA KWEMALI YAKHO NGOBUHLAKANI

INTRODUCTION

Programme Director; Councillor Ndobe, Mayor of Harry Gwala District Municipality
Mayors and Councillors present today
Chairperson of SALGA Municipal Finance Working Group, Councillor Bhamjee
Chairperson of SALGA KZN, Councillor Mdabe
Provincial Executive Officer IEC KZN, Mr Mosery
President of the Institute of Municipal Finance Officers, Ms Masite
Officials from Government (both National & Provincial)
Officials from municipalities
Representatives from public entities (National, Provincial & Local government)
Officials from SALGA
Representatives from the business sector
Distinguished guests
Ladies and gentlemen

It is a great honour and privilege to address this important conference on Municipal Finance and Governance organised by SALGA. Programme Director, let me first take this opportunity and thank our host, SALGA for not only organising, but also ensuring that the theme of the conference remains relevant to one our PGDP's interventions of strengthening the capacity of municipalities through efficient financial management, accountability, transparency and value-for-money activities. Ladies and gentlemen, it must be acknowledged that evidence across the globe has shown that improved financial systems have a directimpact on greater service delivery and development.

As Provincial Treasury, we unequivocally commend SALGA's role in representing, promoting and protecting the interests of municipalities. Government from both national and provincial levels cannot transform municipalities to enable them to fulfill their developmental role without the active involvement of other stakeholders such as SALGA. The advice and support provided by SALGA to the well deserving municipalities in terms of policy analysis, research and monitoring, knowledge exchange and support will never go unnoticed.

As it was clearly outlined by the National Minister of Finance, Honourable Pravin Gordhan, when tabling the national budget last week, our country has beenfaced with serious economic challenges since the2008global financial crisis. The national economic outlook remains subdued and is expected to grow by less than 1 per cent this year.

The rating agencies, such as Moody's, S&P, Fitch and R&I, have also revised South Africa's outlook from stable to negative, thereby raising concerns such as the pressure from weaker demand, electricity rate hikes, an increase in food prices caused by severe drought and effects from the weaker rand. This rating implies that economic growth in the country might be lower than anticipated.

The sluggish economic performance is clearly not boding well with the unemployment rate which is currently estimated at 25.4 per cent. This situation is further compounded by the worst drought experienced in the country over the past two decades, which is driving food prices higher and is likely to push the agricultural sector into recession.

Similar to the national performance, the provincial economic outlook is projected to slow down to 0.6 per cent this year, compared to the average1.1 per cent estimated in 2015. This signals a steeper path ahead in terms of addressing the needs of the people of KwaZulu-Natal.

CHALLENGES FACED BY MUNIPALITIES

Housing

In addition to the economic challenges the country is faced with, municipalities, the sphere of government closest to the people; have unique social and economic challenges which require unique solutions. These include,but are not limited to, theescalating demand for serviced shelter. This is due to rapid urbanisation and results in growing infrastructure backlogs, as well as agreater number ofmarginal and un-serviced settlements areas. This places tremendous strain on municipal finances.

As the demand for services grows, so too does the number of urban poor unable to contribute to municipal coffers. At the same time, the municipal rates base has remained constant, as the economy continues to shed jobs.

The housing demand remains a moving target, given the impact of migration patterns, household growth and other shifting demographics. The concentration of poverty in large urban areas is growing, although rural areas are relatively more deprived.

Property values make housing unaffordable to many South Africans; exacerbating the situation is the lack of sufficient social and rental housing for the lower-end of the market. The PGDP estimates the housing backlog to be in excess of 7000 units.

The ultimate goal of sustainable human settlement design and construction is a decent standard of living, which includes access to transport, safety and security, adequate health care, nutrition, housing, water, electricity and sanitation services, among others. Achieving this requires finding the right mechanisms and levers to bring out fundamental spatial transformation.

Ladies and gentlemen, we need to move away from the current housing model in order to respond to a number of challenges, such as informal settlements upgrading, inner city regeneration and renewal, multi-segmented rental housing (including backyard rentals), devolution of the housing function, access to basic infrastructure and services in new developments.

