AN INTEGRATED DEBT MANAGEMENT MODEL FOR MUNICIPALITIES IN THE FREE STATE PROVINCE

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ABSTRACT

Municipal debt management in the public sector has emerged as a critical topic in the post-apartheid era in South Africa. After 20 years of democracy, the culture of non-payment for municipal services in South Africa continues to pose a serious financial challenge to municipalities. Therefore, an attempt has been made to identify debt management and its implications for public service delivery.

In South Africa, there are 278 municipalities spread across the nine provinces and each plays a pivotal role in alleviating poverty and creating jobs. The availability, price and reliability of services have an impact on local economic performance and can significantly affect the quality of life of poor households.

Municipalities receive intergovernmental transfers through the annual *Division of Revenue Act*. However, municipalities' own revenue collection has been significantly declining as a result of greater reliance placed on intergovernmental transfers as a revenue source. The municipalities are the custodians of public funds, whether raised from their own revenue sources or received through intergovernmental grants. They are tasked with using these resources to respond to their communities' need for infrastructure, service provision and spatial development within their boundaries.

However, it is of concern that in many cases, the funds dedicated to service delivery growth and expansion are being mismanaged by municipal officials. Consequently, this has impacted on the quality and extent of the provision of essential services across the spectrum of municipalities in the Free State Province.

It is evident that there is now a culture of non-payment, and the quantum of debt is material and substantial for debtors exceeding 90 days. This imposes the challenge of implementing stringent credit control and debt collection policies and procedures in order to arrest the growing escalation of debt. If the problem of non-payment persists, the government will be faced with a situation in which all major public utilities are likely to incur large and possibly unsustainable losses due to non-payment. Government will be expected to support these utilities through

subsidies. Cognisance should be taken of the fact that should the current trend of non-payment for services continue in the future, a collapse in service delivery will become inevitable.

The purpose of the study is to identify debt management, its consequences, and the development of an integrated debt management model for municipalities in the Free State Province.

The introduction to this research topic within the context of municipal debt points to the significance of this research topic and its intended benefits. Chapter 1 provides a theoretical review of governance in municipal financial management. Chapter 2 provides the legislative framework for local government financial administration, as well as the statutory roles, responsibilities and duties of officials and structures, followed by a discussion of revenue management and administration of debtors and funding models for municipalities. Municipalities are the custodians of public funds and are tasked with using these resources to respond to their communities' needs in terms of infrastructure, local services such as water, electricity and refuse removal, and the guiding of spatial development within their localities.

Chapter 3 discusses local government financial management and the challenge of debt management. Aspects discussed in this chapter include the policy framework of financial management and the requirements of local government, the *Local Government: Municipal Finance Management Act* (MFMA), 2003 (Act 56 of 2003) (RSA, 2003), the preparation of the annual local budget, the budget cycle, and the composition of the budget. In addition, the chapter details the roles and responsibilities of both the political and administrative functionaries within a municipality in terms of the budget.

Chapter 4 outlines the debtor management cycle and the debtor control system, with an evaluation of municipal debt over three years in the Free State Province and its socioeconomic impact on debt and on the achievement of MDG goals by municipalities. The chapter concludes with a discussion of the debt challenges experienced by municipalities.

Chapter 5 provides a comparative study, using secondary data from the National Treasury Database, of the debt position of Free State municipalities comparative to the municipalities in the other eight provinces.

Chapter 6 discusses the research methodology employed in the study, including the analysis and interpretation of the data. Chapter 7 concludes the study by discussing the conclusions drawn, suggesting some recommendations, and highlighting the limitation of the study, as well as the implications for further research.

DECLARATION

I, Moganathan Chetty, do hereby declare that this research project is my original work and contains no material or work that has been previously written or published by any other individual. To the best of my knowledge, this project has not been used as the basis of a degree or diploma awarded at a university or at any other institution of higher learning. Wherever contributions of others are involved, every effort has been made to indicate this clearly, with due reference to the literature. This thesis is submitted for the degree Doctor Technologiae in Public Management at the Central University of Technology, Free State (CUT).

M. Chetty

This day ……………..of ………………..2015

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GLOSSARY / LIST OF ABBREVIATIONS AND ACRONYMS

1. ASGI-SA – Accelerated Supported Growth Initiative of South Africa
2. BUSA – Business Unity South Africa
3. CFO – Chief Financial Officer
4. CoGTA – Cooperative Governance and Traditional Affairs
5. CONSTITUTION – Constitution of the Republic of South Africa, 1996
6. DBSA – Development Bank of Southern Africa
7. DMs – District Municipalities
8. DoRA – Division of Revenue Act
9. EFT – Electronic Fund Transfer
10. ERA – Electricity Regulation Act, 2006 (Act 6 of 2006)
11. FBS – Free Basic Services
12. FFCA – Financial and Fiscal Commission Act, 1997 (Act 99 of 1997)
13. FMG – Financial Management Grant
14. GDP – Gross Domestic Product
15. GVA – Gross Value Added
16. IBT- Inclining Block Tariff
17. IDP – Integrated Development Plan
18. KPIs – Key Performance Indicators
19. LED – Local Economic Development
20. LGES – Local Government Equitable Share
21. LGDA- Local Government Demarcation Act, 1998 (Act 27 of 1998)
22. LGTAS – Local Government Turnaround Strategy
23. MBAPRMA – Money Bills Amendment Procedure and Related Matters Act, 2009 (Act 9 of 2009)
24. MBRR – Municipal Budget and Reporting Regulations
25. MDGs – Millennium Development Goals
26. MFMA – Local Government: Municipal Finance Management Act, 2003 (Act 56 of 2003)
27. MFPFA – Municipal Fiscal Powers and Functions Act, 2007 (Act 12 of 2007)
28. MIG – Municipal Infrastructure Grant

29. MPRA – Municipal Property Rates Act, 2004 (Act 6 of 2004)
30. MSA – Local Government: Municipal Systems Act, 2000 (Act 32 of 2000)
31. MSIG – Municipal System Improvement Grant
32. MTEF – Medium-Term Expenditure Framework
33. NERSA – National Electricity Regulator of South Africa
34. OLGA – Organised Local Government Act, 1997 (Act 52 of 1997)
35. PMS – Performance Management System
36. SALGA – South African Local Government Association
37. SCM – Supply Chain Management
38. USAID – United States Agency for International Development
39. WSA – Water Services Act, 2004 (Act 30 of 2004)
40. WPLG – White Paper on Local Government
41. WPTPSD – White Paper on the Transformation of Public Service Delivery

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CHAPTER ONE :
INTRODUCTION AND BACKGROUND TO THE STUDY

1.1 INTRODUCTION AND BACKGROUND TO THE STUDY

This chapter provides an introduction to the study in the context of municipal debt. The significance of the study lies in the extraction of conclusions from the primary findings that will benefit municipalities. This chapter indicates the aims of the research from which the measurable objectives are outlined, while a problem statement is formulated for the proposal of possible solutions. A set of research questions is discussed in relation to the specific objectives listed in this chapter. The format of the study is clearly outlined in order to provide the reader with an overall perspective of the study.

There is no clear consensus on the causes of the escalating municipal debt in South Africa. However, there are researchers who relate municipal debt to the current levels of unemployment, whilst others speculate that the debt is due to the economy, a culture of non-payment and a sense of entitlement in certain sections of communities. This position still needs to be substantiated, as there is a dearth of research to support either argument. There is one certainty, and that is that municipal debts owed by households, corporations, government departments and other statutory bodies continue to grow at an alarming rate.

After 20 years of democracy the culture of non-payment for municipal services in South Africa continues to pose a serious financial challenge to local governments. The purpose of the study is to identify debt management, its consequences, and the development of an integrated debt management model for municipalities in the Free State Province. Part of the study is devoted to assessing the implications of non-payment of debt in relation to unemployment, poverty, and the impact on service delivery.

1.2 BACKGROUND TO THE PROBLEM

The Constitution of the Republic of South Africa, 1996 (Act 108 of 1996) – hereafter referred to as the Constitution (RSA, 1996) was adopted as the supreme law of the country and states in its preamble that it aims to improve the quality of life of all citizens. Effective financial management is a constitutional requirement for all three spheres of government.

Section 215 of the Constitution (RSA, 1996) holds that national, provincial and municipal budgets and their budgetary processes must promote transparency, accountability and the effective financial management of the economy and debt. In terms of the Constitution, local government has been established as a separate sphere with the primary responsibility for service delivery to the communities that they serve. The White Paper on Local Government, 1998 (RSA, 1998c) outlines the developmental role of municipalities that requires all municipalities to structure and manage their administration and budgeting and planning processes in such a manner as to prioritise the basic needs of their communities.

Since 1994 the transformation of local government has been associated with changes in view of creating developmental and cooperative local government, transforming political, institutional and administrative systems, and creating a new framework for municipal finances. Therefore all municipalities play a pivotal role in eradicating poverty, addressing equity needs and promoting growth that supports economic development.

The services they provide, i.e. water, sanitation, refuse removal and electricity, are fundamental inputs to social wellbeing and the growth of the economy. The availability, price, sustainability and reliability of these services impact on local economic performance and can significantly affect the quality of life for the majority of households. In addition, demographic trends vary significantly between large urban municipalities and their smaller rural counterparts, with varying demands on municipal budgets. The priorities of fiscal policy, such as poverty alleviation and job creation, present the municipalities with different and significant challenges. Effective strategies are needed to restore financial discipline, to address outstanding debts and to generate the necessary cash flows to ensure the sustainability of municipalities.

Section 64 of the Local Government Municipal Finance Management Act (MFMA), 2003 (Act 56 of 2003) (RSA, 2003) requires municipal managers to have effective revenue collection systems, as well as effective credit and debt control policies.

The MFMA (RSA, 2003) introduced a performance-based system for outputs and measurable objectives to enable municipalities to maximise their capacity to promote effective service delivery and to modernise the way in which municipal finances are managed.

The MFMA (RSA, 2003) not only supports the developmental role of local government, but also proposes a new system to address the root causes of financial problems in municipalities to empower them to execute their constitutional mandate.

According to Fourie, Opperman, Scott and Kumar (2011:238) all municipalities in South Africa are facing a critical risk in terms of their inability to collect revenue due to them for services rendered to the communities they serve. Sections 96 and 97 of the Municipal Systems Act (MSA), 2000 (Act 32 of 2000) (RSA, 2000) provide for the debt collection responsibility of municipalities, as well as their ability to adopt, maintain and implement a credit control and debt collection policy as specified. In terms of Section 96(a) of the MSA (RSA, 2000) a municipality must collect all monies due to it, subject to the provisions contained elsewhere in the Act and any other applicable legislation. Section 96(b) of the MSA (RSA, 2000) stipulates that a municipality must adopt, maintain and implement a credit control and debt collection policy that is consistent with its rates and tariff policies and compliant with the provisions of the MSA (RSA, 2000).

Section 97(2) of the MSA (RSA, 2000) provides that a municipality's credit control and debt collection policy may differentiate between various categories of ratepayers, users of services, debtors, taxes, services, service standards and other matters, as long as the differentiation does not amount to unfair discrimination. The national government transfers funds to local government through the annual Division of Revenue Act (DoRA), with such funds having continued to grow significantly in real terms since 2003/04. In terms of the annual DoRA the vertical division of revenue determines only the quantum of nationally raised resources that are available to the local government sphere and gives expression to the policy priorities of government.

In terms of Section 155(4) of the Constitution (RSA, 1996), all municipalities are expected to raise their own revenues in addition to the national transfers they receive from national government. This principle is an important feature of any democratic local government system, creating a revenue-service link between the municipality and its customers that empowers customers to hold the municipality directly accountable for the services it provides. Municipalities should consider an integrated approach to growing and protecting their revenue base, with institutional knowledge as a positive contributor in this regard.

Such an approach should also support the regression of the debtor's book and not jeopardise municipal infrastructure programmes, particularly where the municipalities have planned on their own revenue contributions towards capital funding.

The main sources of revenue for municipalities are borrowings, grant funding, and user charges generated by the sale of water and electricity. The provision of basic services, such as electricity, water, sanitation, and refuse and waste removal, is a critical requirement of the people living in the areas serviced by municipalities. Hyman (1999:632) argues that the goods typically provided by local authorities, such as fire protection, public sanitation and refuse removal, traffic control and municipal roads, water, electricity and sewerage, are local public goods, i.e. their public benefits pertain mostly to a limited region. Where goods possess public features, this affects the way in which government delivers them. Chapter 7 of the Constitution (RSA, 1996) places the responsibility on local government to ensure that such services are progressively expanded to all citizens. Municipalities will only be in a position to provide these services if they have sufficient revenue.

In light of the above, Van der Waldt, Venter, Van der Walt, Phutiagae, Khalo, Van Niekerk and Nealer (2007:199) state that the accounting officer of a municipality is responsible for the management of the revenue of that municipality. Van der Waldt *et al.* (2007:198-199) further hold that municipal councils must adopt by-laws to give effect to the credit control and debt collection policy, as well as to ensure that such policy is implemented and enforced.

Moreover, Fourie *et al.* (2011:239) hold that Section 97 of the MSA (RSA, 2000a) determines that a municipality's credit control and debt collection policy must be consistent with its rates and tariff policies.

According to MFMA Circular 70 (National Treasury, 2013c:7) it has become increasingly apparent that municipalities are not recovering the full cost associated with trading services, such as electricity, water, waste management and waste water management, and this position is further exacerbated by the fact that no consideration is given to overhead costing and its influence on the total cost of providing the service. This in turn impacts on tariff setting, and in many instances municipalities are cross-subsidising a trading service from property rates revenue – a totally defective approach to the pricing and tariff setting of municipal trading services.

With the global economy biting, the South African economy is set to register growth of about 2.7 per cent, further dashing the hopes of millions of unemployed South Africans seeking to secure jobs (Bernard, 2012:15). In 2012, Bernard (2012:15) stated that according to the South African Minister of Finance, current indications were that growth was likely to be below 2.7 per cent, with the South African Reserve Bank being applauded for cutting interest rates in light of the weakening domestic and global economic outlook. However, in the time since then, growth has continued to decline, while inflation and interest rates have been rising.

The recessionary effect of the global economy has a ripple effect on the ability of municipalities to sustain their revenue base, with previously paying clients expected to be grouped in the "indigent" category because of growing unemployment, thus placing pressure on the national fiscal economy. The Local Government Budget and Expenditure Review (National Treasury, 2011a:62) indicated that as at 31 December 2010, municipalities were owed a total of R62.3 billion, representing an increase of 10.8 per cent from the same month in 2009. This indicates that the weak global economic outlook is placing pressure on municipal own revenue, thus significantly growing their debtors book.

It is against this backdrop that municipalities need to closely examine the socioeconomic factors at play, to be able to respond appropriately to these challenges.

1.3 PROBLEM STATEMENT

According to the Local Government Budget and Expenditure Review (National Treasury, 2011a:27), never before in the history of South African local government, has municipal debt impacted so heavily on the management of municipalities and on service delivery. The national government transfers funds to local government through the annual DoRA, with such funds having grown significantly by R23 billion since 2003/04.

According to the United States Agency for International Development (USAID, 2010:2) many municipalities in South Africa have been confronted by uncollectible consumer debts and service delivery backlogs, which have increased significantly over the past decade. The municipalities within the Free State Province need to intensify their collection strategy to motivate consumers to pay their debt in a timely manner so as to enhance and maintain a sustainable budget. Whilst it is acknowledged that the issue of municipal debt is complex, effective debt collection policies and strategies should be put into place to reduce outstanding debt. Table 1.1 below shows the total outstanding debt for all municipalities within the Free State at the end of June 2012, amounting to R6.5 billion. The year-on-year comparison shows a total increase of R1.66 billion for debtors from the same period in the previous financial year.

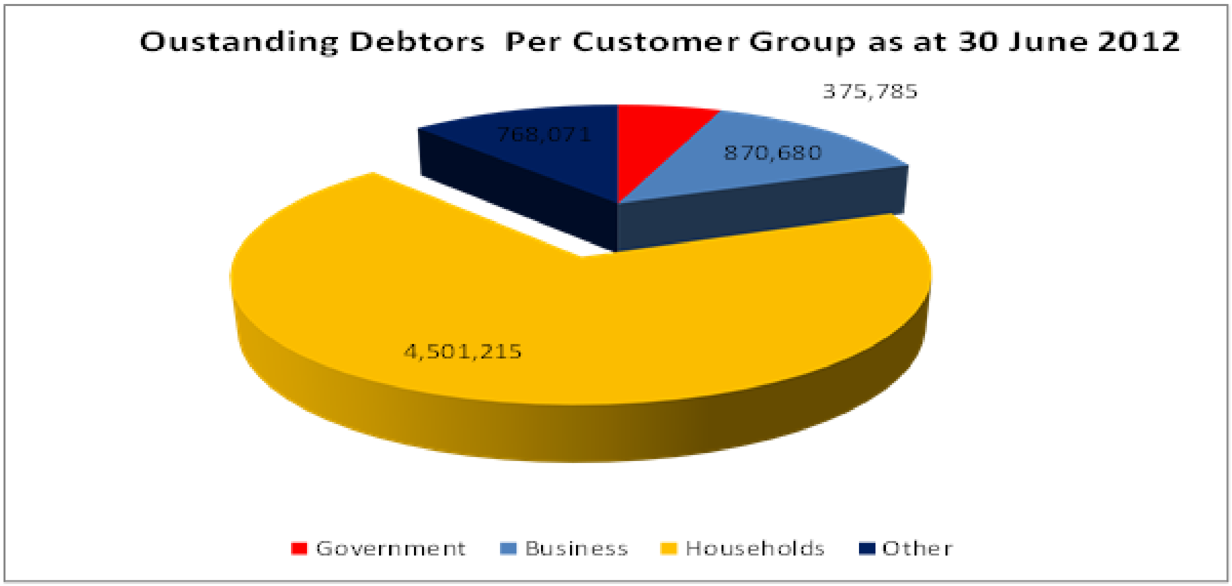
Table 1.1: Total Outstanding Debt at Free State Municipalities

	0-30 Days	**31-60 Days**	**61-90 Days**	**Over 90 Days**	**Total**
2010/11	444,538	231,716	678,514	3,496,439	4,851,207
2011/12	564,227	268,834	680,902	4,966,855	6,515,751
Increase/(Decrease)	**145,622**	**37,118**	**11,388**	**1,4704,416**	**1,664,544**

Source: Free State Provincial Treasury (2012a)

Furthermore, the debtors' age analysis for the 2011/12 financial year, as cited in the MFMA Section 71 Report (Free State Provincial Treasury, 2012b:2), indicates that 76.2 per cent or R4.966 billion of the total debt is outstanding for more than 90 days. This is a reflection of the municipalities' failure to enforce debt control policies and intensify collection measures. The successful collection of this debt is also highly unlikely, and municipalities may therefore consider writing off debt. Figure 1.1 below, as cited by the Free State Provincial Treasury, (2012a:2), shows the outstanding debtors per customer group as at 30 June 2012.

