

**ADDRESSING THE FINANCIAL CHALLENGES IN MUNICIPALITIES IN
THE CONTEXT OF A REVIEW OF THE LOCAL GOVERNMENT MODEL**

**INSTITUTE OF MUNICIPAL FINANCE OFFICERS ANNUAL
CONFERENCE**

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Traditional Affairs**

Allow me, in the first place, to say how pleased and honoured I am to be here. I convey too the heartfelt good wishes of Minister Sicelo Shiceka, who, as much as he was keen to attend, simply could not be here today. He spoke last Tuesday at the Association of Public Accounts Committees Conference in Cape Town, and I would commend his speech to you, as it is of immediate relevance to the work you do.

On behalf of both of us, I extend our sincerest congratulations to you on your 80th Anniversary. I am struck by the value of your theme for this Conference "Making the Elephant Dance". And I agree with your President, Mr George van Schalkwyk, when he says in the Foreword to the Conference programme, "So making the elephant dance is not easy. We will have to do things differently as the current strategies, management practices, environmental governance and work ethic are just not sustainable. We will need to innovate and learn the new tune, the beat and the appropriate steps to better utilize the available resources." And I agree too when he says "what really matters is not what IMFO members put into the profession or what they get out of serving the profession, the real test is what they leave behind when they move on." And it is around these themes of "Making the Elephant Dance", and on innovation and leaving a legacy that this talk is pegged.

You are indeed, as municipal finance officers, crucial to the success of local government. Much, much depends on you. How much, it sometimes seems, you are not aware of. But, believe me, you are absolutely crucial. And so it is too that we welcome the Memorandum of Understanding you signed with SALGA last year – and we hope it will be effectively implemented.

It is clear, certainly, that unless we improve financial management and fiscal governance in municipalities we will not be able to significantly improve service delivery and development. There is a very close relationship between improved financial management and fiscal governance, and effective service delivery and development. Indeed, it may well be too that if we improve service delivery and development, we will, also, in turn, improve financial management of municipalities.

It is clear that the “service delivery protests” that have been breaking out all over the country this year are not just about municipal service delivery. They are about a range of issues affecting all three spheres of government and are better termed “community protests”. But, interestingly, in many cases residents protested about issues relating to financial mismanagement, fraud and corruption at municipal level. In some cases they seemed to have separated these issues from service delivery – but in others they clearly identified these issues as being responsible for the poor service delivery in their areas. Whatever the case, it is clear that financial management and service delivery are closely related.

There is a general perception that there are high levels of fraud and corruption in municipalities. It’s not as if, of course, that provincial and national government do not have these challenges either. But it’s the fraud and corruption at local government level that is most in the public eye. Partly the financial mismanagement in municipalities is due to a variety of technical failures, including lack of skills, resources and knowledge of the legislation. But partly the financial mismanagement is a reflection of corruption. The better municipalities manage their finances and fiscal governance, the more fraud and corruption will be reduced, and the less the fraud and corruption, the better will municipalities manage their finances and fiscal governance.

A Review of the Cooperative Governance Model

As you know, our Department is facilitating a major review of the cooperative governance system. The respective powers and functions of national, provincial and local government are being reviewed. The review is dictated by practical, not ideological, imperatives. We are 15 years on now. What has been our experience? How has our system of cooperative governance been working? What aspects of the system work and what do not?

Remember that we shaped our current system in a particular context of a negotiated settlement. But are we in the same context as in 1994–96? Are we under the same pressures? Do we need a more objective foundation for our governance system that is based more on our long-term needs and less on the need to strike immediate political compromises? Which features of our cooperative governance system should endure and which are contingent, having been shaped largely to meet the needs of a different context? We need a debate about this! A huge public debate. The debate has barely begun. As key stakeholders, you need to actively participate in this debate.

A major imperative for the review of the cooperative governance system is our need to build a developmental state and ensure far more effective service delivery and development. It is unlikely that the cooperative governance system that is at the heart of our Constitution will be dismantled. It is likely though that the *form* of our cooperative governance system will change. The particular powers and functions allocated to the three spheres of government

may well change. At the very least, they will be fine-tuned and clarified. A much more integrated and effective inter-governmental system is likely to be developed that is more consistent with the needs of an activist developmental state committed to accelerating service delivery and development.