Inner cities play an important role as '*arrival areas'*, as well as offering the potential for access to employment and informal economies, reduced transport costs, even walking to economic opportunities and thereby reducing household expenses. It is within this realisation that the renewal and redevelopment of inner cities has been prioritised, with the focus on *providing affordable housing, improving public sector investments and management, and urban management* to make the area safer. Inner city regeneration is therefore one of the priorities in bigger cities. However,thisrequires partnerships between government, private sector and housing finance institutions.

Informal areas are important areas of access to the city, especially for the very poor, including migrants from rural areas. Informal areas are generally located in areas where they promote access to services, although in some cases they are found in environmentally unsuitableareas. It is therefore by no default that the National Upgrade Support Programme(NUSP)has been accelerated, and provinces and municipalities in particular are playing a central role to ensure that the targets are met.

Intensification of a far greater intergovernmental collaboration is needed for integrated planning, spatial frameworks, and access and availability of well-located land. This is especially important when planning for the provision of social infrastructure, such as schools, health facilities, libraries; etc. and economic infrastructure. In responding to this challenge; government is now ensuring that future development is aligned with plans such as the Strategic Infrastructure Programmes (SIPs), and coordinating planning with other sectors and stakeholders is essential.

Unfortunately, we, as government cannot alone meet the demand for well-located housing. We need to work in partnership with the private sector and other key stakeholders. Inclusionary housing can result in greater integration and can enable lower income groups to access housing and employment in higher income areas.

Infrastructure

As indicated by the Presidential Infrastructure Coordination Committee (PICC), integrated urban infrastructureis a necessity for both universal access and more inclusive economic growth. Infrastructure is also an essential bridge between rural and urban areas, and between the agricultural sector and other sectors of the economy.

To drive South Africa’s infrastructure programme, the Presidential Infrastructure Coordination Committee (PICC) was set up to co-ordinate the country's infrastructure build and upgrade programme across all spheres of government and priority sectors of the economy, as well as contribute to social development and overcome basic services backlogs.

It therefore becomes essential for municipalities to intensify their efforts in formulating integrated development plans and spatial development frameworks, which should ideally include comprehensive, integrated infrastructure plans. However, this becomes extremely complex because of different sector-specific national regulatory and policy frameworks and shared responsibility for regulation and funding between different spheres of government.

Funding is considered inadequate for municipalities to be able to deal with their infrastructure and service delivery challenges such, as backlogs as well as infrastructure for growth. However, some municipalities still struggle to spend their infrastructure budgets. As at the end of the second quarter of the 2015/16 financial year, according to Section 71 reports, municipalities in the province spent R5 billion or 35.5 percent of their capital budget.During the 2014/15 Rollover process; National Treasury identified R 1775 million in terms of conditional grants that were not spent as at 30 June 2015. Of concern is the fact that the largest amounts offset are in respect of the basic infrastructure grants, namely PTIS (R480.1 million), NDPG (R64.7 million), MIG (R54.7 million) and INEP (R40.6 million).This has a negative impact on service delivery and development in the Province.

Historically, a total amount of over R1.7 billion of unspent conditional grants was returned to the National Revenue Fund (NRF) for the period 2010/11 to 2014/15. These are funds that could have been used by our municipalities to develop infrastructure and provide essential services but has now left our Province due to poor management of grants by municipalities.

Nonetheless, investment in infrastructure is critical if we are to address the backlog of basic services, particularly in townships and informal settlements, as well as for the economy. Forging a new economic path, towards an inclusive and dynamic economy, implies urgent investments in rail, water and energy infrastructure, alongside regulatory reforms that provide policy certainty. The supply of energy and water needs to be reliable and sufficient for a growing economy, and the responsibilities of municipal maintenance of distribution systems need to be appropriately allocated and funded.