Figure 1.1: Outstanding Debtors per Customer Group for Free State Municipalities, as on 30 June 2012



Source: Free State Provincial Treasury (2012a)

Figure 1.1 above shows that the majority of the outstanding debt is from households (69.1 per cent or R4.501 billion), followed by business with 13.3 per cent or R870.680 million, and other with 11.82 per cent or R768.071 million, with government departments owing R375.785 million or 5.8 per cent of the total outstanding debt. The fact that there is no integrated debt management model to assist municipalities to improve their debt management, the debt situation at municipalities has deteriorated.

Another challenge for municipalities is the ongoing diminishing revenue collection from own sources. Cloete and Thornhill (2005:174) attribute the declining revenue base to the period of high inflation, when municipalities always found it difficult to make ends meet as a result of the increasing costs of material and labour. Cloete and Thornhill (2005:174) further maintain that the municipalities cannot increase their service charges indiscriminately, as indigent households would then be unable to maintain their homes and pay for essential services. Based on the above discussion the problem statement for this study is as follows: The lack of an integrated debt management model in the Free State local government has resulted in municipalities' failure to improve its debt management, which has a negative effect on service delivery.

1.4 AIM OF THE STUDY

The aim of the study is to develop an integrated debt management model to assist municipalities in the Free State Province to improve their debt management. The study further assesses the implications of non-payment of debt in relation to unemployment, poverty, the culture of non-payment, and the impact thereof on service delivery. Finally, an integrated debt management model is provided to assist municipalities to improve their debt management.

1.5 OBJECTIVES OF THE STUDY

Emerging from the above, the study has the following co-objectives:

- To investigate, through an extensive literature study, the legislative frameworks and policy guidelines, requirements, and principles of municipal financial management, municipal revenue, debt management, and local and international municipal funding models;
- To determine, through the evaluation of municipal financial reports from 2009 to 2012, as well as through structured interviews within the selected municipalities, the current debt management challenges and the impact thereof on effective service delivery of municipalities in the Free State Province;
- To conduct a comparative analysis between municipal debt in the Free State and that in other provinces;
- To test the dependence of debt management on service delivery, municipal policies, financial systems and controls;
- To make specific recommendations based on research findings in view of improving effective debt management in municipalities; and

- To develop an integrated debt management model for the Free State Province municipalities based on the literature analysis and empirical study.

1.6 RESEARCH DESIGN AND METHODOLOGY

In seeking to fulfil the research objectives, the necessary information was acquired from both secondary and primary sources by means of a literature review and an empirical study. The literature review is based on a qualitative study, which includes literature, legislation, policy documents, journal articles, books, conference papers, internet resources, and government reports on municipal financial management, credit control and debt management. The main aim of the study is to develop an integrated debt management model to assist municipalities in the Free State Province to improve their debt management. A model is a presentation of a complex reality that has been simplified in order to understand some aspects of the reality better and to describe and explain the relationships between the different variables in that reality (Bailey, 1994:322) According to Brynard, Hanekom, Brynard (2014:5) a model is the presentation, replica or copy of an existing thing or of a proposed structure and it indicative of a particular design or style. For this study the model will be developed based on the literature study (Chapter 2, 3, 4 and 5) and empirical findings (Chapter 6) followed by recommendations in the final chapter. A quantitative research method was used to evaluate objective data consisting of numbers and the analysis of causal relationships between variables.

A structured questionnaire was employed in conducting structured interviews with the relevant municipal managers and officials of relevant municipalities in the Free State Province.

1.6.1 Research Design

The research design is a general plan of how the researcher goes about answering the research question (Saunders, Thornhill & Lewis, 2009:136). According to Cooper and Schindler (2003:149), the research design is regarded as the blueprint for collecting, measuring and analysing data. This study follows a two-pronged approach, namely a literature study and a questionnaire used during structured interviews. The literature study is based on a qualitative study, which includes literature, legislation, policy documents, journal articles, books, conference papers, internet resources and government reports on municipal financial management, credit control and debt management. An empirical study was conducted by means of administering a questionnaire, with quantitative research used to evaluate objective data consisting of numbers and to analyse causal relationships between variables.

1.6.2 Research Strategy

A research strategy is a plan adopted by the researcher to produce systematic and orderly research. The research questions and objectives provide guidance when devising a research strategy. This study involves both qualitative and quantitative research. Mouton (2005:161) and Welman, Kruger and Mitchell (2008:6-7) hold that qualitative research methods reflect certain approaches to knowledge production and include any research that makes use of qualitative data. This is pertinent to this study, which is concerned with information that may resolve the challenges of debt management in municipalities in the Free State Province. The purpose of quantitative research is to evaluate objective data consisting of numbers and to emphasise the measurement and analysis of causal relationships between variables.

1.6.3 Sampling

Sampling is defined as the process of choosing a small group of respondents from a larger defined target population, assuming that the results discovered about the small group will allow the researcher to draw conclusions concerning the larger group (Hair, Bush & Ortinau, 2003:333). Two sampling techniques, namely the convenience sampling method and the simple probability random sampling method, were considered. In convenience sampling, respondents are selected on the premise that they are readily available or easily accessible (Welman *et al.* 2008:69-70). In order to ensure that the sample also remains representative of the population, a stratified sample was taken, based on budget size and debtors book value, and this was combined with the random sample.

Simple random sampling was used to select municipal managers and chief financial officers (CFOs) from selected municipalities in the Free State Province. Brynard and Hanekom (1997:43), as well as Leedy (1985:154), are of the opinion that randomisation means the selection of a sample from the whole population in such a way that the characteristics of each of the units of the sample approximate the characteristics of the total population. Welman *et al.* (2008:59) maintain that in the case of simple random sampling, each member of the population has the same chance of being included in the sample, and each sample of a particular size has the same probability of being chosen. To promote representation in the sample, two strata were considered, namely budget size and debtors book value.

A sample size of 10 municipalities, out of a population of 24 municipalities, was considered. The reason for selecting 10 municipalities was that this provided a representative sample of 41.6 per cent of the 24 municipalities in the province. The selection of 10 municipalities provides a practical measure of the debt problem and its implications for service delivery, given the commonality of the debt situation across municipalities. It was anticipated that the response rate of the 10 municipalities would be approximately 90 per cent; however the response rate was ultimately 100 per cent. The following Free State municipalities were selected for the study:

- Mohokare Municipality
- Kopanong Municipality
- Masilonyana Municipality
- Tokologo Municipality
- Dihlabeng Municipality
- Letsemeng Municipality
- Mantsopa Municipality
- Ngwathe Municipality
- Metsimaholo Municipality
- Matjhabeng Municipality

1.6.4 Research Instrument

According to Saunders *et al.* (2009:395), there are two types of questionnaires, namely self-administered questionnaires and interviewer-administered questionnaires. A self-administered questionnaire, in the form of a structured questionnaire, is a data collection strategy whereby respondents are expected to read the questions, then choose their preferred answer and record it in the absence of the interviewer (Hair *et al.*, 2003:265).

A structured questionnaire containing six categories was developed to elicit information during the structured interviews with the municipal managers and CFOs of the relevant municipalities. The questionnaire comprised closed and open-ended questions. Close questions were used to determine the respondent's debt position, cash flow challenges, the impact of debt on service delivery, IT solutions, policies and internal controls. Open-ended questions were also directed at the debt and cash flow challenges.

The structured questionnaire was distributed through electronic mail to the selected municipalities. Owing to time constraints, structured interviews were conducted telephonically with the municipal managers and CFOs. In certain instances, on-site meetings were conducted with those interviewees needing more clarity on the questions. It is thus to be inferred that the research is a fair reflection of the perceptions of the respondents.

1.6.5 Pilot Study

A pilot study was conducted to test the instrument and data feedback. According to Robson (2002:59), a pilot study is a valuable means of finding out "what is happening; to seek new insights, to ask questions and to assess phenomena in a new light, prior to the substantive research". Municipal managers and CFOs at two municipalities were given the questionnaire to complete in an effort to test the validity and reliability of the questionnaire. The final questionnaire was then reviewed before being adopted and distributed to the selected sample.

1.6.6 Limitations

The study is subject to certain conditions, with external factors possibly having an influence on the study, such as the commitment and willingness of participants to participate in the structured interviews.

Other external factors with a possible influence on the study include the fact that some municipalities may be implementing debt collection strategies and credit policies effectively, whereas other municipalities may not be so effective. As such, the results may not be reflective of the municipalities as a whole. Moreover, other provinces may face different challenges and circumstances when it comes to debt and its impact on service delivery.

1.7 SIGNIFICANCE OF THE STUDY

The study is significant for the following reasons:

- The study provides current statistics and supports the notion of the escalating debt position at South African municipalities.
- The study highlights the factors influencing municipal debt management.
- The study discusses socio-economic conditions as a means of providing additional insight into the factors affecting municipalities.
- Whilst focusing on a selected sample of municipalities in the Free State, the study also provides impetus to other researchers to conduct similar studies in other provinces.
- The proposed integrated debt management model would assist municipalities in the Free State Province to improve their debt management.
- The researcher has commenced with piloting the integrated debt management model at Matjhabeng Municipality in the Free State Province.

1.8 FORMAT OF THE STUDY

The research is structured as follows:

Chapter 1: General introduction; problem statement; research methodology; research questions and research objectives.

Chapter 2: Theoretical review of governance in municipal financial management; legislative framework for local government financial administration; statutory roles, responsibilities and duties of officials and structures; revenue management and administration of debtors; funding models for municipalities.

Chapter 3: Local government financial management and the challenge of debt management; policy framework for financial management; MFMA requirements; preparation of the annual local budget; budget cycle; composition of the budget; roles and responsibilities of political and administrative functionaries in terms of the municipal budget.

Chapter 4: Municipal debt management: Debtor management cycle; debtor control system; evaluation of municipal debt over three years; socioeconomic impact of debt; impact of debt on municipalities' ability to achieve MDG goals; debt challenges facing municipalities.

Chapter 5: Debt profile of Free State municipalities: Comparative study, using secondary data from the National Treasury database, of the debt position of Free State municipalities comparative to that of municipalities in the other eight provinces.

Chapter 6: Empirical research – methodology and findings: Statement of findings and analysis of data received from interviews at selected municipalities; presentation and analysis of findings; presentation of data by means of tables and graphs; discussion of the reasons for the findings.

Chapter 7: Conclusion and recommendations; summary of the study; conclusions and recommendations regarding municipal debt and the debt position, and the impact thereof on service delivery, with specific reference to the proposed guidelines.

1.9 SUMMARY

The aim of the study is to develop an integrated debt management model to assist municipalities in the Free State Province to improve their debt management. The study assesses the implications of non-payment of debt, how it relates to unemployment and poverty, and the impact on service delivery. Chapter 1 provided background information on the problem and a brief history of the municipal debt situation, along with an outline of the problem statement, the aim and objectives of the study, the research questions and the format of the study.

Chapter 2 provides a comprehensive summary of the theoretical review of governance in municipal financial management. The chapter subsequently outlines the legislation of local government administration, as well as the statutory roles, responsibilities and duties of municipal officials and structures, followed by a discussion of revenue management, debt management, the administration of debtors and the funding mix for municipalities. The theoretical review on governance is done to develop an integrated debt management model due to the fact there is no debt management model to assist municipalities.

CHAPTER TWO :

THEORETICAL REVIEW OF GOVERNANCE IN MUNICIPAL FINANCIAL MANAGEMENT

2.1 INTRODUCTION

In terms of Section 41 of the Constitution (RSA, 1996) the principles of governance are accountability, effectiveness and efficiency, public participation, transparency, responsiveness, and the equitable division of resources. Governance can be said to be an act or process of governing. Good governance is a relatively new term that is often used to describe the desired objective of a nation-state's political development.

In terms of Section 216(1)(c) of the Constitution (RSA, 1996) national legislation must prescribe measures to ensure both transparency and expenditure control in all spheres of government by introducing uniform treasury norms and standards, such as standard chart of accounts. This in effect involves organisational culture, policies, strategies, and communication with stakeholders. Furthermore, structures such as financial committees should provide objective, independent advice to improve oversight and good governance and to mitigate possible risks.

According to Fourie, Opperman and Scott (2007:238) all municipalities in South Africa are facing a critical risk in terms of their ability to collect revenue due to them for services rendered to the communities they serve. Sections 96 and Section 97 of the MSA (RSA, 2000a), as amended by the Local Government Laws Amendment Act, 2002 (Act 51 of 2002) (RSA, 2002), provides for the debt collection responsibility of municipalities, as well as their ability to adopt, maintain and implement a credit control and debt collection policy. In terms of Section 96(a) of the MSA (RSA, 2000a) a municipality must collect all monies due to it, subject to the provisions contained elsewhere in the Act and any other applicable legislation. Section 96(b) of the MSA (RSA, 2000a) provides that a municipality must adopt, maintain and implement a credit control and debt collection policy that is consistent with its rates and tariff policies and c omplies with the provisions of the MSA.

Section 97(2) of the MSA (RSA, 2000) provides that a municipality's credit control and debt collection policy may differentiate between various categories of ratepayers, users of services, debtors, taxes, services, service standards and other matters, as long as the differentiation does not amount to unfair discrimination. In this regard, municipalities must comply with national government legislation, as well as their own adopted by-laws.

Section 214 of the Constitution (RSA, 1996) provides the basis of funding for municipalities from the national fiscus through the annual DoRA, with such national transfers to municipalities having continued to grow significantly in real terms since 2003/04. In addition, municipalities fund their budgets by collecting revenues from the services provided. The vertical division of revenue determines only the quantum of nationally raised financial resources that are available to the local government sphere, giving expression to the policy priorities of government. This chapter provides the legislative framework for local government administration, as well as the statutory roles, responsibilities and duties of officials and structures, followed by a discussion on revenue management and administration of debtors and the funding models for municipalities.

2.2 LEGISLATIVE FRAMEWORK FOR LOCAL GOVERNMENT, WITH SPECIFIC REFERENCE TO MUNICIPAL FINANCIAL MANAGEMENT

This section covers the legislative framework for local government, starting with the provisions of the Constitution (RSA, 1996) and various pieces of legislation governing local government in South Africa in support of their revenue and debt management. It should also be emphasised that the legislative framework supporting the revenue and debt management of local government may not be restricted to that discussed hereunder, due to the pace at which local government legislation in South Africa is being modernised.

The Constitution (RSA, 1996) has been adopted as the supreme law of the country and states in its preamble that it aims to improve the quality of life of all citizens. Therefore, effective financial management is a constitutional requirement for all three spheres of government. Section 215 of the Constitution (RSA, 1996) holds that national, provincial and municipal budgets and their budgetary processes must promote transparency, accountability, and the effective financial management of the economy and debt. In terms of the Constitution (RSA, 1996) local government was established as a separate sphere with the primary responsibility for service delivery to the communities they serve.

Chapter 7 of the Constitution (RSA, 1996) places the responsibility on local government to ensure that basic services are progressively expanded to all citizens. Municipalities will only be in a position to provide these services if they have sufficient revenue.

In this regard, Chapter 2 of the MSA (RSA, 2000a) gives municipal councils the right "to fund the affairs of the municipality by charging fees for services". Furthermore, Section 75A of the MSA (RSA, 2000a) gives a municipality the general power to levy and recover fees, charges and tariffs in respect of any municipal function or service provided. Section 74 of the MSA (RSA, 2000a), in turn, provides specific information as to what is required from the municipalities to give effect to the execution of such responsibilities.

In light of the above, Section 12 and Section 13 of the MSA (RSA, 2000a) deal extensively with municipal legislative processes, particularly the passing and publishing of municipal by-laws in a provincial government gazette, as required by Section 162 of the Constitution (RSA, 1996). The municipal by-laws are legally required to give effect to decisions taken by the municipal councils. In addition, Section 15 of the MSA (RSA, 2000a) defines the 'municipal code' as a compilation of all municipal by-laws that municipalities must have in place. Municipalities are therefore legally required to ensure that the municipal code is compiled, that it is appropriately annotated and updated, and that it is available to any member of the public at a reasonable fee. The Constitution (RSA, 1996), the MSA (RSA, 2000a), the MFMA (RSA, 2003) and other sector-specific legislation in support of local government enable municipalities to charge for services rendered, to collect monies due, and to levy interest on outstanding amounts.

2.2.1 Constitution of the Republic of South Africa, 1996

The Constitution (RSA, 1996) has been adopted as the supreme law of the country and states in its preamble that it aims to improve the quality of life of all citizens. Effective financial management is therefore a constitutional requirement for all three spheres of government. Section 215 of the Constitution (RSA, 1996) holds that national, provincial and municipal budgets and their budgetary processes must promote transparency and accountability and ensure the effective financial management of the economy and debt collection. In terms of the Constitution (RSA, 1996) local government has been established as a separate sphere with the primary responsibility for service delivery to the communities being served.

In terms of Section 229 of the Constitution (RSA, 1996) municipalities are empowered to levy charges on property rates and for the provision of service areas such as water, sanitation, electricity, refuse removal and other services. Section 229(2) of the Constitution (RSA, 1996), however, cautions that when levying property rates and surcharges, care should be exercised to ensure that national economic policies, economic activities across municipal boundaries, and the national mobility of goods, services and capital or labour are not prejudiced.

Where two municipalities have the same fiscal powers and functions in the same area, Section 229(3) of the Constitution (RSA, 1996) guides the municipalities in dividing such powers in line with national legislation, in consideration of the following: the need to comply with sound principles of taxation; the powers and functions performed by each municipality; the fiscal capacity of each municipality; and the effectiveness and efficiency of raising taxes, levies and duties, and equity.