Local Government in Distress

It is certainly clear that the current model of local government is not working. We just can't afford to let local government continue the way it does. We need changes. Among the questions we need to ask are:

- Should the boundaries of municipalities without a minimum fiscal base be re-drawn?
- Is the two-tier system of District and Local municipalities working? Do we need to improve the system or abolish it?
- How do we ensure greater national and provincial government support for local government?
- Do we need to more clearly separate the legislative and executive functions of local government as we do in the case of provincial and national government?
- How can we ensure that IDPs are productively linked with provincial and national development plans?
- What would be an effective funding model for local government?
- What would a good financial management and fiscal governance model for municipalities?
- How can we improve public participation in local government, including through ward committees?
- How can we ensure effective capacity-building of municipal councillors and officials?

Of course, there are many other crucial questions too. And you must help to shape them. You will be particularly helpful in helping us to deal with the financial challenges. Perhaps you could also help us with a fundamental question: to what extent are the many current financial and financial management challenges in municipalities linked directly to the complex local government model we have? How by changing the model would we be better able to cope with the financial and financial management challenges being faced by municipalities? In other words, which of the financial and financial management challenges we currently experience at local government level can be addressed by changing the model and which challenges are more general and will persist whatever the model? And in respect of the latter, how do you think we could address these challenges effectively? We need new methods, surely, new ways of dealing with the challenges? As we have failed so far to effectively deal with these challenges.

It's not, of course, as if we can take major decisions on the local government or cooperative governance system overnight. There will be full and considered discussions with all the key stakeholders, and the public generally will be given full space to have their say. Some of the changes agreed to may be introduced before the 2011 local government election. But most of the changes will probably follow the 2011 elections.

Local government is, however, currently in severe distress. And we have to act more immediately to address the distress. So, the Department, together with other key stakeholders, including SALGA, is working on a local turnaround strategy. We have received "state of local government" reports from the provincial departments of local government and are putting together a national report as the basis for a turnaround strategy to be developed at a National Indaba on Local Government from 20 to 22 October which will be addressed by the President.

The turnaround strategy will be implemented in two phases. The first phase will be from January 2010 until the 2011 local government elections. The second phase will be implemented from the 2011 elections onwards. The strategy will evolve and be fine-tuned as the features of the new model of local government are shaped through the policy review process.

Some Financial Challenges

But whatever the model of local government decided on, there are some financial challenges that will have to be addressed – and addressed far more effectively than now. It is on these aspects that I will focus on today. And not on all of them – which you, in any case know more about than me – but on some of them. Aspects of how to address the challenges must, certainly, be inserted into the turnaround strategy.

Most of us know what the financial challenges are. What we don't know are the answers to them. The "state of local government" reports submitted by the provinces are still being processed. But, so far, what is emerging from them about the financial challenges is largely familiar. Based partly on these reports and what we all know generally the following, very briefly, are some of the financial challenges of municipalities that can be identified:

- There are municipalities that are simply not financially viable. They just do not have a fiscal base. Without grants from the national and provincial government they will wither away. In fact, according to our Department, 57 municipalities receive more than 75% of their revenue from national transfers. Also, according to our Department, a number of local municipalities have indicated that they are 100% grant dependent – these include, for example, Aganang and Molemole (in Limpopo), Ndwedwe and Maphumulo (in KZN), and Mamusa and Molopo (in N.West).

- To increase the efficiency of service delivery, the intergovernmental system is dependent on the proper co-ordination of policy, budgeting, planning, implementation and reporting between the spheres. Substantial increases have been made to the transfers - both operational and infrastructure - to local government over the last few years in acknowledgement of its increased service delivery responsibilities. Yet, many municipalities are not in a position to meet their developmental mandate due to an inadequate economic base or high levels of poverty and unemployment. An increasing reliance of municipalities on transfers - equitable share and others - from national government to fund their activities is evident - with government grants at 22.4 per cent of total operating revenue in 2007/08 as the second largest source of revenue for municipalities. "The Local Government Budgets and Expenditure Review: 2003/4 – 2009/10" indicates that at 42 per cent in 2006/07, service charges are the largest source of operating revenue for municipalities. The share of service charges in total operating revenue has however declined from 49 per cent in 2003/04 to 42.9 per cent in 2009/10, mainly due to the sharp increase in national transfers.
- There is an acute lack of financial management skills, even of the most basic kind. There is a scarcity of professionals with financial skills. But also: in far too many cases the people appointed to financial positions in municipalities do not have the necessary skills. Often they are political appointments – people appointed because of their political leverage, not their technical skills. Even where financially skilled people are appointed, they are not retained – there is too high a turnover of financial staff.
- There is a lack of internal controls and poor governance. Most of the audit committees in municipalities do not function effectively.
- There are ineffective business processes and systems.
- There are onerous, complex and costly financial reporting requirements, placing a major administrative burden on municipalities. According to the FFC (Financial and Fiscal Commission) submission for the Division of Revenue for 2009/10, 225 questionnaires from national organs of state were distributed to municipalities within one year. Many of them seek similar data. This is not to mention requests from provincial government departments. The analysis of this data is seldom shared with municipalities, says SALGA. Municipalities are also required to conform to GRAP accounting standards by 30 June 2010, irrespective of their fiscal and