It is through this realisation that a review of financing mechanisms to enable investments in infrastructure that supports economic growth is getting maximum government attention. The current fiscal policy, as outlined by the National Minister of Finance last week, ensures a substantial expenditure on rehabilitating and maintaining infrastructure. This is clearly demonstrate by the R870 billion budgeted expenditure on the public sector infrastructureprogramme over the 2016/17 Medium term Expenditure Framework.

Significant progress has been made in delivering basic infrastructurein rural municipalities. However, there is still much to be done. Extending and sustaining access to basic services in rural areas requires clear direction. Firstly, a new consensus needs to be forged with rural communities on the necessity to use appropriate and affordable technologies. In many rural areas, networked services such as water-borne sewerage andpiped water are simply too expensive to install, and unaffordable to operate. This needs to be recognised, and alternative technologiesneed to be used to optimise access given the existing affordability levels,and the availability of resources.

Secondly, greater innovation is required in the development and deployment of technologies that are appropriate to rural areas. These include water harvesting, ground water supply through bore holes for water; on-site sanitation options, and non-grid energy options. If properly managed, these are not only environmentally friendly service options, but could provide a more efficient and affordable way of supplying rural services. Finally, technical skills supporting infrastructure delivery are a scarce resource in the country, and even more so in rural areas where attracting these skills remains a challenge.

mSCOA REGULATION AS ONE OF THE MULTITUDE SOLUTIONS

The economicchallenges faced by the country have resulted in National and Provincial Government intensifying various cost containment measures, including the review of our current local government reporting to ensure that we are able to do more with less.

The total number of municipalities in the country is currently 278, each with a different municipal chart of accounts. A municipality may budget and categorise expenditure on catering for an *Aids awareness workshop as "catering",* whilst another municipality may refer to such expenditure as *"special programmes".*

As most of you are aware, municipalities are required in terms of *Section 71 and 72* of *the Municipal Finance Management Act, No. 56 of 2003*, to report on the budget and financial performance of the municipality to National Treasury, who are then responsible for tabling such financial information to

Parliament and the Legislature.The aggregation of the budget and financial information therefore becomes very difficult and distorted due to inconsistent interpretation and application of account descriptions within the municipal sphere.

Such distorted and inconsistent information compromises government's ability to formulate coherent policies affecting local government, and its ability to use the budget as a redistribution tool to address poverty and inequality. This has a direct negative impact on our ability as a country to compete for global funding on an international platform, as we are unable to accurately measure our spending on service delivery programmes.

Programme Director, this further impedes the oversight role that councillors are required to play, as incorrect or unclear categorization of recorded transactions lowers the quality of the financial information presented for decision making.

As Provincial Treasury, our oversight function affords us with the opportunity of reviewing the municipalities IDP, Budget, SDBIP, in-year monitoring reports and Annual Financial Statements. Disturbingly, it is often identifed that what was planned at the beginning of the year was not necessarily implemented during the year and reported on in the Annual Financial Statements at year- end.

The inaccuracies in the financial information further contributes to weak audit opinions and, as government, we are often required to invest in resources at year end to assist in correcting the financial information to present to the Auditor- General.

OBJECTIVE OF MUNICPAL STANDARDS CHART OF ACCOUNTS (mSCOA) Regulation

Ladies and gentlemen, the reporting challenges and concerns I have alluded to, have resulted in National Treasury promulgating the *Municipal Standards Chart of Accounts (mSCOA) Regulation on 22 April 2014,*with effect from 1 July 2017, which applies to all municipalities and municipal entities. Municipalities and their respective entities will be required to transact in compliance with the requirements of the Regulation with effect from 1 July 2017.

The primary aim of mSCOA is therefore to provide a national standard for the uniform recording and classification of municipal budgets and financial information. This means that all municipalities will record financial transactions in the same way, with the same account decriptions. The mSCOA will assist in organising the transactions into specific standard classifications. In order words, it requires each transaction to be recorded at its lowest possible level.

One of the key benefits of implementing mSCOA is to link the IDP to the Budget and the SDBIP, in -year reporting, Annual Financial Statements and the annual report. This will therefore ensure that the service delivery priorities as set out in the National Development Plan, PGDP and, in turn, IDPs, can be measured throughout the reporting cycle as required by the MFMA.