According to Section 214 of the Constitution (RSA, 1996), “An Act of Parliament must provide for the equitable division of revenue raised nationally among the national, provincial and local spheres of government” and “any other allocations to provinces, local government or municipalities from the national government's share of that revenue, and any conditions on which those allocations may be made”.

Section 214(2) of the Constitution (RSA, 1996) furthermore stipulates that this division of revenue must take into account the following:

a) The national interest;

b) Any provision that must be made in respect of the national debt and other national obligations;
c) The needs and interests of the national government, determined by objective criteria;
d) The need to ensure that the provinces and municipalities are able to provide basic services and perform the functions allocated to them;
e) The fiscal capacity and efficiency of the provinces and municipalities;
f) The developmental and other needs of provinces, local government and municipalities;
g) Economic disparities within and among the provinces;
h) Obligations of the provinces and municipalities in terms of national legislation;
i) The desirability of stable and predictable allocations of revenue shares; and
j) The need for flexibility in responding to emergencies or other temporary needs, as well as other factors based on similar objective criteria.

The above is further reinforced by the objectives of local government as set out in Section 152 of the Constitution (RSA, 1996), namely:

- Providing a democratic and accountable local government for local communities;
- Providing services to communities in a sustainable manner;
- Promoting social and economic development; and
- Encouraging the involvement of communities and community organisations in the matters of local government.

Thus, the Constitution (RSA, 1996) clearly provides for municipalities to charge for services rendered, and to collect monies due to them, and to provide democratic and accountable local government for its citizenry. The supportive legislation in terms of the MSA (RSA, 2000a) enables municipalities to charge for services and to collect revenue. Therefore, it is imperative that the municipalities have effective financial management practices in place to effect these obligations, and that the service charges are cost reflective. The MSA (RSA, 2000a) is subsequently discussed below.

2.2.2 Local Government: Municipal Systems Act, 2000 (Act 32 of 2000)

Sections 96 and 97 of the MSA (RSA, 2000a) and Moeti, Sebola, Khalo, Mafunisa, Makonda, Nsingo and Nkuna (2014:163) provides for the debt collection responsibility of municipalities, as well as their ability to adopt, maintain and implement a credit control and debt collection policy. In terms of Section 96(a) of the MSA (RSA, 2000a) a municipality must collect all monies due to it, subject to the provisions contained elsewhere in the Act and any other applicable legislation. Section 96(b) of the MSA (RSA, 2000a) furthermore provides that a municipality must adopt, maintain and implement a credit control and debt collection policy that is consistent with its rates and tariff policies and which complies with the provisions of this Act. Moreover, a municipality is empowered by the MSA (RSA, 2000a) to levy and recover fees, charges or tariffs in respect of any function or service of the municipality, and to recover collection charges and interest on any outstanding amount subject to the provisions of the National Credit Act, 2005 (Act 34 of 2005) (RSA, 2005b).

Section 97(2) of the MSA (RSA, 2000a) provides that a municipality's credit control and debt collection policy may differentiate between various categories of ratepayers, users of services, debtors, taxes, services, service standards and other matters, as long as the differentiation does not amount to unfair discrimination.

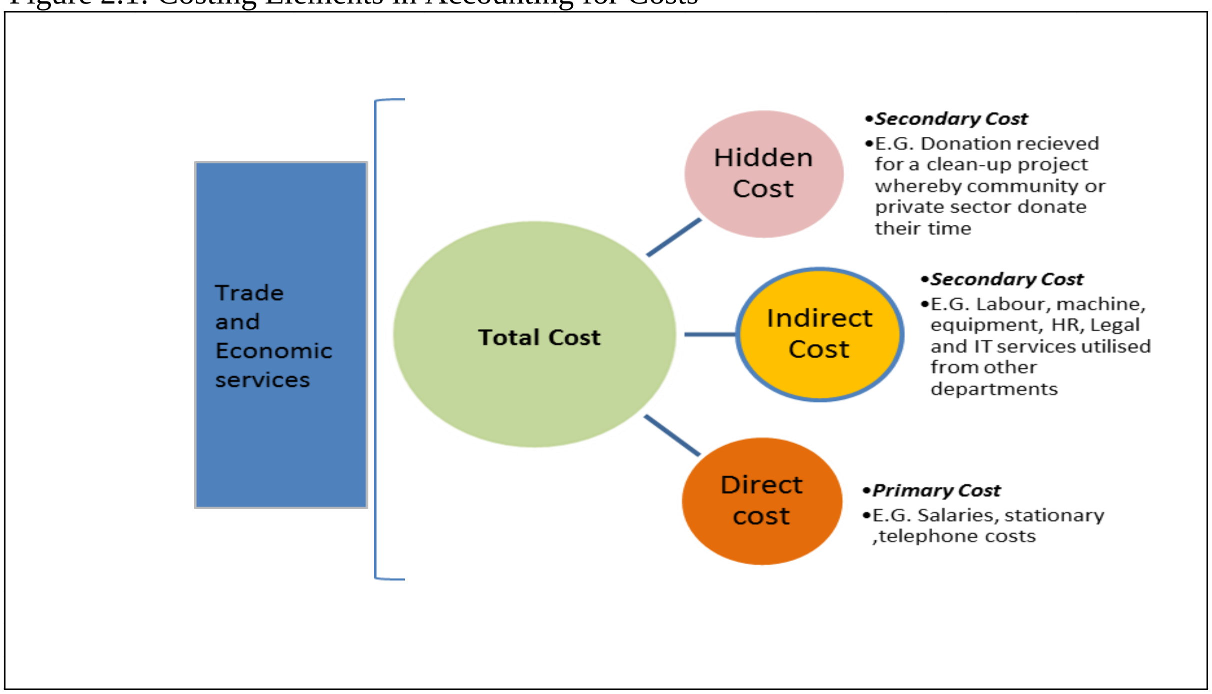
Through Section 75 of the MSA (RSA, 2000a) municipalities are given the power to pass by-laws to give effect to the implementation and enforcement of their tariff policies. In turn, Section 75A of the MSA (RSA, 2000a) empowers municipalities to levy and recover fees, charges and tariffs in respect of any function or service of the municipality and to recover collection charges and interest on any outstanding amount. Before levying any fees, the municipal council must pass a resolution in this regard that enjoys the support of the majority of its council members, and immediately thereafter the municipal manager is expected to make a public notice of the resolution for a period of at least 30 days.

Section 96 of the MSA (RSA, 2000a) requires municipalities to implement debt collection and credit control policies, as well as the respective by-laws in support of the fees and levies charged by the municipalities for the services provided.

Section 74(2)(d) of the MSA (RSA, 2000a) states that "tariffs must reflect the costs reasonably associated with rendering the service, including capital, operating, maintenance, administration and replacement costs, and interest charges".

Section 64(2)(c) of the MFMA (RSA, 2003) requires customer statements to be fair, and it is therefore imperative that municipal finance officials have an understanding of cost drivers (direct and indirect costs) and the importance of sound budgeting. Municipal finance officials must ensure that cost drivers are not limited to cash outflow items such as remuneration, bulk purchases and contracted services, but care must be taken in understanding the impact of items such as depreciation and debt impairment, especially in relation to trading services. Figure 2.1 below shows the costing elements involved in accounting for costs.

Figure 2.1: Costing Elements in Accounting for Costs



Source: Adapted from MFMA Circular 29 (Free State Provincial Treasury, 2014)

2.2.3 Local Government: Municipal Finance Management Act, 2003 (Act 56 of 2003)

The MFMA (RSA, 2003) introduces a performance-based system for outputs and measurable objectives that enables municipalities to maximise their capacity to promote effective service delivery and to modernise the way in which municipal finances are managed. The MFMA (RSA, 2003) not only supports the developmental role of local government, but also proposes a new system to address the root causes of financial problems in municipalities in order to empower municipalities to execute their constitutional mandate.

Section 64 of the MFMA (RSA, 2003) guides municipalities in ensuring that the fees levied are cost reflective and are collected and accounted for on the basis of the internal control system, as well as the policies and procedures that municipalities are expected to implement in terms of revenue management.

Section 64 of the MFMA (RSA, 2003) requires municipal managers to implement effective revenue collection systems and effective credit and debt control policies. Section 60 of the MFMA (RSA, 2003) places the responsibility on the municipal manager as the accounting officer to ensure that the municipality creates and implements an effective credit control and debt collection policy. Section 229 of the Constitution (RSA, 1996) empowers municipalities to levy the relevant charges on property rates, while Section 64(a) of the MFMA (RSA, 2003) requires municipalities to have effective systems in place in terms of billing and collecting revenue.

2.2.4 Local Government: Municipal Property Rates Act, 2004 (Act 6 of 2004)

Section 2 of the Municipal Property Rates Act (MPRA), 2004 (Act 6 of 2004) (RSA, 2004a) grants municipalities the power to levy rates on property within their respective areas. In the case of district municipalities, they may levy a property rate only within a district management area. Municipalities are expected to pass a rates policy that will provide a framework at municipal level within which a transparent and fair system of rating, exemptions, reductions and rebates can be implemented (Tshangana, 2010:1).

Municipal property rates are taxes levied on the market value of properties within the municipality's jurisdiction, as determined in terms of the MPRA (RSA, 2004a).

The MPRA (RSA, 2004a) provides for municipalities to adopt a rates policy that is consistent with the relevant provisions for the levying of property tax on all rateable properties within the relevant area of jurisdiction. Furthermore, each municipality must pass a by-law in this regard, published in the provincial gazette, to give effect to and legalise the levying of property rates by the municipality.

The municipality's budget finalisation process must include the passing of a resolution on the levying of property rates per category of property, to be promulgated in the provincial gazette upon ratification of the budget decisions.

According to Section 3 of the MPRA (RSA, 2004a), the municipal property rates base is the value of all rateable properties within the municipal boundaries, which the municipality has valued for the purpose of levying property rates, in accordance with the rates policy. The general valuation roll and subsequent supplementary valuations are the source of this baseline information, giving an indication of the property rates revenue the municipality has the potential to raise from its property base. This information is fundamental to equitable and fair budget planning in respect of the municipal tariff-setting process for property rates; that is, determining the rate in rand applicable for each of the categories of property provided for in the municipality's rates policy. The municipality must firstly ensure that it has accurate information on all the land and/or properties within its area of jurisdiction – i.e. the cadastre. It is imperative that a municipality's revenue management function makes provision for the reconciliation of billing data to the deeds registry office to confirm the accuracy of property ownership information, and to the valuation rolls to confirm the accuracy of property values and the category of property (with consideration for 'use' and 'permitted use') that informs the usage and the applicable cent to the rand (RSA, 2004a).

In light of the above, municipalities must comply with this promulgation process to render the applicable cent to the rand enforceable for a particular municipal financial year, consequently reducing the risk to the municipality's financial sustainability. In addition to revenue from property rates and other sources of revenue such as fees and fines, municipalities are guaranteed to receive an equitable division of revenue raised nationally among all the spheres of government, in terms of Section 214(1)(a) of the Constitution (RSA, 1996), based on the payment schedule to be determined by the annual DoRA.

2.2.5 Annual Division of Revenue Act (DoRA)

The annual DoRA is enacted each year to determine the equitable share to be allocated to municipalities. This also gives an indication of the conditional and unconditional grants allocated to municipalities in order to supplement their efforts in carrying out their mandate of service delivery to their communities. The amount allocated in terms of the DoRA is not only applicable to the current financial year, but is also indicative of the allocations for the next two financial years according to the medium-term expenditure framework. Section 4 of the Municipal Fiscal Powers and Functions Act (MFPFA), 2007 (Act 12 of 2007) (RSA, 2007) empowers municipalities to levy new forms of municipal taxes.

2.2.6 Municipal Fiscal Powers and Functions Act, 2007 (Act 12 of 2007)

The MFPFA (RSA, 2007) regulates any new municipal taxes and surcharges, other than property rates and user charges, to achieve the following objectives: to ensure that the taxes are reasonable and consumers are not overwhelmed, considering the overall tax burden to consumers; and to ensure that the surcharges on fees for services do not materially and unreasonably prejudice national economic policies, economic activities across municipal boundaries, or the national mobility of goods, services, capital or labour. In addition, MFMA Circular 67 (National Treasury, 2013b) provides guidelines on municipal increases in preparation for the 2013/14 budget estimates, in view of the prevailing slow economic recovery and the constraints of the global environment and domestic restructuring.

Based on Section 4 of the MFPFA (RSA, 2007) the first step towards the introduction of any new form of property tax by a municipality is to lodge the relevant application with the Minister of Finance, who will in turn consult with his/her counterpart in the Department of Cooperative Governance and Traditional Affairs (CoGTA) and other stakeholders.

Section 5 of the MFPFA (RSA, 2007) requires municipalities to indicate the following aspects when applying for a new tax base: the purpose of and reasons for the tax base; the tax rate; any exemptions applicable; the tax-collecting authority; the person responsible for remitting the tax; the methods and likely costs of enforcing compliance with requirements of the new tax to be levied; and any other requirements. The objectives of the MFPFA (RSA, 2007) are as follows:

(a) To promote predictability, certainty and transparency in respect of municipal fiscal powers and functions;
(b) To ensure that municipal fiscal powers and functions are exercised in a manner that will not materially and unreasonably prejudice national economic policies, economic activities across municipal boundaries, or the national mobility of goods, services, capital or labour;
(c) To effectively oversee the exercise of municipal fiscal powers and functions; and
(d) To provide for an appropriate division of fiscal powers and functions where two municipalities have the same fiscal powers and functions with regard to the same area, in accordance with Section 229(3) of the Constitution, 1996 by -
    (i) regulating the exercise by municipalities of their power to impose municipal surcharges on fees for services under Section 229(l)(a) of the Constitution, 1996;
    (ii) authorising the municipal taxes that municipalities may impose under Section 229(1)(b) of the Constitution, 1996; and
    (iii) regulating the exercise by municipalities.

Thus, it is imperative for municipalities to comply with the MFPFA (RSA, 2007) so as to enable them to be granted fiscal powers and to levy charges for services offered in a specific service area. The White Paper on Local Government (RSA, 1998c) sets out government's policy for transforming local government.

2.2.7 White Paper on Local Government, 1998

In the foreword to the WPLG (RSA, 1998c), the then Minister of Provincial and Local Government stated that the document "can almost be regarded as a 'mini-constitution' for local government". The WPLG (RSA, 1998c) outlines the developmental role of municipalities, requiring all municipalities to structure and manage their administrations and budgeting and planning processes in such a manner as to prioritise the basic needs of their communities.

In terms of municipal finance, the WPLG (RSA, 1998c:85) lists the following policy objectives for the new system of local government financing of which the local government equitable share forms a part:

- ***Revenue adequacy and certainty*****:** The WPLG (RSA, 1998c:85) indicates that municipalities must have access to adequate sources of revenue, such as own resources or intergovernmental transfers, to enable them to carry out the functions that have been assigned to them. The WPLG (RSA, 1998c:85) further states municipalities should be encouraged to fully exploit these sources of revenue to meet their developmental objectives, and that they should have reasonable certainty of revenue to allow for realistic planning.
- ***Sustainability*****:** The WPLG (RSA, 1998c:85) further maintains that financial sustainability requires that municipalities ensure that their budgets are balanced (income should cover expenditure). It further provides that given revenue constraints, this involves ensuring that services are provided at levels that are affordable, and that municipalities are able to recover the costs of service delivery. No bailout shall be provided to a municipality that overspends its budget and/or fails to institute proper financial management controls. It is the responsibility of the political leaders to ensure that they set realistic budgets. However, there is a need for subsidisation to ensure that poor households that are unable to pay even a proportion of service costs also have access to basic services.
- ***Effective and efficient resource use*****:** The WPLG (RSA, 1998c:85) further states that economic resources are scarce and should be used in the best possible way to reap the maximum benefit for local communities. However, there are no mechanisms available to

ensure that municipal decisions will indeed lead to the effective allocation of resources. It is therefore important that local residents provide the necessary checks and balances, which they can do by participating in the budgeting process to ensure that resources are being put to their best use. Efficiencies in public spending and resource allocation will ultimately improve access of the poor to basic services.

The WPLG (RSA, 1998c:92) makes it clear that the transfer of funds from national government is only one part of the framework for the municipal financial system and that this includes local revenue instruments and private investments (including borrowing). At the time of being compiled, the WPLG (RSA, 1998c:92) estimated that "on average, municipalities have sufficient revenue-raising powers to fund the bulk of their expenditure, and finance 90 per cent of their recurrent expenditure out of own revenues". However, this situation has changed substantially since 1998, with transfers currently accounting for 25 per cent of municipal budgets on average, while in poor municipalities transfers can make up more than 75 per cent of municipal revenue.

The WPLG (RSA, 1998c:85) is highly critical of the system of intergovernmental transfers that existed prior to 1998, describing such transfers (mostly paid from provinces to municipalities) as unpredictable, inconsistent and inequitable, with grants not being based on objective rational policy criteria, and the incentives in the system sometimes encouraging poor financial management. It furthermore stipulates that the equitable share will only fund the operating costs of municipalities and that capital transfers will be made through conditional grants. This means that the equitable share will constitute only a part of the total amount transferred to municipalities. Section 44 of the MFMA (RSA, 2003) provides for the settlement of disputes, and in this regard the main responsibility of organised local government is to promote municipalities and the settlement of disputes – thus again highlighting the importance of the WPLG (RSA, 1998c) in terms of debt management.

2.2.8 Organised Local Government Act, 1997 (Act 52 of 1997)

According to Fourie *et al.* (2011:23), the OLGA, 1997 provides for the recognition of national and provincial organisations representing the different categories of municipalities and includes procedures by which local government may designate representatives to participate in the National Council of Provinces and to serve on the Finance and Fiscal Commission.

2.2.9 Local Government Demarcation Act, 1998 (Act 27 of 1998)

According to Fourie *et al.* (2011:25) the objective of the LGDA, 1998 is to provide criteria and procedures for the determining of municipal boundaries by an independent authority, namely the Municipal Demarcation Board.

Section 24 of the LGDA (RSA, 1998a) provides the demarcation objectives, including the determining of an area that will:

- Enable the municipality to provide services to the community in an equitable and sustainable manner;
- Promote effective local governance;
- Allow for effective local government; and
- Have a tax base as inclusive as possible of users of municipal services in the municipality.