financial capacity. At 30 June 2008, according to SALGA, at least one-third of the municipalities had still to convert to the new standards.

- According to the Auditor General's 2007-08 report, the audit outcomes of the municipalities were as follows:

○ Adverse opinion	3%
○ Disclaimer of opinion	30%
○ Qualified	20%
○ Unqualified – emphasis of matter items	32%
○ Unqualified – No findings	1%
○ Audits outstanding	13%

- Municipalities have poor debt collection records. Municipalities are owed over R53 billion. According to our Department, in June last year 85 municipalities had debtor levels higher than 50% of their own revenue. Of course, a significant part of this debt to municipalities is owed by government departments and the private sector. Service charges are the main source of revenue for municipalities, and so challenges experienced with enforcing debt collection and an increase in the age of debts (i.e. outstanding debts of more than 90 days) impact hugely on their financial viability. This is compounded by the high number of indigents and the culture of non-payment. 43 municipalities reported negative opening cash positions for the third quarter ending 31 March 2009. Of course, many municipalities report losses (both water and electricity) due to illegal connections.

- Many municipalities show a poor ability to accurately plan and spend their budgets. The NT reports, with the preliminary results of the financial year 2008/9, that 35 municipalities over-spent their budgets by R2.6 billion while 182 municipalities under-spent by R19.1 billion.

- The grants allocated from national government are not co-ordinated. Last year, according to SALGA, there were about 17 different grants administered and managed by different national sector departments.

- In several cases, Municipal Infrastructure Grants and other conditional grants are spent on operational activities.

- There are uncertainties about the financial implications of the restructuring of the electricity distribution industry.

- Assets are managed badly.

- There are high levels of fraud and corruption.
- Implementing the Property Rates Act has proved to be far more challenging than expected.
- The financial capacity-building programmes need to be co-ordinated and be significantly more effective.
- There is undue political interference by both political parties and councillors in the financial management of municipalities, with the lines of division between politicians and administrators being blurred.

Some Responses to the Financial Challenges

These are just some of the challenges. Of course, there are many more. But the point really is what to do about them? And we just cannot afford the luxury of inadequate responses any more. We simply have to get the right answers. Of course, some of the things we have to do will be the same as before – only we will have to do them far more effectively and maybe in new ways. But we also have to think of doing new things. We have to find new methods, new responses, that are far more effective. You are the experts. We want your help. We want you to be innovative and imaginative – and we want you to come up with effective responses to the many financial challenges municipalities confront. We want you to help us “make the elephant dance”.

As a Department we are, in cooperation with other stakeholders, obviously working on responses. I will deal with some of them here. And also raise other responses that we might want to consider too.

Clearly, there has to be better overall governance in municipalities to ensure better financial management. Changes to the current model of local government will have to provide for more effective governance of municipalities. Aspects of this would, for example, include greater clarity on the respective roles of politicians and administrators in the financial management of municipalities; a clearer separation of the legislative and executive functions of municipalities; and more effective oversight by councillors of executive structures.

A key consideration in the shaping of changes to the current model of local government and the entire cooperative governance system has to be the funding model of local government and the financial management challenges. We need to ensure that changes made provide that local government is able to get the funds necessary to implement its constitutional mandate and manage its finances more effectively. The financial management model needs to be simplified yet effective. Certain core requirements should apply to all

municipalities, but other requirements should differ according to the fiscal and financial capacity of municipalities. There is a need for a reasonable differentiated approach. In this regard, it will be very useful to hear from you what changes you think should be made to the Municipal Finance Management Act and other legislation affecting the financial management of municipalities. It will also be useful to hear what you think of a differentiated approach – and how this differentiation should be determined.