Most importantly, mSCOA forces proper planning and budgeting, as well as the recording of transactions accurately and timeously in terms of day to day operations. This in turn promotes more time for managing and less time needed to compile reports, as the accurate data will be readily available.

The system further promotes zero based budgeting, which means that all projects and related expenditure will have to be justified in order to be included in the budget. Revenue collections will further have to be realistically determined, as opposed to basing such projections on historic data. This system therefore helps to ensurethat payment processes are linked to quality control measures that are in place.

It therefore goes without saying that mSCOA enhances sound financial information, comparability and benchmarking between similar municipalities in Districts, Provinces and Nationally. This should impact positively on audit outcomes and reduce the time needed and, hopefully, Auditor -General fees, during the audit process.

Ladies and gentlemen, as Provincial Treasury, we are of the firm view that the successful implementation of mSCOA Regulation will also assist in improving the number of municipalities achieving Clean Audits from 18 in the 2014/2015 financial year to a much higher level. The on-going good working relations and hard work between SALGA, Department of Co-operative Governance and

KZN municipalities is therefore expected to pay off and translate into significant improvements in audit outcomes and in theperformance of our municipalities.

Another disturbing factor about financial management is the harsh reality that a total of 3 municipalities in KZN were categorised as those in red zones in the audit outcomes for the 2014/15 financial year. It is, however, encouraging to notice that this number has dropped substantially from 79 in the 2012/13 audit outcomes.This is an indication that the *Municipal Audit Support Programme* (*MASP*) undertaken by SALGA in collaboration with Treasuries and CoGTA is a step in a right direction.

An added benefit expected from the full implementation of mSCOA is the seamless link in legislative reporting requirements across accountability cycles compiled from the same financial information, which will therefore reduce the number of reports required, and time needed to generate such reports, as required by Provincial and National Government.

However, as political leaders, service delivery is our primary responsibility, and it must be acknowledged that municipal information is not just about the numbers, but rather the people that we serve. Accurate municipal information will enable us to measure the impact on service delivery therefore strengthening councillors' decision- making and governance responsibilities across all municipalities.

More particularly, ward councillors will be in a position to measure service delivery impact based on a geographical region. Improved planning during the budget process will enable us to accelerate procurement processes, as officials willknow exactly what is required to implement projects at the budgeting stage, prior to the commencement of the financial year, therefore making a much needed impact on the lives of our people.

In addition, efficient implementation of mSCOA is expected to have a significant reduction in fraud and corruption, particularly as municipal accounts will become more transparent and understandable to the community. Local government will be in a better position to hold officials accountable, as sound financial information will provide the tools to measure performance of officials.

Municipalities will further be in a position to accurately measure the cost spent on core versus non-core functions, and take the required actions to ensure that core functions are given the required priority. Tariff modeling and policy setting will become much easier, as it will be possible to compare the cost of providing a service against the revenue that is being collected.

THE mSCOA JOURNEY

Programme director, it has come to my attention that there are concerns in KZN regarding the implementation of mSCOA, specifically with regard to the consultation process undertaken that led to the promulgation of the Regulation. It must be noted that the consultation process commenced in 2010, with engagements with municipalities, vendors and other key governmental stakeholders, during the development of the Regulation.

The draft mSCOA Regulation was published for public comments by the National Minister of Finance, on 3 September 2013. Subsequent to this, a formal consultation and awareness campaign was hosted by National Treasury across the country. This included workshops with all municipalities, vendors, various government stakeholders, including the Provincial Treasuries.

Comments received during these consultations have refined mSCOA to the current standard. It can therefore be said that all municipalities have been made aware of the Regulation since the commencement of the consultation process in 2010, and therefore should have paid the required attention to be able to actively participate in this process.