The Municipal Demarcation Board had done extensive work on municipal boundaries, reducing the initial 804 municipalities to the current status of 278 municipalities to ensure viability and service delivery in the local sphere of government. However, not all citizens have been satisfied with the processes followed by the Municipal Demarcation Board – a case in point being the February 2013 protests against the proposed merger of the Ngwathe and Metsimaholo municipalities in the Free State Province.

2.2.10 Other Relevant Legislation Governing Local Government

The Housing Act, 1997 (Act 107 of 1997) (RSA, 1997b) applies to municipalities that have been given the housing function, i.e. metropolitan municipalities and municipalities with the capacity to deal with this function.

Section 220 of the Constitution (RSA, 1996) provides for the establishment and functioning of the Financial and Fiscal Commission Act, 1997 (Act 99 of 1997) (RSA, 1997a), whereby a commission is appointed to make an annual submission for a particular financial year. The division of revenue is determined in terms of Section 214(1) of the Constitution (RSA, 1996), Section 9 of the Intergovernmental Fiscal Relations Act, 1997 (Act 97 of 1997) (RSA, 1997c), and Section 4(4c) of the Money Bills Amendment Procedure and Related Matters Act, 2009 (Act 9 of 2009) (RSA, 2009). The commission reviews the local government equitable share formula jointly with CoGTA and the National Treasury. The review has a much broader scope to include the different aspects of the functional and fiscal arrangements of the local government system.

The objective of the Promotion of Access to Information Act, 2000 (Act 2 of 2000) (RSA, 2000b) is to promote and foster a culture of transparency and accountability in public institutions and private bodies. The Act provides a vital platform for communities to raise their concerns at municipal council meetings by gaining access to information with regard to the municipality's business.

The Intergovernmental Relations Framework Act, 2005 (Act 13 of 2005) (RSA, 2005a) establishes a framework for the national, provincial and local governments to promote and facilitate intergovernmental relations, to provide for mechanisms and procedures to facilitate the settlement of intergovernmental disputes, and to provide for matters connected therewith. The objective of this Act is to provide – within the principle of cooperative government, as set out in Section 41(1) of the Constitution (RSA, 1996) – a framework for the national, provincial and local governments, and all organs of state within those spheres of government, to facilitate coordination in the implementation of policy and legislation, including:

- Coherent government;
- Effective provision of services;
- Monitoring the implementation of policy and legislation; and
- Realisation of national priorities.

The Municipal Structures Act, 1998 (Act 117 of 1998) (RSA, 1998b) has the objective of providing for the establishment of municipalities in accordance with requirements relating to the categories and types of municipalities:

- To establish criteria for determining the category of municipality to be established in an area;
- To define the types of municipality that may be established within each category;
- To provide for the appropriate division of functions and powers between categories of municipality;
- To regulate the internal systems, structures and office-bearers of municipalities;
- To provide for appropriate electoral systems; and
- To provide for matters in connection therewith.

The Water Services Act (WSA), 2004 (Act 30 of 2004) (RSA, 2004b**)** determines and controls the following:

(a) The right of access to basic water supply and the right to basic sanitation necessary to secure sufficient water and an environment not harmful to human health or wellbeing;
(b) The setting of national standards and norms and standards for tariffs in respect of water services:
(c) The preparation and adoption of water services development plans by water services authorities;
(d) A regulatory framework for water services institutions and water services intermediaries;
(e) The establishment and disestablishment of water boards and water services committees, as well as their duties and powers;
(f) The monitoring of water services and intervention by the Minister or by the relevant province;
(g) Financial assistance to water services institutions;
(h) The gathering of information in a national information system and the distribution of that information;
(i) The accountability of water services providers; and

(j) The promotion of effective water resource management and conservation.

The responsibility lies with the municipality as a water services authority to take reasonable measures to realise these rights. As such, basic water supply refers to the prescribed minimum standard of services necessary to support life and personal hygiene. According to the WSA (RSA, 2004b) a municipality cannot deny any person access to basic water services due to non-payment where that person proves, to the satisfaction of the municipality, that he or she is unable to afford to pay for basic services. The implications of this for municipalities is that they cannot disconnect or discontinue services beyond the basic water supply as defined, but may limit or restrict the flow of water to property as per Section 4 of the Act.

The Electricity Regulation Act (ERA), 2006 (Act 6 of 2006) (RSA, 2006) allows for a municipality to charge a levy on electricity, to alter the circumstances in which a licence shall not be required for the generation of electricity, to provide for the transfer of servitudes on the transfer of undertakings, and to provide for incidental matters. This Act is vital for municipalities that must sell electricity to their clients and in order to make an adequate return on sales to cover their bulk expenditure and improve their sustainability. The Act prohibits a municipality from reducing or terminating the supply of electricity unless:

- The customer is insolvent;
- The customer has failed to honour, or refuses to enter into, an agreement for the supply of electricity; and/or
- The customer has contravened the payment conditions of that licensee.

The literature review implores municipalities to enhance their revenue value chain and internal controls to improve debt collection. In addition, municipalities must protect and enhance their revenue streams and taxes, while consumer accounts must be kept affordable.

Having examined the legislative framework for local government administration supporting the revenue and debt management of municipalities, the next section considers the roles and responsibilities of municipal structures concerning revenue and debt management.

2.3 ROLES AND RESPONSIBILITIES OF MUNICIPAL STRUCTURES

The legislative framework provides broad guidance to concretise local government responsibilities in being accountable to the people being served. In this regard, the roles and responsibilities of municipal councils are paramount.

2.3.1 Roles and Responsibilities of Municipal Councils

Municipal councils must establish structures that will enable community participation. Local government should be transparent, meaning that it has to make its information available to the community by means of releasing income and expenditure statements to the community, as prescribed by Section 75 of the MFMA (RSA, 2003). If such information is not made available to communities, the process of participation and engagement with such communities will fail.

Section 4(2) of the MSA (RSA, 2000a) outlines the rights and duties of the municipal council as follows:

- To exercise the municipality's executive and legislative authority and to use the resources of the municipality in the best interests of the local community;
- To provide, without favour or prejudice, democratic and accountable government;
- To encourage the involvement of the local community; and
- To give members of the community equitable access to the municipal services to which they are entitled.

The municipal council plays an executive and legislative role, as per Section 11 of the MSA (RSA, 2000a), and is responsible for the enforcement of law and administrative decision-making. The MSA (RSA, 2000a) 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. The responsibilities of the mayor are stipulated in Section 52 of the MFMA (RSA, 2003) and Cloete and Thornhill (2014:113) and include the following:

- Providing general political guidance in terms of the fiscal and financial affairs of the municipality;
- Taking reasonable steps to ensure that the municipality performs its constitutional and statutory functions within the limits of the budget; and
- Reporting to council, within 30 days of the end of each quarter, on the implementation of the budget and the financial state of the municipality, as well as the performance of the assigned duties.

The above are just some of the major financial responsibilities involved in ensuring the effective administration and sustainability of municipal services.

2.3.2 Roles and Responsibilities of Municipal Officials

In terms of Section 60 of the MFMA (RSA, 2003) the municipal manager of a municipality is the accounting officer, and is responsible for the following:

a) Exercising the functions and powers assigned to an accounting officer in terms of Section 64 of the MFMA (RSA, 2003);
b) Taking responsibility for the management of the revenue of the municipality, and taking reasonable steps to ensure that the municipality has an effective revenue collection system in place consistent with Section 95 of the MSA (RSA, 2000a) and the municipality’s credit control and debt collection policy;
c) Ensuring that the municipality implements and maintains a system of internal controls in respect of debtors and revenue; and
d) Ensuring that the municipality charges interest on arrears accounts, except where the council has granted exemptions.

2.3.3 Roles and Responsibilities of Municipal Chief Financial Officers and Treasury Officials

According to Section 81 of the MFMA (RSA, 2003) the Chief Financial Officer (CFO) is administratively in charge of the budget and treasury office and must perform the responsibilities attached to this office and the delegated responsibilities of the budget and treasury office in terms of Section 81 of the MFMA (RSA, 2003), which include the following:

- To be administratively in charge of the budget and treasury office;
- To advise the accounting officer on the exercising of the powers and duties assigned;
- To assist in the administration of the primary bank account; and
- To perform budgeting, accounting, analysis, financial reporting, cash management, review and other duties as may be assigned in terms of Section 79 of the MFMA (RSA, 2003).

According to Section 60 and Section 81 of the MFMA (RSA, 2003) the municipal manager and CFO are accountable for the management of revenue and debt management, as explained in the subsequent section.

2.4 REVENUE AND DEBT MANAGEMENT

Section 64 of the MFMA (RSA, 2003) requires a municipality's annual budget to be funded by realistically anticipated revenues to be collected. The municipal revenue is alternatively referred to as the municipal tax. Section 12 of the MFMA (RSA, 2003) defines municipal tax as the property rates, taxes, levies or duties imposed by the municipality on its residents.

Gildenhuys (2008:243) asserts that the tax system has three functions: firstly, a revenue function aimed at supplying enough money to finance the costs of supplying public goods and services; secondly, a redistribution of wealth function aimed at spreading the aggregate wealth of a country more evenly over the total population – in other words, reducing wealth differentiation; and thirdly an economic regulation function to create greater economic stability, which means equilibrium between economic growth, inflation and unemployment.

The Local Government Budget and Expenditure Review (National Treasury, 2011b:62) states that all municipalities are expected to raise own revenues in addition to the national transfers they receive from national government. This principle is an important feature of any democratic local government system, since it creates a revenue-service link between the municipality and its customers, which empowers customers to hold municipalities directly accountable for the services provided. Municipalities should consider an integrated approach when it comes to growing and protecting their revenue base, as such institutional knowledge will be a positive contributing factor. According to the Local Government Budget and Expenditure Review (National Treasury, 2011b:63) consumer debts as a percentage of own revenues have been declining. This can be partly attributed to the rapid increase in own revenues due to the increase in electricity tariffs, as well as debt write-offs. The Local Government Budget and Expenditure Review (National Treasury, 2011b:63) also maintains that there is evidence that certain municipalities have been paying greater attention to revenue management.

The main sources of revenue for municipalities are user charges and funds generated by the sale of water and electricity. The provision of basic services such as electricity, water and sanitation, and refuse and waste removal is critical for all people living in the areas serviced by the respective municipalities. Sections 152(1) and 152(2) of the Constitution (RSA, 1996) place the responsibility on local government to ensure that such services are progressively expanded to all citizens. Municipalities will only be in a position to provide these services if they have sufficient revenue.

In light of the above, Van der Waldt *et al.* (2007:199) mention that the accounting officer of a municipality is responsible for the management of that municipality's revenue. Van der Waldt *et al.* (2007:199) further hold that the accounting officer must take all reasonable steps to ensure that:

- The municipality has effective revenue collection systems in place consistent with the municipality's credit control and collection policy;
- The revenue due to the municipality is calculated on a monthly basis;

- The accounts for municipal tax and charges for municipal services are prepared every month, or less often if the monthly accounts are uneconomical;
- All money received is promptly deposited into the municipality's bank account;
- The municipality maintains proper management, accounting and information systems that recognise revenue, accounts for debtors, and accounts for receipts of revenue;
- The municipality maintains its systems of internal control over debtors and revenue;
- The municipality charges interest on arrears, except in cases where the municipal council has granted exemptions in accordance with its budget-related policies; and
- All revenue received by the municipality, including revenue received by any collection agents on its behalf, is reconciled on a weekly basis.

What is contemplated above is that all municipalities (i.e. metropolitan, district and local) must ensure that the aforementioned revenue management controls are in place.

Van der Waldt *et al.* (2007:198-199) assert that municipal councils must adopt by-laws to give effect to the credit control and debt collection policy and ensure the implementation and enforcement thereof. Fourie *et al.* (2011:239) further hold that Section 97 of the MSA (RSA, 2000a) determines that a municipality's credit control and debt collection policy must be consistent with its rates and tariff policies and must provide for the following:

- Credit control procedures and mechanisms;
- Debt collection procedures and mechanisms;
- Provision for indigent debtors consistent with the rates and tariff policies, as well as any national policy in this regard;
- Realistic targets consistent with generally recognised accounting practices and collection ratios, including estimates of income set out in the budget, less any acceptable provision for bad debts;
- Interest on arrears;
- Time extensions for account payments;
- Termination or restriction of services when payments are in arrears;

- Provision for matters related to the unauthorised consumption of services, as well as theft and damages; and
- Provision for any other matters that may be prescribed.

In light of the above, as stated by Fourie *et al.* (2011:239), municipalities can only pay for bulk services, maintain their infrastructure and fund new infrastructure if their own revenue and credit control management functions are effective. Effective credit control and debt collection are key to the sustained financial viability of municipalities.

According to the State of Local Government Finances and Financial Management Report (National Treasury, 2011c:6), a municipality should at a minimum maintain a positive cash position. This will require that municipalities firstly collect all monies due to them and secondly rehabilitate debtors to ensure receipt of future payments. Section 45 of the MFMA (RSA, 2003) provides that municipalities are not allowed to close the financial year with any short-term borrowing or overdraft.

Section 64(1) of the MFMA (RSA, 2003) states that the accounting officer of a municipality is responsible for the management of that municipality's revenue. According to Section 64(2) of the MFMA (RSA, 2003) the accounting officer must take all reasonable steps to ensure:

a) That the municipality has effective revenue collection systems in place consistent with Section 95 of the MSA (RSA, 2000a) and the municipality's credit control and debt collection policy;
b) That revenue due to the municipality is calculated on a monthly basis;
c) That accounts for tax and charges for municipal services are prepared at least monthly;
d) That in accordance with the MFMA (RSA, 2003), all money received is promptly deposited into the municipality's primary and other bank accounts;
e) That the municipality implements and maintains a management, accounting and information system that –
    i. recognises revenue when it is earned
    ii. accounts for debtors

iii. accounts for receipts of revenue

f) That the municipality implements and maintains a system of internal control in respect of debtors and revenue, as may be prescribed;

g) That the municipality charges interest on arrears, except where the council has granted exemptions in accordance with its budget-related polices; and

h) That all revenue received by the municipality, including revenue received by any collecting agent on its behalf, is reconciled at least on a weekly basis.

In addition, Section 64(3) of the MFMA (RSA, 2003) states the accounting officer must immediately inform the National Treasury of any payments due by an organ of state to the municipality in respect of municipal tax or for municipal services, if such payments are regularly in arrears for periods of more than 30 days. Furthermore, Section 64(4) of the MFMA (RSA, 2003) indicates that the accounting officer must take all reasonable steps to ensure the following:

a) That any funds collected by the municipality on behalf of another organ of state is transferred to that organ of state at least on a weekly basis; and

b) That such funds are not used for purposes of the municipality.

According to Section 95(a) of the MSA (RSA, 2000a) a municipality must establish a sound customer management system that aims to create a positive and reciprocal relationship between persons liable for these payments and the municipality and, where applicable, a service provider. Section 96 of the MSA (RSA, 2000a) requires municipalities to collect all revenue that is owed to them in terms of applicable legislation.

The MSA (RSA, 2000a) and MFMA (RSA, 2003) provide these legislative requirements in order to promote and ensure efficiency in revenue and debt management processes.

2.4.1 Importance of Service Delivery in Enhancing Revenue Collection

Section 155(4) of the Constitution (RSA, 1996) provides that all municipalities are expected to raise own revenues in addition to the transfers they receive from national government. This principle is an important feature of any democratic local government system, since it creates a revenue-service link between the municipality and its customers, which empowers customers to hold municipalities directly accountable for the services they provide. Municipalities should consider an integrated approach when it comes to growing and protecting their revenue base, since such institutional knowledge will be a positive contributing factor in this regard.

The main sources of revenue for municipalities are user charges and funds generated by the sale of water and electricity. The provision of basic services such as electricity, water and sanitation, and refuse and waste removal is critical to the people living in the areas serviced by the respective municipalities. However, municipalities will only be in a position to provide these services if they have sufficient revenue.

The delivery of quality services by municipalities is a fundamental success factor in terms of improving revenue collection.

De Villiers and Michel (2006:8) indicate that residents should not be expected to tolerate poor services in return for their money. People inevitably have different perspectives on what is considered important, depending primarily on their income, social status, time perspective and level of development. Effective service delivery is enhanced by technical competence, friendliness, speed, correctness and overall effectiveness in creating a total positive image or perspective on the part of the user (De Villiers & Michel, 2006:8).

Van der Waldt *et al.* (2007:199) further hold the view that the accounting officer must take all reasonable steps to ensure that:

- The municipality has effective revenue collection systems in place consistent with the municipality's credit control and collection policy;
- The revenue due to the municipality is calculated on a monthly basis;
- The accounts for municipal tax and charges for municipal services are prepared every month, or less often if the monthly accounts are uneconomical;
- That all money received is promptly deposited into the municipality's bank account;

- That the municipality maintains proper management, accounting and information systems that recognise revenue, as well as accounts for debtors and accounts for receipts of revenue;
- That the municipality maintains its systems of internal control over debtors and revenue;
- That the municipality charges interest on arrears, except in cases where the municipal council has granted exemptions in accordance with its budget-related policies; and
- That all revenue received by the municipality, including revenue received by any collection agents on its behalf, is reconciled on a weekly basis.

These guidelines are in line with the requirements of Section 64 of the MFMA (RSA, 2003) in view of promoting effective revenue and debt management. Van der Waldt *et al.* (2007:198-199) maintain that municipal councils must adopt by-laws to give effect to the credit control and debt collection policy, and to ensure that such policy is implemented and enforced. Fourie *et al.* (2011:239) further hold that Section 97 of the MSA (RSA, 2000a) determines that a municipality's credit control and debt collection policy must be consistent with its rates and tariff policies, and must provide for the following:

- Credit control procedures and mechanisms;
- Debt collection procedures and mechanisms;
- Provision for indigent debtors consistent with the rates and tariff policies, including any national policy in this regard;
- Realistic targets consistent with generally recognised accounting practices and collection ratios, including estimates of income set out in the budget, less any acceptable provision for bad debts;
- Interest on arrears;
- Time extensions for account payments;
- Termination or restriction of services when payments are in arrears;
- Provision for matters related to the unauthorised consumption of services, as well as theft and damages; and
- Provision for any other matters that may be prescribed.