Some of us believe that the Municipal Demarcation Board needs to give serious attention to the re-drawing of the boundaries of municipalities that are not financially viable.

We need a new, massive financial training programme for councillors and officials to be developed through the concerted co-operation of all the stakeholders, including IMFO, SALGA, National Treasury, COGTA, DBSA, the private sector, tertiary education institutions

As you probably know, our Department, in co-operation with National Treasury, the Auditor General's Office, SALGA and DBSA has launched the *Operation Clean Audit Programme, 2014*. Our aim is to significantly improve financial management and fiscal governance in local and provincial government so that service delivery and development can be improved. I will focus mainly on the municipalities here. We want to see municipalities produce quality financial statements so that the AG can express accurate opinions on the financial state of municipalities. The campaign also seeks to encourage managers to have a holistic and integrated approach to fiscal management that is linked to constantly improving service delivery, rather than a narrow focus on financial statistics. Sometimes there is too narrow a focus in municipalities on aspects of financial management. There needs, in our view, to be more focus on asset management, procurement, value-for-money, cost-benefit analysis with regard to projects and on economy, efficiency and effectiveness. It doesn't help for managers to look at financial statements without looking at the overall constitutional mandate of municipalities to ensure service delivery and development.

Municipalities also have to have functioning and effective audit committees. Audit committees must scrutinize financial statements and risk management reports so that the ability of a municipality to deliver services to people is clearer.

Operation Clean Audit is also directed at ensuring that the key political leaders of municipalities are keenly aware of financial issues and take decisions with financial implications that are sustainable, and they should not be "short-termist" and populist. For Operation Clean Audit to work there has to be an effective relationship between the political leaders and administrators in municipalities.

As part of Operation Clean Audit we will be encouraging the provincial government departments to work closer with municipalities. We feel that it is important too that provincial departments and municipalities share information and learn from each other and emulate best practices.

Our aim is that by 2011 municipalities will not have adverse reports or disclaimers from the AG, and by 2014 municipalities will have unqualified audits with no matters of emphasis. We are under no illusions about how challenging these targets are. But we think if we all cooperate properly these targets are attainable. Certainly, we should try to achieve them. We believe that by doing some very simple things we can improve financial management in municipalities. For example, the filing systems in many municipalities can be improved fairly easily. There are some basic lessons that can be drawn on to improve financial reporting. Together with NT, DBSA and SALGA we are finalising a major capacity building programme to improve financial management at municipal level. We are very keen to hear from you on what you think of this capacity-building programme and how you can help. Our Department will soon contact you in this regard.

We are also to work closely with NT and DBSA to assist municipalities to find CFOs and other financially skilled people. Here again IMFO could help. Please do!

By clean audits, we do not just mean technically clean. We also mean clean of fraud and corruption. The more the audits are technically clean, the less the chance of fraud and corruption. And the less the fraud and corruption, the better the prospects of technically sound audits.

We launched Operation Clean Audit at a major meeting in Johannesburg in July. We have since launched Operation Clean Audit in four provinces and hope to have covered all the provinces by year end. Minister Shiceka led a debate in the National Assembly on Operation Clean Audit, and is to address several parliamentary committees on the programme tomorrow. We want parliament to monitor progress on Operation Clean Audit and hold us to account for it. So it's clear that we are serious about Operation Clean Audit – and we appeal to you for help!

As you know, the MFMA provides for financial oversight committees in municipalities. And there is also National Treasury Circular 32 on oversight. We feel that this oversight must also be undertaken by Municipal Public Accounts Committees (MPACs). However, it is only in Gauteng that municipalities have MPACs in all municipalities. But, in general, they do not seem to be particularly effective. National Treasury is meant to assist with the establishment of MPACs – but municipalities show little interest in them. Our Minister has now sent letters to all the MECs of Local Government to seek to ensure that MPACs are set up in all municipalities by 15 December. Obviously, this deadline will be difficult to meet – but we believe that reasonably soon MPACs must be set up. We are going to work with NT, APAC (Association of

Public Accounts Committees), SALGA and other stakeholders to do this. We are also working on a model for MPACs. Here too you could help.