CURRENT STATUS QUO - mSCOA REQUIREMENTS

National Treasury has identified pilot municipalities across the country, which are representive of the nine financial system vendors that are currently operating in local government. These vendors are currently modifying their current systems to accommodate mSCOA requirements and are in a testing phase to ensure that their modifications comply with such requirements and reporting envisaged. At this stage, no pilot municipality, and in turn no system vendor, has complied fully with mSCOA requirements.

National Treasury has issued MFMA Circular No. 57, Municipal Financial Systems and Business Processes, which advises municipalities and their respective entities to follow the process of changing their financial systems as indicated in the Circular, should they require to do so. This process includes undertaking a feasibility study and current assessment of the system which needs to be communicated to National Treasury for approval to change systems. The intention of this Circular is to prevent municipalities from changing to a system that may not meet the mSCOA requirements on 1 July 2017, and therefore preventing possible fruitless and wasteful expenditure from incurring.

The results of the pilot municipalities are currently under consideration by National Treasury and it is anticipated that further guidance will be issued to municipalities before the end of this month. The results will clearly dictate the system requirements and processes that municipalities need to follow in evaluating the current ability of the accounting systems of vendors in terms of mSCOA requirements.

I understand that there area number of municipalities who are of the view that they are unable to proceed with the implementation until National Treasury provides guidance on the evaluation of the service providers. I strongly disagree with this view, as there are many planning activities that still need to be undertaken by the municipality that should be done before the service provider is commissioned.

In order to be ready for effective implementation from 1 July 2017, we need to understand that this reform does not only affect information technology by either upgrading or changing accounting systems, it impacts on the internal business operations of the municipality and, possibly, the organizational structure.

Hence, municipalities and municipal entities should have already commenced preparing for business process change, by understanding the requirements of mSCOA, comparing the current chart against the mSCOA chart and, more importantly, documenting and planning for how mSCOA will change the current day to day operations of a municipality.

PLANNING PROCESSES FOR mSCOA

As I mentioned earlier, National and Provincial Treasuries have extensively consulted all municipalities with regard to the mSCOA reform. In addition, both National and Provincial Treasuries have clearly outlined the planning processes that municipalities should have commenced via Circulars and the mSCOA Provincial Forum. Municipalities and their respective entities should have achieved a number of planning processes as outlined in the packs that have been shared with you. The following are just a few out of a list of possible 13:

- Tabled the Municipal Regulations on Standard Chart of Accounts (mSCOA) to Council to provide for broader awareness, and more specifically, explained the impact of the Regulation on the municipality;
- Studied the Regulation, mSCOA project documents, associated segments and requirements on National Treasury's and Provincial Treasury websites in order to obtain clear understanding of what is required;
- Appointed a senior official from within the municipality as a project manager, in writing, to manage the implementation of this reform;
- Established an mSCOA project committee comprising representatives from all departments within the municipality to enable internal awareness and information sharing, including ensuring that all key stakeholders understand the requirements;
- Attended the National Treasury three day mSCOA training rolled out in the Province.

Fellow Councillors, I have noted with concern that the majority of the municipalities in our Province have not adequately achieved these planning processes, and I challenge you here today, to request your officials to account to you, at your next Council engagement, on the progress made in this regard.

I cannot stress enough how important it is for all municipalities and their respective entities to address these planning processes urgently, in order to comply with the legislated deadline of 1 July 2017.

Provincial Treasury is also aware that certain municipalities have not taken this Regulation seriously, and they are considering outsourcing the entire implementation to service providers, as they feel it is too much of work to undertake internally. Whilst I understand and appreciate the capacity constraints in local government, the planning processes that I have discussed earlier must be undertaken by municipal officials in order to ensure that they understand what is required, and that officials lead the process rather than being led by service providers.

FUNDING REQUIREMENTS

I have alluded earlier to the economic crisis facing the country, and this is clearly understood and felt by National and Provincial Treasuries. The national fiscus has significantly reduced and all programmes within the Treasuries have absorbed significant budget cuts, which has had a direct impact on the funding that is available for support.

National Treasury has revised the conditions of Local Government Municipal Systems Grant and Local Government Municipal Finance Management Grant to accommodate mSCOA requirements. The Municipal Demarcation Grant for municipalities affected by the Demarcation Act further includes funding for mSCOA related expenditure.