According to the State of Local Government Finances and Financial Management Report (National Treasury, 2011c:6), at a minimum a municipality should maintain a positive cash position. This will require municipalities to firstly collect all monies due to them, and secondly to rehabilitate debtors to ensure the receipt of future payments. Some municipalities undertake extensive debt collection exercises, which often have little or no impact due to, amongst other things, inaccurate or poor information. Debt management can be extremely time consuming and costly, and often has a detrimental effect on the relationship between the community and the municipal council. Having explained the importance of revenue collection to enhance service delivery, the following subsections explain the reasons why municipalities are experiencing debt problems.

2.4.2 Reasons for Municipalities' Debt Problems

According to the State of Local Government Finances and Financial Management Report (National Treasury, 2011c:12), as well as Van der Waldt *et al.* (2007) and Fourie *et al.* (2011), there are several factors that could possibly be contributing to the escalating municipal debt, namely:

a) Resistance amongst certain communities to paying for certain types of services

The general media has attributed the under-collection of outstanding municipal revenue to the fact that certain customers withhold payment for services without any regard to the quality of such services.

b) Affordability

As the majority of the citizens derive their income from employment, it could also be argued that the problem could be the result of the prevailing high levels of poverty due to the high unemployment rate in the country.

It is argued that the poverty of many households makes them unable rather than unwilling to pay, hence the need for free basic services to the poorer segments of the population and/or a lowering of the rates. This argument is supported by McDonald (2002b), amongst others. It is assumed that an understanding of the relationship between payment for services and provision of services is a critical factor for compliance; consequently, the prescription is the education and political mobilisation of ratepayers, combined with the restoration of law and order.

c) Culture of entitlement

The problem of non-payment also stems from a "culture of entitlement" and dependency. It is argued that many people believe that public services are a basic right and should not be paid for. In many cases, people are overly dependent on government, feeling entitled to receiving services free of charge (Fjeldstad, 2004:8).

d) "Free-rider" problem

A survey conducted by Burger (2001:13) found that in many urban municipalities, households and individuals that can in fact afford to pay for services instead opt for a "free ride" under the basic behavioural assumption that people in general are "free riders". The problem of non-payment stems from such "free-riding"; in other words, nobody would voluntarily contribute to government unless the threat of punishment renders this the most sensible option. The temptation to not comply, even where others are in fact complying, defines the problem of "free-riding".

In reality, there are some residents who opt not to pay for their services simply because they feel they can get away with it, and because they know of many other residents who are also not paying for services and have thus far not suffered any negative consequences as a result (Burger, 2001:14). With the high levels of non-payment evident all around, it is not surprising that some residents take advantage of the situation. To improve service delivery it is of crucial importance to address the broader problem of "free-riding". According to Burger (2001:14) many people are in a position to pay for services but opt not to do so.

The negative effect of the municipal debt problem is becoming increasingly evident. Municipalities routinely receive poor audit reports and therefore gain a reputation of poor service delivery, ineffectiveness, incompetence and high levels of corruption. Drawing from the 2009 State of Local Government Report and lessons learned from the 2006 province-wide municipal assessment conducted by the Department of Cooperative Governance and Traditional Affairs, the Local Government Turnaround Strategy (LGTAS) was implemented (Van Niekerk, 2012:58-59). The LGTAS is a comprehensive strategy for the mobilisation of all municipalities in embarking on a concentrated effort to address factors undermining the country's municipalities and to restore good performance, effective financial management and service delivery.

2.4.3 Consultation with Residents and All Stakeholders

Section 29 of the MSA (RSA, 2000a) emphasises the importance of municipalities consulting with residents and other stakeholders in terms of successful service delivery and revenue generation. In this regard, consultation with customers is paramount in fostering the Batho Pele principles as contained in the White Paper on the Transformation of Public Service Delivery (RSA, 1997e.)

2.4.3.1 Batho Pele Principles

The White Paper on the Transformation of Public Service Delivery, otherwise known as the Batho Pele White Paper (RSA, 1997e), provides eight Batho Pele principles, namely consultation, service standards, access, courtesy, information, redress, value for money, openness and transparency. Municipal officials must uphold these Batho Pele principles in view of providing services that will have a positive impact on their communities in terms of revenue and debt. The Batho Pele principles are part of the initiative to encourage public servants to be service oriented through the improved provision of excellent services. These principles are meant to be a simple and transparent mechanism allowing customers to hold public servants responsible for the quality of services delivered.

Municipalities must at all times uphold the eight Batho Pele principles as follows:

- Consultation: Municipalities should always consult with their communities and other stakeholders regarding all decisions on the quality of services to be rendered, and the community and stakeholders should be given the option to choose the type of services to be provided.
- Service Standards: Municipal councillors should be honest when communicating with their communities and stakeholders regarding the level and quality of services to be offered by the municipality. Such honesty will ensure that the community is aware of the level of service to be expected.
- Access: The entire community, including the indigent or poor, should have access to the services offered by the municipality. This should include physical access to municipal facilities by the disabled.
- Courtesy: All residents must be treated with courtesy and consideration in all respects, including the manner of answering telephones, friendliness, helpfulness, and treating others with dignity and respect.
- Information: Councillors and officials should always provide full and accurate information about the services to which their communities are entitled.
- Openness and Transparency: Engaging with residents on the operation of national and provincial government departments with regard to service delivery is crucial, particularly during consultation on the budget process.
- Redress: It is important for councillors to communicate with residents in a timely manner regarding any challenges or delays in service delivery (Cloete and Thornhill, 2014:111). The community is entitled to the clear communication and full explanation of all processes.
- Value for money: Municipal services should be economical, effective and efficient, with municipalities always striving to provide services of the best possible quality.

Thus, Batho Pele highlights the standards to be observed by local government practitioners in view of having a positive impact on the debt management function. Support from the various levels of government is needed to ensure that the municipalities succeed in their service delivery mandate.

2.4.3.2 Intergovernmental Cooperation in Service Delivery

Section 40(1) of the Constitution (RSA, 1996) describes the three spheres of government to be distinctive, independent and interrelated. In this regard, the national, provincial and local governments must work together within the intergovernmental relations framework in order to solve service delivery challenges.

The South African Local Government Association (SALGA, 2010:31) maintains that the only way in which municipalities with no significant urban centre are able to increase their revenue is by eliminating service delivery backlogs and providing housing to informal settlements. However, this would require ongoing fiscal support from government in general in order to make inroads towards the eradication of backlogs and the expansion of services to finance the relevant operating and maintenance costs.

The diversity of services provided by municipalities also impacts on their financial self-sustainability. SALGA (2010:20) asserts that a municipality with a diverse revenue base is more likely to be self-sustainable than a municipality that does not provide a wide range of services. Moreover, the expansion of services to indigent people cannot be fully recovered through cross-subsidisation from higher-income consumers and ratepayers.

From the above narrative it is paramount that revenue pricing is realistic, affordable and fully consultative before implementation by Municipal Councils. The spending of municipal budgets is discussed in section 2.5, with specific reference to unspent conditional grants and management reporting.

2.5 SPENDING OF THE BUDGET

According to Alberts (2008:28) the country's largest municipalities still spend far less than their estimated capital budgets, and because the municipalities adjust their budgets during the financial year, they appear to be spending more than they actually intended at first. The under-spending in several cities has been attributed to a lack of spending capacity, poor planning, and the unreliability of the grant system, especially the low-cost housing grant. The Municipal Budget and Reporting Regulations (MBRR), as signed by the Minister and published in Government Gazette 32141 (National Treasury, 2009), indicates that the municipal adjustment budget process takes place after the legislated budget mid-year review process, with the municipalities – particularly those that have recorded significant under-spending – later having to adjust their budgets to more realistically reflect actual capital expenditure. In light of the above, the unspent conditional grant is discussed hereunder.

2.5.1 Unspent Conditional Allocation

The annual DoRA provides that any unspent conditional grants should revert back to the National Revenue Fund, unless the municipality can provide evidence, to the satisfaction of the National Treasury, that the unspent conditional funds have been committed to identifiable projects.

In 2010 the CFO of Fetakgomo Municipality in the Sekhukhune District Municipality of the Limpopo Province (Makgatla, 2010:4) conceded that due to lower expenditure levels on their capital projects, the municipality was at risk of budget cuts during the next capital budget allocation from CoGTA. This implies that all municipalities must spend their original budgets in full as planned, if they are to succeed in providing quality service delivery. With their limited financial resources, municipalities in South Africa cannot afford to bear the consequences of having to make repayments to the National Revenue Fund due to low levels of spending.

In order to achieve full spending of their budgets, municipalities need to draft budgets that are credible. A credible budget must be consistent with the Integrated Development Plan (IDP) of a municipality (National Treasury, 2005a) and should be achievable in terms of service delivery and performance targets (National Treasury, 2007:5). Prior to the implementation of the budget, a municipality must prepare a Service Delivery and Budget Implementation Plan (SDBIP), which is a management and implementation tool setting out in-year information, such as quarterly service delivery and monthly budget targets, and linking each service delivery output to the budget of the municipality, thus providing credible management information and a detailed plan on how the municipality will provide such services, as well as the inputs and financial resources to be used (National Treasury, 2005a).

According to Cloete and Thornhill (2005:119-121) the IDP is the principal strategic planning instrument that guides and informs all planning and development, as well as decision-making regarding planning, management and development within the municipality. Furthermore, the IDP binds the municipality in the exercising of its authority within the framework of national and provincial legislation, setting out long-term plans for development strategies and action plans as required to achieve the municipality's objectives.

2.5.2 Management Reporting

Section 71(1) of the MFMA (RSA, 2003) requires the accounting officer of a municipality to submit a report, no later than 10 working days after the end of each month, to the mayor and the relevant provincial treasury, regarding the progress in terms of municipal revenue and expenditure. This requirement concurs with the views of Reddy, Sing and Moodley (2003:56), emphasising the importance of management reporting in informed decision-making. The task of the national and provincial treasuries is to analyse these reports and advise the municipalities accordingly. Section 71 of the MFMA (RSA, 2003) also requires municipalities to table the income and expenditure reports on a quarterly basis and to release the findings to the public through websites and other relevant means in an effort to promote transparency.

The spending of budget is vital for both service delivery and expansion of the municipal revenue base. Underspending of municipal infrastructure grants contributes negatively to the economy and erodes the capacity of service delivery distribution networks. The next section discusses the contribution of local economic development.

2.6 CONTRIBUTION OF LOCAL ECONOMIC DEVELOPMENT

Local Economic Development (LED) within the local sphere of government is at the heart of the development process in South Africa. Through its grassroots links, infrastructure investment programmes, local economic development strategies, partnerships with the private sector and integrated development plans, the local government sphere is the public service agency best able to have a direct and enduring impact on the lives of its citizens (Du Toit, Knipe, Van Niekerk, Van Der Waldt & Doyle, 2002:145).

Van der Waldt *et al.* (2007:133) define LED as a process whereby government authorities enter into partnerships with organs of civil society in order to develop local solutions to the economic challenges and problems confronting society. According to Van der Waldt *et al.* (2007:133) the ultimate objective of LED is to develop a method for utilising local resources and skills to uplift the standard of living for the community in a viable and sustainable manner.

2.6.1 Ensuring and Promoting Competitiveness in Local Commerce and Industry

According to MFMA Circular 70 (National Treasury, 2013c:3) municipalities should ensure that job creation and the competitive nature of commerce and industry are not adversely affected by higher rates and service charges on industry and commerce as a means of subsidising domestic users. Greater transparency is required to ensure that investors are aware of the full costs of doing business in the local sphere of government. This requirement is consistent with Section 75 of the MFMA (RSA, 2003), which requires all municipalities to publish their budgetary and expenditure documents, together with general information about their affairs, on municipal websites.

2.6.2 Need for Economic Diversification

Reddy *et al.* (2003:23) maintain that municipalities can support LED through direct economic services, such as the provision of business facilities, the promotion of agri-industry, and the support of tourism initiatives and human development programmes. Matlawe (2006:56) refer to the fact that the dependence on one or two strong sectors leaves the economy of the area vulnerable to external influences such as fluctuations in commodity prices, with a consequent negative impact on employment.

Matlawe (2006:56) therefore calls for urgent economic diversification to absorb any negative impact that may result from changes by the dominant sector within a municipality. Free State municipalities must therefore jointly channel their efforts towards ensuring that all possible investors will harness sectors that are currently untapped, specifically the mining sector.

2.6.3 Consequences of Ecological and Climate Change

Alberts (2007:25) raises two aspects of concern that could have a negative effect on South Africa's efforts to attract business investments: Firstly, since the expansion of the country's electricity-generating capacity has fallen behind, the rising costs of funding electricity infrastructure programmes are likely to threaten South Africa's status as a viable investment destination, in light of the high energy costs involved in running a business enterprise. Secondly, South Africa faces the challenge of keeping overall energy costs low while having to reduce the use of coal as the primary source of energy generation due to the high levels of pollution involved. Moving away from the use of coal and towards the use of crude oil is an expensive enterprise for a developing country like South Africa.

2.6.4 Reskilling Indigents in View of Employment

Another challenge faced by municipalities in rural areas is that the few residents who actually possess formal qualifications mostly tend to move away and seek job opportunities elsewhere, thus creating a skills shortage in that area. In an effort to assist those residents with some basic skills to become employable, municipalities must work through their ward committees to identify suitable residents to be referred to training programmes being offered by government institutions. In addition, municipalities must make every effort to stimulate the economy so as to create employment for graduates.

2.6.5 Supply Chain Management as a Tool for Local Economic Development

According to Section 217 of the Constitution (RSA, 1996) supply chain management (SCM) policy must be fair, transparent, equitable, competitive and cost-effective. Section 217(3) of the

Constitution (RSA, 1996) furthermore determines that national legislation must prescribe a framework to promote the advancement of persons or categories of persons that were disadvantaged by unfair discrimination, while Section 111 of the MFMA (RSA, 2003) and MFMA Circular 22 (National Treasury, 2005b:1) require municipalities to adopt and implement the SCM policy. According to the Western Cape Government: Provincial Treasury (2010), SCM is the core component of public financial management discipline, which seeks to ensure the proper flow of goods and services between supplier and public institution, at the right quality and quantity, whilst advancing the goals of the Reconstruction and Development Programme (RDP) and pursuing LED priorities.

Municipalities must strengthen their ward committee systems to enchance National and Provincial Government programmes.

2.6.6 Strategies for Improving Revenue Collection

According to Rosenberg (2008:1), revenue enhancement requires government to be committed to optimising revenue sources that are legally and administratively available, and to exploring opportunities to diversify revenue sources where existing revenues are inadequate to meet the demands for change and growth. Therefore, considering the rationale behind an effective LED programme, the aim should be to ensure that municipalities operate in an environment that is economically sound, by ensuring that the residents are gainfully employed and thus able to pay for municipal services (Van der Waldt *et al.* 2007:133).

2.7 DEVELOPMENT OF REVENUE ENHANCEMENT STRATEGIES AND POLICIES

Rosenberg (2008:1) advises that for any municipality, the first step in improving revenue is to develop a coherent revenue enhancement strategy supported by policies that encourage both revenue growth and diversity. Before implementing such a strategy, municipal councils would be wise to consult with their communities and all other relevant stakeholders in a bid to lure their ‘buy-in’. The purpose of the revenue strategy and the benefits for the community should be explained in detail to the community, after which the necessary by-law can be adopted by the council to give effect to the implementation of the relevant policies.

In terms of the MBRR (National Treasury, 2009:13) municipalities are expected to adopt a funding and reserve policy in determining the projected billings, collections and direct revenues, the provision for revenue not collected, and the funds the municipality can expect to receive from investments and other sources.

In order to enhance and protect their revenue, municipalities should consider the following approaches:

2.7.1 Charging Affordable Tariffs

The National Treasury (2008:107) explains the charging system for municipalities as being complemented by nationally funded subsidies for infrastructure and ongoing services to poor households. As such, tariff charges – particularly those applicable to the poor – must be affordable.

Pro-poor policies should be put in place to identify those ratepayers or customers considered indigent and unable to pay for services, as based on the prevailing income thresholds (Free State Provincial Treasury, 2014:14).

2.7.2 Billboard Advertisements

By establishing an adequate billboard infrastructure across their entire area of jurisdiction, a municipality has the opportunity to enter into fixed-term contracts (three to five years) with members of the business community, whereby the municipality charges such businesses a certain fee for the use of these facilities for advertising purposes (Free State Provincial Treasury, 2014:6).

Such billboard fees would vary (e.g. the cost of advertising on one side of a billboard being less than the cost of advertising on both sides), while the contract in this regard should include a clause allowing the municipality to raise the billboard fees annually before the start of every new municipal financial year.

Some other revenue enhancement and protection strategies, as proposed by USAID (2010:11), are discussed below.

2.7.3 Provision of Metered Services

The use of metered services is said to be a critical task, since it ensures that there is no wastage or pilfering of water and electricity meters. Municipalities must regularly service the water and electricity meters in order to guard against malfunctioning that may result in inaccurate billing, water or electricity leakages, or any other form of loss such as illegal connections (USAID, 2010:12).

2.7.4 Accurate Billing

Accurate metering and billing is important in terms of consumer confidence in the accuracy of service charges. As such, municipalities must have accurate details of their customers' particulars, including residential addresses and names, and must ensure that meter readings are accurately captured. Another important consideration for municipalities is the need to determine whether the tariffs being charged to particular customers are correct in terms of either business tariffs or household tariffs. In fact, there are currently several court cases pending in respect of the incorrect billing of townhouse complexes and retirement homes as businesses. Correct billing ensures satisfied customers (Free State Provincial Treasury, 2014:6).

2.7.5 Revenue Collection

It is important for municipalities to identify and differentiate between those customers who can afford to pay for services and those customers who are indigent (Free State Provincial Treasury, 2014:14). Municipalities should therefore keep accurate registers of indigents who are unable to pay, with their situations be reviewed on an annual basis. At the same time, however, municipalities should work through the Expanded Public Works Programme to create labour-intensive projects within their areas as a means of creating jobs for such indigents and help them to become independent. The benefit of this for municipalities is that they would then be relieved from the burden of having to subside free services for the indigent population.