These MPACs should learn from the experiences of Public Accounts Committees in the provincial legislatures and national parliament. They should examine:

- Financial statements of all the executive organs of a municipality.
- Audit reports on those statements.
- Audit reports on municipal entities
- The Council's Annual Reports
- Any other reports with a financial bearing

The MPACs should also initiate any investigation in areas that fall within their competence.

If Operation Clean Audit succeeds and effective MPACs are established, the prospects of fraud and corruption will be reduced.

Clearly, some of the failures in financial management at municipal level result from weaknesses in our co-operative system of government where unhelpful and wasteful "silo mentalities" still persist. For improvements in municipal financial management, both national and provincial government have to support local government more effectively. Both provincial and national government are going to more actively monitor how municipalities manage their finances. We are considering requiring municipalities to present monthly financial reports to the provincial and national departments. We are also thinking of requiring provinces to play a direct role in the management of the Municipal Infrastructure Grant

Our Department is acutely aware that there are far too many local government capacity-building programmes by too many different organisations with differing orientations. This is costly, wasteful, confusing, and unproductive. And it must come to an end. We need co-ordination among the capacity-building organisations and stakeholders and a clear, consensual and focused approach. Our Department is very keen on this and we are engaging with others to get agreement on this – but even more important, united action on this.

Of course, part of the support national and provincial government can offer to local government is simply pay the debt they owe municipalities. The Minister is committed to actively intervening through the cabinet and other structures to ensure that government departments pay the debt they owe to municipalities. Of course, the arrears will not all be paid immediately, but we are determined to see improvements over time.

We are also looking into how we can help municipalities recover the debt owed to them by the private sector. Of course, the recession is biting hard

and scores of people are losing their jobs. So the numbers of indigent are increasing and the numbers who can pay their debts to municipalities increasing. But there is still significant scope for municipalities to recover part of their debt from those who can afford to pay – and they simply have to do this! We would like to see municipal debt reduced by half by 2014.

We also need to consider extracting the arrears owed to municipalities from the salaries of civil servants and public representatives.

At its September National Executive Committee Legkotla, SALGA considered a report that stressed that municipalities must “improve their overall handling of revenue matters, especially current collections and the management of debtors. If policies on free basic services, indigency and credit control are all correct and in place, and if billing is correct, there is no reason for anyone not to pay what is billed. This is first of all a social and political matter before it is a technical matter, and SALGA calls on all its members to ensure that all revenue collections are greatly improved.” We agree.

Very briefly, among other issues that need to be considered to improve the financial position of municipalities are the following:

- The Division of Revenue Act has to be reviewed to ensure a more equitable and differentiated support to municipalities. The formula for the equitable share also has to be reviewed, partly to ensure that it is more redistributive and provides more support to financially weaker municipalities.
- There needs to be a review of all grants to local government to ensure co-ordination of the grants and their more effective use.
- There is a need for a massive anti-corruption campaign. The supply change management process also has to be reviewed and the procurement process must be tightened to reduce the prospects of fraud and corruption.
- With the phasing out of the RSC levies, the need for an appropriate temperate, sensible business tax for municipalities. We need a debate about the feasibility of this with all the stakeholders, not least the private sector.
- A more productive and effective relationship between party political structures, councillors and administrators.

I understand that this Conference will also be considering the King III Report as it applies to corporate governance in municipalities. This is very important. We are very keen to know what the outcomes of your deliberations are.

Clearly though, however sound the technical changes we can make to the system and however effective our capacity-building programmes, we will not be able to make significant progress unless some of the internal tensions within the ANC and Alliance are effectively addressed. Of course, party structures must guide the performance of councillors, and councillors must guide the work of administrators, but we must avoid undue political interference in the internal workings of municipalities. We need a better, more dialectically constructive relationship between political party structures and municipalities.

So let's "Make the Elephant Dance" then!

So there we are then! Some – by no means all – of the financial challenges confronting municipalities! And some – by no means all – of the possible responses. So what do you say then? And more importantly, what are you going to do? We, as politicians, must do our bit – and we will. But we need your help! Please give it!

Of course, the road ahead isn't going to be easy. Nor will it be traversed quickly. But, after all, it's you who said that we must "make the elephant dance". And you conceded that it won't be easy. But you believe that you can "make the elephant dance". So let's, together, do so!