However, municipalities are required to consider their funding requirements for mSCOA implementation and appropriately allocate funds to meet these requirements during 2016/17 and the 2017/18 Medium Term Revenue and Expenditure Framework (MTREF) budget process.

PROVINCIAL TREASURY SUPPORT MECHANISMS

As Provincial Treasury, we have established an operational task team, consisting of officials from the various support units within the Provincial Treasury, being Municipal Finance, Financial Reporting and Internal Audit and Risk Management. We have engaged with municipalities and municipal entities via various platforms which includes mSCOA road shows, Provincial mSCOA forums, CFO Forums, Bi-lateral budget engagements, MUNIMEC meetings and, more recently, the MANCO meetings in which we have been invited to present.

We have facilitated mSCOA training to 251 municipal officials in the Province.I am pleased to note, the training was attended by all municipalities in the Province.

An mSCOA link has been created on our website which provides templates for project plans and risk registers, terms of reference for committees, provincial circulars, mSCOA checklist and tables for review and all presentations undertaken at the forums by National Treasury, Provincial Treasury and pilot municipalities. A dedicated email address has further been created to address queries and support needs which is mscoa@kzntreasury.gov.za

As Provincial Treasury, we intend to continue our support via the various platforms previously mentioned and, more specifically,we aim to:

- Review project plans, risk registers and mSCOA chart comparisons as submitted to Provincial Treasury;
- Support municipalities in assessment of hardware connectivity and capacity, with the assistance of the ICT support team at KZN COGTA;
- Conduct an information session similar to this one, after the local government elections for all new Councillors to ensure that they are abreast of this reform;
- Provide support to municipalities in the assessment of service providers prior to appointment and the review of Memorandum of Agreements prior to municipalities appointing service providers;
- Monitor the municipalities migration process to mSCOA, review data migration plans, including municipalities that are in the process of being merged;
- Assist in preparing mSCOA compliant MTREF budgets; and
- Providesupport in training and understanding of mSCOA requirements.

Ladies and gentlemen, Provincial Treasury is committed to provide assistance and support to municipalities and their respective entities in the implementation of this reform, but the success of our support hinges on the commitment by the leadership and staff of our municipalities in embracing this very exciting change and implementing the guidance and processes recommended by Provincial Treasury.

WAY FORWARD AND CONCLUSION

As I stand here today, we are 16 months away from the implementation date of this regulation. In order to transact in accordance with mSCOA requirements on 1 July 2017, municipalities and their entities need to adopt a mSCOA compliant budget prior to the commencement of the 2017/18 financial year. We therefore have effectively 12 months before we are required to table mSCOA compliant draft budgets in Council.

Fellow councillors, it is time for us as political leaders at both provincial and in local government levels, to intensify our efforts in ensuring that our municipalities and entities implement mSCOA successfully. The planning processes that I have discussed earlier are on screen for your reference. They have also been included in your presentation packs.

Mayors and Municipal Managers, I therefore request that a report is tabled at the March 2016 Council meeting clearly indicating the progress made with regard to the planning processes that have been undertaken to date, together with an action plan to address outstanding matters. This report, together with the Council minutes;must be submitted to Provincial Treasury for consideration on further support initiatives that could be implemented to assist you.

We know that this can be done. Both National and Provincial Departments have successfully implemented the very same reform in 2004. As said by our great leader, Tata Madiba, "*it always seems impossible until it is done".*

Ladies and gentlemen, as Provincial Treasury, we are positive that your deliberations today and tomorrow will result in tangible strategic resolutions that will be key in increasing the number of municipalities obtaining clean audit outcomes. We are optimistic that the on-going good working relations and hard work between the SALGA, Departments and KZN municipalities will continue to improve and translate into significant improvements in performance of our municipalities.

We are finally determined that delegates will carefully consider all possible factors that need to be considered for budgeting during an election year, as well as some of the special measures for municipalities impacted by major re-demarcations.

I thank you.