According to Section 96 of the MSA (RSA, 2000a), all municipalities' customer care and debt management practices should be stipulated in their credit control and debt collection policies, to be revised annually, as supported by the relevant by-laws. Each municipality must compile and maintain a 'municipal code' comprising all the relevant by-laws, with members of the public entitled to request copies thereof at a reasonable fee. The MSA (RSA, 2000a) provides for the following in this regard:

- The municipality must document the procedures followed in giving effect to the policies and by-laws adopted.
- Consolidated billing should be introduced as a means of facilitating the debt collection process.
- In cases where customers pay only a portion of their municipal accounts, such payments are allocated in a specific order, with the electricity service usually used as leverage to collect the balance of the amount due.
- It is imperative that municipalities ensure accurate billing information before pursuing credit control measures such as disconnection of electricity.
- In terms of the "restraint on transfer of property" stipulated in the MSA (RSA, 2000a), the Registrar of Deeds shall not transfer ownership of any immovable property unless the municipality has certified that all monies due during the two years preceding the clearance application date have been paid in full.
- Any amount due for municipal services, property rates and/or other property taxes is a charge upon the property, and municipalities should use this provision to ensure the timely collection of outstanding debt timely from registered owners.
- Where there is outstanding debt on a property that is older than the two-year minimum period, the municipality must endorse the revenue clearance certificate to confirm that there is debt older than the two-year period and that the new owner shall inherit the debt.

- It is useful for officials working in revenue management, particularly those involved in the legal process, credit control and clearances, to familiarise themselves with all judgements that may have an impact on the municipality's credit control and debt collection activities.

Therefore, the most crucial aspect of debt management is that it must be planned thoroughly, controlled well, and followed diligently. It is important that everyone involved is aware of his or her role and place in the overall plan.

2.7.6 Arrears Management

A suitable debt management process involves the issuing of letters of demand for the payment of accounts in arrears, with all subsequent legal procedures to follow, and the identification of defaulters in a segmented fashion to allow for the targeting of specific defaulters, thus optimising the recovery of funds (DBSA, 2004:23).

Revenue generation is the responsibility of every municipal official, not just the revenue management unit. Municipalities must effectively manage all functions with a potential impact on the protection and growth of their revenue base. The implementation of internal controls along the revenue value chain will aid in effective data handovers, while system data validation mechanisms and service level standards are fundamental in ensuring the integrity of billing data. Municipalities tend to neglect these basics and instead opt for costly 'data cleansing' exercises; however, it is only by protecting data integrity at the source that the municipality will be able to ensure longer-term benefits such as improved debt collection. Municipal functions must be adequately staffed with competently skilled individuals who understand the job requirements and how best to deliver thereon. Municipalities are advised to utilise the clearance process, such as the restraint on the transfer of property, to recover outstanding municipal debt, as outlined in Section 118(1) of the MSA (RSA, 2000a).

2.7.7 Austerity Measures

The introduction of strategic or austerity measures ensures that the operating expenses of the municipality are kept at a minimum. Fourie *et al.* (2007:104), however, maintain that the nature of a municipality's general expenses will depend on the range and nature of services provided by that municipality.

Strict adherence to municipal policies, such as subsistence and travel allowance policies amongst others, is critical in curbing unnecessary costs.

2.8 FUNDING MODELS FOR MUNICIPALITIES

The primary responsibility of a municipality is to deliver services – this is what the municipality's "business" is about. Section 75A of the MSA (RSA, 2000a) allows municipalities to levy and recover fees, charges or tariffs in respect of municipal service delivery functions, and to recover collection charges and interest on outstanding amounts.

Furthermore, Section 75 of the MSA (RSA, 2000a) makes it a necessity for municipalities to adopt and publish by-laws giving effect to the implementation and enforcement of their tariff policies; in fact, all policies and the supporting decisions taken by the municipal council must be supported by the necessary by-law in order to make them legally enforceable. Failure to comply with the necessary by-law requirements may expose the municipality to litigation.

2.8.1 Funding of the Operating Budget

Each municipality in South Africa receives a formula-driven equitable share of the nationally raised revenue allocated to local government. Equitable share allocations are intended to supplement municipal own revenue derived from trading services and property rates. While municipalities may use their equitable share allocation at their discretion, it is primarily intended to fund free basic services (Free State Provincial Treasury, 2014:15).

According to the annual DoRA, national conditional grant allocations are usually intended for a specific purpose and have certain conditions attached as to how the funds should be utilised, for example the Municipal Systems Improvement Grant (MSIG) and the Finance Management Grant (FMG). National conditional grant funding is usually made available for purposes of furthering the national priorities applicable to local government.

Where municipalities fail to meet the conditions as stipulated in the annual DoRA, or where they fail to spend their conditional grant allocations in full, the funds must be returned to the National Revenue Fund. Similarly, provincial transfers are intended for a specific purpose, and municipalities are expected to adhere to the stipulated conditions of each grant. The allocation of such funds is usually specific to the priorities of each province.

Section 216 of the Constitution (RSA, 1996) provides for national government to transfer resources to municipalities in terms of the annual DoRA, in order to assist them in exercising their powers and performing their functions. These allocations are announced annually in the national budget, with such national transfers being supplemented with transfers from provincial government, as well as funding channelled from district municipalities to local municipalities.

2.8.2 Funding of the Capital Budget

The funding of the capital budget presents a challenge in that several municipalities have complained of insufficient funds to undertake capital investment projects (National Treasury, 2011a:64). Municipalities are expected to allocate a portion of their internally generated 'own revenue' towards their capital budget funding mix, but this can only be achieved if surpluses are generated on their Operating Statement of Financial Performance.

To illustrate: In the case of a municipality seeking to construct a road using its 'own revenue', the development of the necessary road infrastructure would traditionally be financed from revenue derived from property rates taxes, but if that municipality's Operating Statement of Financial Performance should fail to generate a surplus, there would consequently be no 'own funding' available to finance the road infrastructure development. On the other hand, if that municipality happened to be in possession of cash-backed reserves from previous financial years, i.e. if surpluses had been generated on the Operating Statement of Financial Performance during previous years, there could well be ‘own funding’ available to the municipality.

Municipalities may also borrow money to fund their capital budget; however, this is dependent on the strength of the municipality’s Statement of Financial Position (balance sheet) and ability to repay the associated finance charges. Funds derived from borrowing should only be utilised to finance infrastructure that is economically beneficial and which generates revenue for the municipality (National Treasury, 2011a:64).

In addition to the provisions above (National Treasury, 2013c:4), national government makes capital transfers to municipalities targeted at specific capital projects, such as the Municipal Infrastructure Grant (MIG) specifically allocated for the eradication of infrastructure backlogs. Another source of funding may be in the form of public contributions and donations where external sources provide money to a municipality – for example, property developers being required to make contributions towards engineering services provided by the local municipality.

Most municipalities across the country derive revenue from the following streams: Firstly, an own revenue stream that includes property rates, traffic fines and service charges for the supply of primary services such as water, sanitation, electricity, refuse removal and other services; secondly, the grants and subsidies from national and provincial governments; thirdly, donations from international or local business funders; and lastly, loans taken out to fund municipal budgets. The sections below discuss the aspects of property rates, electricity services, water and sanitation services, refuse removal, nominal levies and sundry revenue sources, government grants, borrowing and municipal debt management.

2.8.3 Property Rates

Property rates are legislated in terms of the MPRA (RSA, 2004a). De Visser and Singana (2010:15) define property rates as a form of tax imposed on the market value of land and buildings. All local municipalities are empowered by the MPRA (RSA, 2004a) to levy property rates taxes. In order to ensure that the property rates charged are affordable, the MPRA (RSA, 2004a) empowers the Minister of CoGTA to determine the ratios to be followed when levying charges for property rates among the residential and non-residential categories of properties. Determining the different property rates ratios ensures that the existence of public institutions classified as 'public benefit organisations', such as schools, welfare institutions and humanitarian organisations, is not jeopardised.

Sections 32(b) and 77 of the MPRA (RSA, 2004a) require municipalities to update their valuation roll at least once per year in order to keep an accurate roll of all properties. The valuation roll forms the basis in determining the property rates to be charged, based on the market value of the property concerned. The information relating to each debtor is captured and maintained in a debtors' master file or sub-ledger on the municipality's database, and is used for billing purposes (Fourie *et al.*, 2007:170). The selected municipalities are required to review the rates to be levied on an annual basis, thereby prompting the revision of the property rates policies. In light of the risk of organisations attempting to pose as 'public benefit organisations' in a bid to be charged less than they should be paying, municipalities are entitled to evaluate such organisations' audited annual financial statements in order to verify the correct and fair rates to be charged (De Visser & Singana, 2010:15). CoGTA has commenced with a process of public consultation for further amendments to the MPRA (RSA, 2004a) in view of considering the exclusion of poor communities, public service infrastructures, places of worship and communal areas from property rates charges.

According to Cloete and Thornhill (2014:129), municipal property rates are a tax levied on the market value of properties within the municipality's jurisdiction. Property rates must be determined in terms of the MPRA (RSA, 2004a), which provides for municipalities to adopt a rates policy that is consistent with the provisions of the MPRA for the levying of property tax on all rateable properties within the municipality's area of jurisdiction. Furthermore, a municipality must pass an appropriate by-law in this regard and publish it in the provincial gazette, thus giving effect to or legalising the levying of property rates tax by the municipality.

The municipality's budget finalisation process must include the passing of a resolution on the levying of property rates tax per category of property, with this resolution to be promulgated in the policy upon ratification of the budget decisions (RSA, 2003:24). Any failure to comply with this obligation in a particular financial year would render the property rates uncollectable, consequently posing a significant risk to the financial sustainability of the municipality (RSA, 2003:25). It is therefore imperative that municipalities comply with this requirement in order to ensure sustainability and efficiency in terms of revenue collection.

2.8.4 Electricity Services

A municipality is responsible for the provision of electricity to the community, as stipulated in Part B, Schedule 4 of the Constitution (RSA, 1996). The quality supply of electricity services in a sustainable manner is an enormous responsibility that requires a municipality to be well capacitated and highly resourced.

Consequently, in light of the prevailing capacity constraints experienced by South African municipalities, especially those of small and medium capacity, the national electricity provider (Eskom) distributes electricity services directly to such municipalities.

Highly capacitated municipalities with better resources are able to manage the supply of electricity within their respective municipal areas, with the IDP in each case stipulating the municipality's responsibilities in this regard as being the distribution of electricity, along with the provision of energy management, technical services and specialised engineering services. MFMA Circular 67 (National Treasury, 2013b) requires electricity tariffs to be fair and affordable. This is achieved by the submission of the proposed tariff pricing to the National Energy Regulator of South Africa (NERSA) for review and approval, as part of a wider consultation process with the community and all stakeholders of the municipality.

Gower (2010:6) identifies three factors in the distribution of electricity that can be considered 'non-technical losses', namely database errors, faulty electrical installations, and illegal connections and meter tampering. Gower (2010:6) furthermore advises against the over-averaging of meters in cases where accurate meter-reading data is unavailable, since this actually projects inaccurate sales figures until such time as the proper meter-reading data can be confirmed. Thus, municipalities must ensure efficiency and skill in this service area if they are to be profitable.

2.8.5 Water and Sanitation Services

Water is the most essential and indispensable natural resource for mankind and life in general. The provision of water and sanitation services by municipalities emanates from Part B, Schedule 4 of the Constitution (RSA, 1996). All local municipalities in the Free State Province are required to provide water and sanitation services (National Treasury, 2008:11), with Fourie *et al.* (2007:170) pointing out that a municipality may impose a fixed charge per property or per water connection to cover the fixed costs involved, plus a consumption charge per kilolitre of water consumed. In addition, the general scarcity of water resources requires many municipalities to institute a tariff structure or sliding scale for direct consumption, which penalises consumers who use more than a given volume. Fourie *et al.* (2007:170) identify three tariff structures used to determine the pricing structure, namely flat-rate tariff, two-part tariff, and block-rising tariff.

All municipalities provide the first six kilolitres of water per month free of charge to indigent households, and in some cases free water services apply only to registered or identified indigents. However, municipalities face an enormous challenge in having to contend with high debt levels from water supply services, since water is constitutionally protected as a basic necessity.

Fourie *et al.* (2007:169) state that sewage services include waterborne sewage disposal, vacuum or conservancy tanks, and bucket removals. The costs of such services can be calculated independently, for example the case of a waterborne system whereby the tariff is based on water consumption per residence or building.

2.8.6 Refuse Removal

Pauw, Woods, Van der Linde, Fourie and Visser (2009:306) maintain that good waste management and recycling can contribute towards economic growth. Pauw, *et al.* (2009:306) is of the opinion that when determining the tariffs for critical services such as refuse removal, this should be affordable even to poor households and should cover only operating and maintenance costs. Inadequate refuse management could be a serious health hazard with life-threatening consequences for the community.

2.8.7 Nominal Levies and Sundry Revenue Sources

Gildenhuys (1997a:109) refers to the nominal levies that must be paid for privileges or rights granted by municipalities to individuals or business enterprises, since municipalities incur certain expenses in the provision thereof. Some examples of nominal levies and sundry revenues are trading licences, building plan fees and searching fees.

Gildenhuys (1997a:109) also identifies sundry revenues such as public library membership fees, letting fees for municipal sporting facilities such as swimming-pools and sports grounds, rental fees from other municipal properties such as halls, as well as vehicle licences, housing rentals, traffic fines, incidental fines and forfeitures.

2.8.8 Government Grants

The allocation of government grants to the three spheres of governments, namely national, provincial and local government, is guaranteed by Section 215 of the Constitution (RSA, 1996). These allocations are detailed in the annual DoRA as tabled in parliament by the Minister of Finance, together with the budget speech, before the beginning of each financial year.

The equitable share, as one of the grants allocated to municipalities, is an unconditional grant, which means that there is no expectation that the grant should be used to cover any particular expenses (Fourie *et al.,* 2007:408). This grant subsidises the costs of municipal administrative staff, free basic electricity and water, and other basic services.

2.8.9 Borrowing

Municipalities are allowed to borrow money from legally registered financial institutions in order to augment their financial resources for service delivery (RSA, 2003:45). In terms of Section 46 of the MFMA (RSA, 2003) municipalities may incur long-term debt from a financial institution, only for the purpose of financing the capital assets to be used to carry out infrastructural projects. There has been an increase in municipal loans from the Development Bank of Southern Africa (DBSA) in order to finance capital projects to the benefit of many households, such as projects relating to the installation of water and sanitation services and the eradication of the bucket system. The audited financial statements of the three identified municipalities for the financial year ending 2011 show that they had all secured long-term loans for further service delivery. One of the underlying objectives of financial management legislation is to support a borrowing framework, and therefore the associated reforms and regulatory frameworks may be undermined if borrowing levels remain relatively low (SALGA, 2010:34).

2.8.10 Municipal Debt Management

Municipal consumer debt has a number of potential effects, such as the crippling of a municipality's cash position and thus its ability to fulfil its constitutionally mandated responsibilities. Municipal consumer debt can also reduce the funding available for the delivery of basic services, infrastructure, maintenance and upgrading (Free State Provincial Treasury, 2014:6-20). Outstanding payments also represent foregone resources that could be used to improve the living conditions of the poor.

The Free State Provincial Treasury (2014:6-20) gives several possible reasons as to why this type of debt arises. The first reason is poor performance by municipalities, in the form of:

- Inaccurate billing

- Weak credit control measures
- Lack of customer service mechanisms, thus reinforcing non-payment

In addition, consumers may be unable to pay as a result of unemployment and poverty. The causes of non-payment in South African municipalities have been the focus of several studies, including those of Booysen (2001), Botes and Pelser (2001), Burger (2001) and Fjeldstad (2004). However, as most of the studies were carried out in the early to mid 2000s, changes in the local government sphere warrant a thorough and updated investigation of the factors driving this kind of debt.

The multiple impacts of municipal consumer debt are a public finance and intergovernmental fiscal concern. Municipalities and local government policymakers need to understand the extent of this debt and how to better manage the related challenges and risks. This research comes at an opportune time, in light of the key priorities of the Local Government Turnaround Strategy (LGTAS) and Outcome 9 of the delivery agreement for the local government sphere on the optimising of revenue collection and the halving of municipal consumer debt by 2014.

Above discussion was important in order to identify principles and factors for inclusion in the model.

2.9 SUMMARY

This chapter outlined the legislation applicable to local government administration, as well as the statutory roles, responsibilities and duties of officials and structures, followed by a discussion of revenue management, debt management, administration of debtors, and the funding mix for municipalities. Although there is growth potential, more rigorous efforts are necessary in making this growth accessible to the poor. Van der Waldt *et al.* (2007:199) indicate that municipalities must enhance their revenue value and internal controls to improve debt collection. In addition, municipalities must protect and enhance their revenue streams and taxes, while consumer accounts must be kept affordable.

The literature review described how the Constitution (RSA, 1996) and various other pieces of legislation serve to mandate local government in general to levy taxes on municipal services provided to the community. The discussion briefly highlighted effective and efficient service delivery as being a critical success factor in enhancing revenue generation within the selected municipalities. The chapter highlighted the contribution of LED as a crucial tool to be used by the selected municipalities to grow their economy, ultimately leading to more job creation for the residents.

Forming partnerships with young people in the economies of municipalities may go a long way towards increasing the municipal revenue base as a means to turn around the debt burden that all municipalities are facing. This would ultimately help to close the gap between the first economy (sophisticated economy, well-adjusted to global economies, boasting a highly skilled labour force, advanced technological base, elaborate infrastructure, information and communication technologies and secondary industries) and the second economy (high unemployment rate, with people trapped in rural, semi-rural and peri-urban areas without the skills needed by the economy).

As part of the literature study the next chapter gives an overview of local financial management and the challenge of debt management.

CHAPTER THREE :
MUNICIPAL BUDGETS AND DEBT MANAGEMENT

3.1 INTRODUCTION

The previous chapter outlined the legislative framework, as well as the statutory roles, responsibilities and duties of officials and structures, followed by a discussion of revenue management, the administration of debtors and the funding mix for municipalities.

The purpose of this chapter is to explore in detail the financial requirements of the MFMA (RSA, 2003) and the National Treasury (2009) in preparation of the annual municipal budgets. The municipal budget cycle is discussed, along with details of the functions of councillors with regard to the annual budget. To contextualise this chapter, the consolidated Free State Provincial Treasury report on municipal draft budgets for the 2013/2014 municipal financial year (Free State Provincial Treasury (2013a) is discussed.

This chapter further expands on the alignment of the IDP to the budget and the role of the Budget Steering Committee. The chapter concludes by providing a synopsis of the impact of debt on the municipal budget.

3.2 POLICY FRAMEWORK FOR FINANCIAL MANAGEMENT REQUIREMENTS OF THE MFMA (RSA, 2003) AND THE NATIONAL TREASURY (2009) IN THE PREPARATION OF MUNICIPAL BUDGETS

Section 22 of the MFMA (RSA, 2003) states that immediately after the annual budget has been tabled in the municipal council, the municipal accounting officer must submit the annual budget in both printed and electronic format to the National Treasury and the relevant Provincial Treasury.

Furthermore, Section 23(1) of the MFMA (RSA, 2003) which is supported by Craythorne (2006:256) determines that the municipal council must consider any views of the National

Treasury, the relevant Provincial Treasury and any provincial or national organs of state or municipalities that made submissions on the budget.

The purpose of this subsection is to provide insight into adequate legislation and policy directives in making provision for municipal budgets. The Statutory and National Treasury Regulations (National Treasury, 2009) indicate the requirements to which local government must adhere in preparing and reporting the municipal budgets.

Section 216(1) of the Constitution (RSA, 1996) determines that the National Treasury must establish national legislation, and prescribes measures to ensure both transparency and expenditure control in each sphere of government. In terms of Sections 121, 122, 125 and 168 of the MFMA (RSA, 2003) the Minister of Finance, acting with the concurrence of the Cabinet member responsible for local government, may set certain regulations. In light of the above, the former Minister of Finance, Minister Trevor Manuel, submitted the Local Government: Draft Municipal Budget and Reporting Regulations (MBRR) for consultation in 2009, after which they were amended, with the final MBRR (National Treasury, 2009) signed by the Minister and published in Government Gazette 32141 on 17 April 2009. These regulations were introduced for the following purposes:

- To be used in the compilation of the three-year Medium-Term Expenditure Framework (MTEF) budgets;
- To ensure uniformity in the submission of budget data for comparison purposes;
- To promote transparency and user friendliness in the budget schedules for all users of the budget information; and
- To promote relevance, credibility, compliance and sustainability in municipal budgets.

Table 3.1 Summary of the Six Chapters comprising the MBRR

Chapter	Document	Regulations	Format
Chapter 1: Interpretation, objective and application of the regulations	N/A	1 to 3	N/A
Chapter 2: Budget and budget-related matters of municipalities	Municipal Budget and Adjustment Budget	9 to 31	Schedules A, B and C
Chapter 3: Budget and budget-related matters of municipal entities	Municipal Budget and Adjustment Budget	39 to 58	Schedules D, E and F
Chapter 4: Non-compliance with time provisions	Budget Regulations and National Treasury Circulars	67 to 70	Schedule G
Chapter 5: Framework for Unforeseen and Unavoidable Expenditure	Budget Regulations and National Treasury Circulars	71 to 73	N/A
Chapter 6: Unauthorised, Irregular or Fruitless and Wasteful Expenditure	Budget Regulations and National Treasury Circulars	74 to 76	N/A

Source: MBRR (National Treasury, 2009)

The National Treasury (2010b:18) further provides that all municipalities must prepare annual and adjustment budgets for the municipal financial year in accordance with the MBRR (National Treasury, 2009). Section 16 of the MFMA (RSA, 2003) requires every municipality to table budget documents and budget tables before 1 April each year, in compliance with the MBRR (National Treasury, 2009), while Section 23 of the MFMA (RSA, 2003) requires municipal councils to approve their budgets before 30 June each year.

If a municipality fails to prepare its annual and adjustment budgets in accordance with the relevant formats, the actions that the National Treasury may take in accordance with the MBRR (National Treasury, 2009) include the following:

- The municipality will be required to resubmit its documentation in the regulated format by a date determined by the National Treasury;
- The municipality's non-compliance with the required formats will be reported to the Auditor-General; and
- A list of municipalities that fail to comply with the required formats will be tabled in Parliament and the respective provincial legislatures.

In addition, Fourie *et al.* (2011:151) maintain that the municipal budget must set the realistic expected revenue for the budget year from each revenue source.

The main objective of the MBRR (RSA, 2009) is to formalise norms and standards which, when applied, will improve the credibility, sustainability, transparency, accuracy and reliability of municipal budgets. Budget schedules, supporting tables and associated charts have been developed to translate the budget regulation requirements into practical outcomes.

The budget templates are designed to assist with the production of all schedules, tables, supporting tables and charts in compliance with the MFMA (RSA, 2003) and the MBRR (RSA, 2009). The budget templates comprise the following:

- Schedule A: Municipal budget file;
- Schedule B: Municipal adjustment budget file;
- Schedule C: Municipal monthly budget statement file;
- Schedule D: Municipal entity budget file;
- Schedule E: Municipal entity adjustment budget file; and
- Schedule F: Municipal entity monthly budget statement file.

The above requirements are intended to enhance the municipal budget preparation process and performance data to be more accurate and to promote credibility during reporting. The objectives of the municipal budget and financial reporting formats support the other financial management reforms introduced by the MFMA (RSA, 2003), i.e. Supply Chain Management and Borrowing Framework, in addition to improving the local government spheres' ability to deliver basic services to all by addressing issues of financial sustainability, and facilitating informed policy choices and medium-term planning of service delivery by requiring targets to be aligned to achieve backlog elimination.

3.3 COMPOSITION OF THE ANNUAL BUDGET

According to Section 17(2) of the MFMA (RSA, 2003) the annual budget must generally be divided into capital and operating budgets in accordance with the MBRR (National Treasury, 2009).

Sections 18(1) and (2) of the MFMA (RSA, 2003) require the municipal budget to be funded only from the following sources:

- Realistic anticipated revenues to be collected;
- Cash-backed accumulated funds from previous surpluses not committed for other purposes; and
- Borrowed funds, but only for the capital budget referred to in Section 17(2) of the MFMA, (RSA, 2003).

In terms of Part 1 of Schedule A of the MBRR (RSA, 2009) the municipal annual budget and supporting documentation must commence with a table of contents, with the headings in the following sequence:

- Mayor’s report;
- Council resolution approving the budget;
- Executive summary of the budget; and
- Annual budget tables consisting of 10 A-schedule tables and 37 supporting tables.

In terms of Part 2 of Schedule A of the MBRR (National Treasury, 2009), the following supporting documentation must be included in the budget in order to ensure uniformity in the budget process and comparability by oversight departments to identify struggling municipalities and institute corrective measures:

- Overview of the annual budget process;
- Overview of the alignment budget with the IDP;
- Measurable performance objectives and indicators;
- Overview of budget-related policies;
- Overview of budget assumptions;
- Overview of budget funding;
- Expenditure on allocations and grant programmes;
- Allocations and grants made by the municipality;
- Councillor and board member allowances and employee benefits;
- Monthly targets for revenue, expenditure and cash flow;
- Annual budget and service delivery and budget implementation plans;
- Annual budgets and service delivery agreements;
- Contracts having future budgetary implications;
- Legislation compliance status;
- Other supporting documents; and
- The Municipal Manager’s quality certificate of the budget.

Municipalities are required to prepare balanced budgets (National Treasury, 2010b), which means that they have to make reasonable estimates of income and match these to anticipated expenditure. The discussion that follows deals with the municipal operating and capital budgets separately. Section 22(b)(i) of the MFMA (RSA, 2003) requires that immediately after the annual budget has been tabled in the municipal council, it must be submitted to the National Treasury and the relevant provincial treasury in both printed and electronic format. Section 24(3) of the MFMA (RSA, 2003), read together with Regulation 20(1), requires that the approved annual budget must be submitted within 10 working days after being approved by the council. If the council only approves the annual budget on 30 June, the final date for such submission is 14 July, otherwise an earlier date applies (National Treasury, 2011a:11). To strengthen the relationship between transparency, understandability and accountability, it is a requirement of the National Treasury (2013b:20) that municipal budgets provide for the following:

- It is required that information covering seven years be presented, consisting of the previous three financial years, the current year, the budget year, and the next two MTEF years;
- To ensure consistency between budget and reporting formats (monthly, mid-year performance assessment, Service Delivery Budget Implementation Plan (SDBIP) and reports relating to municipal entities); and
- To ensure consistency with national and provincial government reporting requirements.

According to Schedule A of the MBRR (National Treasury, 2009) the municipal manager must submit the budget documentation as set out in the main tables (A1 - A10) and all the supporting tables (SA1 – SA37) in both printed and electronic format; and the draft service delivery and budget implementation plan in both printed and electronic format; and in the case of approved budgets, the council resolution together with a quality certificate indicating the budget data is credible in terms of content.

In addition, the MBRR (National Treasury, 2009) promotes good practice in municipal financial reporting, as per Part 5, Sections 28 to 35:

- Promoting simplicity by ensuring terminology is consistent between all formats, with the usage of charts necessary to simplify the interpretation of trends and the impact of budgetary decisions.

- Ensuring standardisation across the local government sphere by very clearly specifying the information requirements, thus enabling municipalities and their information system suppliers to develop software and report-writing formats that are unlikely to need changing in future. It will also facilitate reporting on the 'whole-of-local government', and thus contribute to improved 'whole-of-government' reporting, monitoring and evaluation.

- Developing a standardised budget structure that municipal councils will use to approve municipal budgets. The structure will promote long-term consistency in monitoring performance, and will preserve comparative financial performance history even when the organisational structure of a municipality changes. The MBRR standardised structure provides that all municipalities approve revenue and expenditure according to:
  - a ‘modified’ standard classification.
  - a vote structure that can be adapted to the needs of the municipality, and
  - revenue by source and expenditure by type.

  The standard will improve monitoring and oversight responsibilities and identify distressed municipalities through uniform indicators.

According to Craythorne (2006:255) and Section 17(2) of the MFMA (RSA, 2003) the municipal annual budget is divided into capital and operating budgets in accordance with international best practice.

3.3.1 Composition of Operating Budget

According to the National Treasury (2011a:5), the operating budget framework is to improve the quality of services provided to its citizens. The main sources of revenue for the operating budget are derived from property rates, electricity, water, sanitation and refuse removal. The other secondary sources for the operating budget could be from traffic fines, rentals, interest earned and disposal of property. The operating budget is also largely funded from annual allocations from the national Revenue Fund through the annual DoRA of that particular financial year. According to the National Treasury (2013d:12) municipalities are becoming more reliant on national grants and little effort is made to accurately bill and collect revenue in the serviced areas. Furthermore, the National Treasury (2013d:12) is of the opinion that municipal services have also significantly regressed and this also contributes to the public apathy to pay for services. Most municipalities are relying on short-term borrowing for sustainability of their operational budgets.

The main drivers of municipal operating budget expenditure, as annotated in Schedule A4 of the MBRR, are employee-related costs, depreciation, impairment bulk purchases, contractual services and other expenditure. However, municipal operating budgets are becoming labour driven and costs are on the increase and may not be sustainable in the medium to long term if municipalities do not significantly increase their revenue (National Treasury, 2013d:8).

Financial plans, e.g. IDP, have separate budgets for operations and capital investments. This is to allow municipalities to show how they are financing their capital investments. It also ensures that municipalities do not finance their operational expenses by obtaining loans, but rather helps them to be financially viable.

According to paragraph 6(d) of Schedule A of the MBRR (National Treasury, 2009) this section of the budget must show how much money is spent on running the administration and delivering the day-to-day services including the maintenance of existing assets and infrastructure. The operating budget also shows where the money originates from (sources of revenue). The sources of revenue or income may be from rates and taxes, service charges and inter-governmental transfers.

The operating budget is divided into operating expenses and operating revenue. As per Table A4 in part 2 of the MBRR, the operating budget is divided as follows:

Operating expenses: Used to cover the following expenditure items which are ongoing expenses that a municipality needs to deliver day-to-day services and to conduct its own administration:

- Salaries and allowances: This refers to salaries and wages for municipal staff and allowances such as subsistence and travel.

- General expenses: This includes items that are used for the general running (also known as current expenditure) of a municipality. Examples are telephone expenses, postal cost, rent of equipment or accommodation and also the purchase of bulk water and electricity for resale to the residents.

- Repair and maintenance costs: These are the costs incurred for maintaining infrastructure, including electricity reticulation and water purification, and maintaining infrastructure such as buildings and municipal facilities.

- Capital charges: This refers to money that is used for the repayment of loans to commercial banks and the DBSA. Municipalities are discouraged from loaning money for operational expenditure. If they do, they should repay it within the same financial year, as per Section 45 of the MFMA (RSA, 2003).

- Provision for working capital: This refers to money that may be used to write off bad debt of the arrears of poor people, insolvent companies, etc. unable to pay for basic services already provided to them.

- Operating revenue: Typical sources of revenue to meet the above expenditure items include property rates – a tax that is charged on properties. The tax application should comply with the MPRA (RSA, 2004a).

- Service charges: Electricity, water, sewerage and refuse services are generally regarded as trading activities for municipalities. Monies are collected for these services offered by the municipality. Municipalities do monthly meter readings of water and electricity usage and charge for services accordingly (Fourie *et al.,* 2011:128).

- Grants: Grants refer to money made available by national government to provide basic services. It is allocated to municipalities to supplement the municipalities' own income. These grant allocations are published in the annual DoRA and are allocated to all municipalities by a formula methodology, which also takes into account the revenue needs for the poorest municipalities whose local tax base is limited. The money is mainly to enable municipalities to provide basic services to low-income households and to maintain basic administration.

- Interest and investment income: Some municipalities may receive income on investments or from interest on overdue accounts.

The structured format will allow both the municipal council and communities to interact on spending and planning of the municipal budget during the public participation processes.

3.3.2 Composition of Capital Budget

According to Craythorne (2006:255) and Fourie *et al.* (2011:144), the capital budget is a budget for the construction or acquisition of fixed assets. The main sources of revenue for capital budgets are from municipal infrastructure grant allocations received in terms of the annual Division of Revenue Act. The main grants allocated to municipalities to fund their capital projects are the Municipal Infrastructure Grant, Urban Settlement Grant, Municipal Water Infrastructure Grant, Public Transport Infrastructure Grant, Rural Road Asset Management System Grant, Rural Household Infrastructure Grant, Neighbourhood Development Partnership Grant, Integrated Cities Development Grant, Integrated National Electrification Grant, Regional Bulk Infrastructure Grant, and Municipal Disaster Recovery Grant. Other secondary sources of revenue are from borrowing and own sources.

The main expenditure drivers are infrastructure repair, general maintenance and renewal and new capital projects. Fourie *et al.* (2011:144) are of the opinion that if municipalities do not improve collections and expenditure on capital maintenance and repair of infrastructure, regression will be significant and contribute to non-payment by paying consumers. Multi-year capital budgeting, which is a requirement of the MBRR (National Treasury, 2009), will enable councillors and officials to develop a medium-term plan for spending and enable them to monitor spending and to identify infrastructure gaps timeously and to plan accordingly.

According to the National Treasury (2013b:3) and Fourie and Mazibuko (2013:135), the capital budget must be clearly linked to the IDP of the municipality, which reflects the current and future development priorities. Municipalities must revise their capital spending plans and prioritise funds to ensure that key objectives are achieved and well-performing capital projects are supported.

Municipalities must ensure efficiency gains, eradication of non-priority spending and reprioritisation of capital spending relating to core municipal infrastructure. This requirement ensures that the needs prioritised by the community and agreed to by the council are budgeted for.

3.3.2.1 Budgeted Capital Expenditure

The budgeted capital expenditure shows how much money local government is planning to invest in infrastructure or other capital assets (Moeti, *et al.* (2014:163). The National Treasury (2013b:3) maintains that municipalities must support faster growth, including accelerated public infrastructure development, new spatial plans for cities, improved public transport, upgrading of informal settlements, and broadening and strengthening of industrial development. These capital projects will contribute to the medium-term capital budget framework in adapting to the challenging economic and fiscal environment. Some of the core capital projects include physical developments such as road constructions, expansion of infrastructure on trading services and housing.

If the yearly contributions from residents (property taxes, levies, tariffs and service charges) have to cover the entire cost of projects, local government would only be able to afford a few small projects. Capital projects are extensively funded by government grants and will benefit the community for many years to come. Municipalities are allowed to borrow money to initiate long-term capital projects, as provided for in Section 46 of the MFMA (RSA, 2003).

3.3.2.2 Budgeted Capital Revenue

Fourie *et al.* (2011:139) maintain that capital revenue is a source that is funded from internally generated services, grant allocations received from organs of state, and investments made by the municipality. Most capital projects are expensive and require large sums of money. Municipalities cannot afford to finance capital projects over a period of one year.

Internal sources of revenue for capital expenditure are generated by the municipality itself, for example from rates and taxes and services such as leasing of buildings and user charges or tariffs, e.g. busses and meters for parking (Fourie *et al.*, 2011:128).

External sources of revenue are generated from outside the municipality, and may be loans obtained from financial institutions, such as the DBSA. The DBSA, a major public entity, provides significant amounts to municipalities as loans. The loans provided to municipalities are intended to support the finances of local authorities by making credit accessible for municipalities and providing technical assistance to municipalities in their use of financial resources. This type of loan charges high interest rates and is not always suitable for rural municipalities, which may find it difficult to repay the loans (RSA, 2003).

Sections 45 and 46 of the MFMA (RSA, 2003) provide for municipalities to obtain external loans from the capital market such as from commercial banks. Many municipalities are not credit worthy, which makes it difficult for them to borrow money. The government still needs to find ways of overcoming these challenges.

The MBRR (National Treasury, 2009), must contribute to realistic, relevant and sustainable budgets of municipalities to deliver prioirity services to communities.

3.4 FREE STATE MUNICIPALITIES' DRAFT BUDGET ANALYSIS FOR THE 2013/14 FINANCIAL YEAR

Of the 24 municipalities in the Free State, 20 municipalities tabled their budgets on or before 31 March 2013 as required by Section 26 the MFMA. Four municipalities did not table their budgets timeously, namely Moqhaka, Ngwathe, Dihlabeng and Fezile Dabi.

The total of the draft municipal budgets in the Free State for the 2013/14 financial year amounts to R10 billion of which R1.6 billion is for capital projects and R8.4 billion for operating expenditure. This represents an increase of 5.8 per cent from the R9.4 billion in 2012/13.

Table 3.2 below provides a summary of the budgets for the 2013/2014 financial year.

Table 3.2: Summary of Municipal Budgets for 2012-2014

Municipalities R'000	2012/13			2013/14			% Increase/ Decrease
	Capital Budget	**Operating Budget**	**Total**	**Capital Budget**	**Operating Budget**	**Total**	
Xhariep	7,887	65,708	**73,595**	5,901	100,345	**106,246**	44.4
Letsemeng	25,542	69,639	**95,181**	36,802	105,000	**141,802**	49.0
Kopanong	27,521	238,158	**265,679**	47,231	245,393	292,624	10.1
Mohokare	33,729	128,143	**161,872**	44,888	126,552	**171,440**	5.9
Naledi	15,598	84,111	**99,709**	21,235	87,337	**108,572**	8.9
Mantsopa	36,531	193,595	**230,126**	31,638	207,809	**239,447**	4.1
Lejweleputswa	3,842	105,124	**108,966**	3,170	105,366	**108,536**	-0.4
Masilonyana	45,543	143,496	**189,039**	58,376	182,803	**241,179**	27.6
Tokologo	59,867	43,237	**103,104**	57,354	44,089	**101,443**	-1.6
Tswelopele	35,571	107,653	**143,224**	65,239	102,940	**168,179**	17.4
Matjhabeng	235,030	1,425,428	**1,660,458**	212,482	1,509,381	**1,721,863**	3.7
Nala	55,367	335,761	**391,128**	81,815	361,361	**443,176**	13.3
Thabo Mofutsanyana	0	126,591	**126,591**	0	88,582	**88,582**	-30.0
Setsoto	78,757	478,815	**557,572**	105,853	525,225	**631,078**	13.2
Dihlabeng	90,233	497,749	**587,982**	73,196	548,640	**621,836**	5.8
Nketoana	52,048	242,365	**294,413**	68,697	213,691	**282,388**	-4.1
Maluti a Phofung	418,068	1,471,929	**1,889,997**	388,133	1,461,000	**1,849,133**	-2.2
Phumelela	86,684	103,331	**190,015**	25,277	109,184	**134,461**	-29.2
Fezile Dabi	8,036	197,343	**205,379**	3,796	195,527	**199,323**	-2.9
Moqhaka	56,896	544,173	**601,069**	95,524	583,476	**679,000**	13.0
Ngwathe	67,854	420,332	**488,186**	47,889	425,882	**473,771**	-3.0
Metsimaholo	95,637	762,841	**858,478**	176,476	881,279	**1,057,755**	23.2
Mafube	45,876	117,735	163,611	31,213	141,245	172,458	5.4
TOTAL	1,582,117	7,903,257	9,485,374	1,682,185	8,352,107	10,034,292	5.8

Source: Free State Provincial Treasury (2013a)

The total capital budget for the Free State municipalities amounted to R1.6 billion for the 2013/14 financial year, which represents an increase of R100 million in comparison with the 2012/2013 financial year.

Although municipalities indicated that the capital budgets are aligned to their IDPs, the Free State Provincial Treasury could not ascertain this information, mainly due to the fact that most municipalities did not submit their IDPs to the Provincial Treasury to confirm the alignment between the two documents.

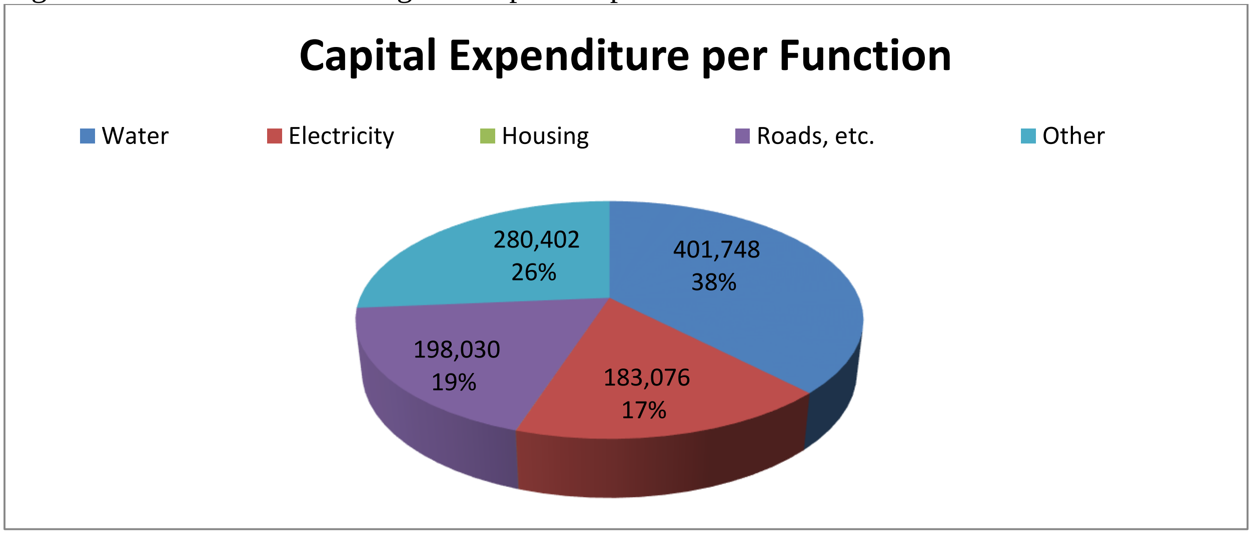
The breakdown of expenditure in function is tabulated in the Table 3.3, showing increases in water and electricity and regression in expenditure on housing, roads and other capital expenditure. The housing function is not entrusted to all municipalities because of capacity constraints.

Table 3.3: Breakdown of Budgeted Capital Expenditure

Function	**2012/13**	**2013/14**	**% Increase/ (Decrease)**
Water	361,699	401,748	11.1
Electricity	130,153	183,076	40.7
Housing	668	88	-86.8
Roads	207,135	198,030	-4.4
Other	320,915	286,402	-10.8
Total	**1,020,570**	**1,069,344**	**4.8**

Source: Free State Provincial Treasury (2013a)

Figure 3.1: Breakdown of Budgeted Capital Expenditure



From Figure 3.1 it can be deduced that the capital expenditure budget will be funded mostly (82 per cent) by 'Grants and Subsidies' from the National Treasury, with 10 per cent of the capital funding being obtained from 'internal contributions' and eight per cent from 'external loans'.

- Budgeted Operating Expenditure

The total operating expenditure budget amounts to R8.4 billion for municipalities in the province. This represents an increase of R4.8 million or 5.8 per cent compare to the 2012/13 financial year.

Table 3.4 shows the Free State municipalities with the highest operating budgets.

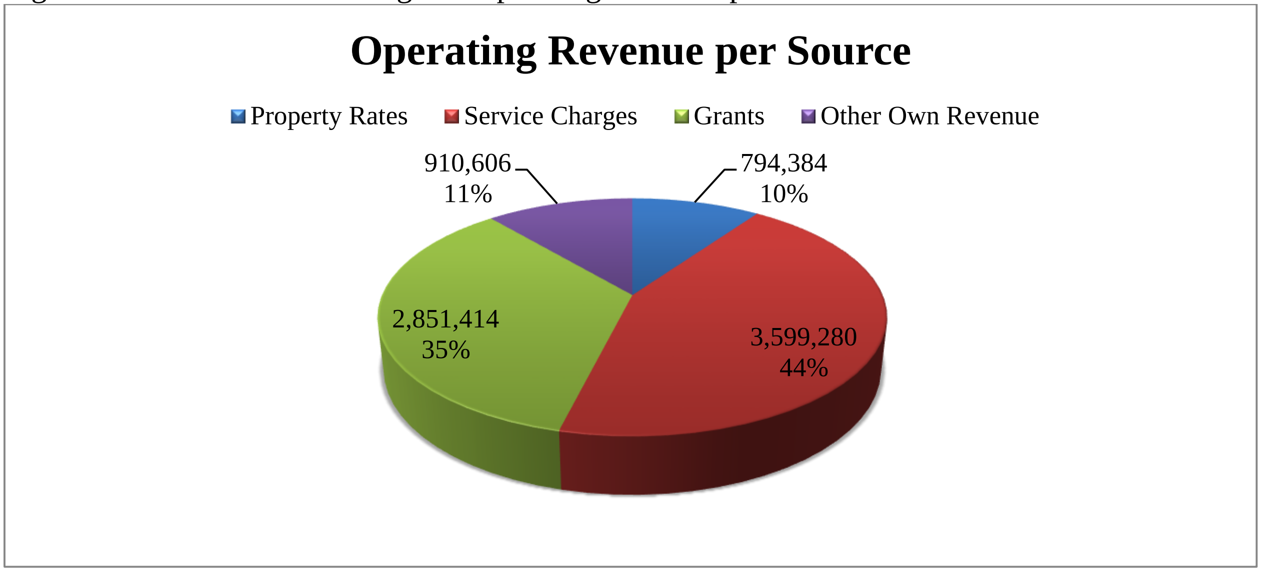
Table 3.4: Municipalities with the Highest Operating Budgets

Municipality	2012/13 R'000	2013/14	% Increase / (Decrease)
1. Matjhabeng	1,425,428	1,569,381	3,7
2. Maluti a Phofung	1,471,929	1,461,000	(2,2)
3. Metsimaholo	462,841	881,279	23,2
4. Dihlabeng	497,749	548,670	5,8
5. Setsoto	478,815	525,225	13,2

Source: Free State Provincial Treasury (2013a)

A total of 44 per cent of the budgeted operating revenue of R8.4 billion will be collected from service charges, while 35 per cent of the total revenue will come from grants and subsidies, which is received from the annual equitable share allocation as determined by the annual DoRA, and 65 per cent from rates and consumer accounts.

Figure 3.2: Breakdown of Budgeted Operating Revenue per Source of Income



'Other Revenue' represents 11 per cent of the total operating revenue generated in the province.

This revenue includes items such as:

- Interest on investments and outstanding debt;
- Hiring of venues;
- Reconnection fees; and
- Traffic fines, etc.

At the end of March 2013 the total outstanding debtors amounted to R8.118 billion of which 78 per cent is outstanding for longer than 90 days. This is indicative that most municipalities are struggling to collect all revenue for services and therefore the municipalities are more dependent on grants.

The Fiscal and Financial Commission (FFC, 2010:157) further suggests that South Africa has to follow a sustainable pro-poor growth pattern. Unless municipalities exercise fiscal discipline by spending their funds on budgeted programmes and projects, the majority of vulnerable people will be exposed to harsher realities of poverty and unemployment.

According to the National Treasury (2010a:30) the growth in the level of consumer debtors pre-dates the slowdown in the economy, and so the slowdown can only be a partial explanation. Debt is caused by, inter alia:

i. A failure on the part of mayors and municipal councils to provide political backing to revenue enhancement programmes (often councillors are in arrears with their own payments).
ii. A failure on the part of municipal managers to allocate sufficient staff/capacity to the revenue collection function, thus compromising the implementation of policies to enhance revenue.
iii. Poorly designed revenue management, indigent and debtor policies.

iv. Resistance among certain communities to paying for certain types of services (or to being billed in a particular way).
v. Ratepayer boycotts, sparked by deteriorating service delivery, and perceptions that the municipality is unresponsive to community concerns.
vi. Ineffective implementation of credit and debtor control policies.
vii. High increase in debtors for most municipalities, which negatively impacts on service delivery and increases the dependence of the municipalities on grants.
viii. Municipalities do have a debtors policy in place but do not implement it, with one of the reasons being political interference.
ix. Most municipalities do not have a debt collection strategy.
x. Councillor's are not playing their oversight and monitoring role in an effective and efficient manner.

The above indicates that municipalities have deficiencies in systems and management controls that contribute to debt challenges.

The following are highlights from the National Treasury on the budget benchmarking conducted with municipalities:

- Unrealistic revenue projections, hence the collection rate is not satisfactory or achievable.
- Municipalities increase revenue projections annually but fail to increase their revenue base.
- Failure by municipalities to compare previous years' performance with regard to revenue collection. As a result their revenue projections are often over-stated.
- Revenue budget is based on levied revenue and not the actual collection.
- Failure by the municipalities to measure reticulation losses.
- Fifty per cent of municipalities budgeted for a deficit (National Treasury, 2013d:14-33).

Low budgeting for repairs and maintenance results in deteriorating infrastructure as well as municipal and public facilities. Thirteen municipalities budgeted below five per cent for repairs and maintenance.

Table 3.5: Repairs and Maintenance Spending as at 31 March 2013

Municipalities	2013/14		% Against Operating Budget
	Operating Budget (R000)	Repairs & Maintenance (R000)	
Xhariep	100,345		0.0
Kopanong	245,393	10,812	4.4
Mohokare	126,552	7,747	6.1
Naledi	87,337	1,236	1.4
Mantsopa	207,809	10,227	4.9
Lejweleputswa	105,366		0.0
Tokologo	44,089	0	0.0
Tswelopele	102,940	5,530	5.4
Nala	361,361	11,516	3.2
Thabo Mofutsanyana	88,582		0.0
Fezile Dabi	195,527	1,055	0.5
Moqhaka	583,476	0	0.0
Ngwathe	425,882	20,226	4.7

Source: Provincial Treasury (2013a)

For most of the municipalities the salary budget is more than 50 per cent of the operating budget. This places severe pressure on service delivery, as most of the municipalities' funds are allocated for personnel expenditure.

Performance agreements, delegations and the Service Delivery Budget Implementation Plan (SDBIP)

Performance agreements and SDBIP documents were not submitted to the Free State Provincial Treasury as required by the Section 53 of the MFMA (RSA, 2003). Most municipalities have no financial delegations in place or if in existence they are outdated. In addition, performance management was not in place and as a result top management is paid performance bonuses even if service delivery is inadequate.

Conditional grants

According to Fourie and Mazibuko (2013:140) and the National Treasury (2013b) most municipalities are not spending their conditional grants as stipulated in the annual DoRA and use conditional grants, amongst other, to pay salaries. Municipalities are also not spending their conditional grants due to poor planning and lack of capacity, which eventually leads municipalities to surrender the unspent conditional grants to the National Revenue Fund. Municipalities are also only spending their conditional grants toward the end of the financial year because of planning gaps and long-winded supply chain processes.

The key to provision of services is the efficiencies of municipal councils to hold both the political and administrative arms at the municipality accountable.

3.5 MUNICIPAL ANNUAL BUDGET CYCLE

In terms of the delegations under Section 6 of the MFMA (RSA, 2003), from the Minister of Finance to the MEC for Finance, the Provincial Treasury must, amongst other functions, comment on draft and final approved municipal budgets prepared by the 23 delegated municipalities (23 municipalities delegated to the Provincial Treasury for monitoring and reporting) to ensure effective and efficient allocation of resources.

Section 16(2) of MFMA (RSA, 2003) requires the mayor of the municipality to table the draft annual budget at a council meeting at least 90 days before the start of the municipal budget year.

The six steps in preparing a budget, as introduced by the National Treasury (2004b), remains current and should be followed for the budget process. These steps provide guidance to municipalities and municipal entities on the budget and focus on the early preparatory work. The municipal manager must ensure that full support is provided to the mayor immediately to begin work on the coordination of the budget process calendar and events. The municipal annual budget cycle steps are discussed hereunder.

3.5.1 Planning

According to the National Treasury (2004b:2) the planning stage of the budget cycle provides for various engagements and for appropriate reviews to assess progress in the implementation of the municipal budget. The municipality should then factor changes into the next planning and budgeting cycle. At this stage the mayor is required by Section 21(1)(b) of the MFMA (RSA, 2003) to table in council a time schedule outlining key deadlines for:

- The preparation, tabling and approval of the annual budget;
- The annual review of –
  - the IDP as required by Section 34 of the MSA (RSA, 2000a) and
  - the budget-related policies
- The tabling and adoption of any amendments to the IDP; and
- Community participation timeline on the budget.

3.5.2 Strategising

The National Treasury (2004b:2) maintains that the strategic phase involves reviewing the IDP and setting service delivery targets for the next three years, consulting with stakeholders on tariffs, indigents, credit control and free basic services, and considering local, provincial and national issues, as well as the previous year's performance and current economic and demographic trends. Municipalities must obtain feedback in the early stages of the previous year's performance and discussion with sector government departments to align the IDP with national, provincial and district municipal plans.

Section 21(1)(b) of the MFMA (RSA, 2003) requires that a revised IDP be adopted at the time of adopting the budget. Therefore, the process leading to the adoption of the budget and IDP must be incorporated into one process, together with the process for approving taxes, levies, user charges and budget-related policies. This will ensure credible plans and budgets that are realistic and implementable.

National Treasury MFMA Circular 10 (2004b:2) indicates that strategic consultation should commence between September and October, with the mayor convening a meeting of the mayoral or executive committee and senior managers. The purpose is to determine the priorities of the municipality for the coming budget, taking into account the financial and political pressures facing the municipality. It should also consider what revisions should be considered to its current IDP. This phase of consultation ends when the mayor tables the budget and revised IDP before the end of March.

3.5.3 Preparing

The preparing stage includes revenue and expenditure projections, draft budget policies, consult and consider local, provincial and national priorities. The eradication of infrastructure backlogs and the provision of basic services has been one of government's key priorities. National Treasury MFMA Circular 10 (2004b:3) maintains that the budget preparation includes the following processes:

- Integration of strategic objectives with budget allocations;
- Appropriate planning and improved project management;
- Assessing affordability of rates and service charges, and identifying poor households unable to afford such rates and charges;
- Accurate in the estimation of revenue and expenditure projections;
- Consultation and review of national, provincial and local priorities; and
- Assessment of previous year performance and corrective action to be incorporated in the new budget.

The technical preparation of the budget is undertaken by the municipal manager, senior managers and CFO. The mayor should meet with the municipal manager and CFO on a monthly basis after the priorities are set, particularly during November, January, February and March. Such political oversight is necessary to guide officials and to assist in making the trade-offs necessary to determine the new budget.

3.5.4 Tabling

Section 16 of the MFMA, 2003 requires the draft budget and revised IDP to be tabled in council no later than 1 April (90) days before the start of the municipal budget year together with the proposed resolutions and changes to budget-related policies. Section 75 of the MFMA, 2003 indicates that the accounting officer (municipal manager) must immediately (on the same day) post the budget, revised IDP and all related documents onto the municipal website so that the information is accessible to the public. The accounting officer must also thereafter make available to the public hard copies of the budget and all other related documents and send (hard and electronic) copies to the national and provincial treasuries and other relevant organs of state.

3.5.5 Approving

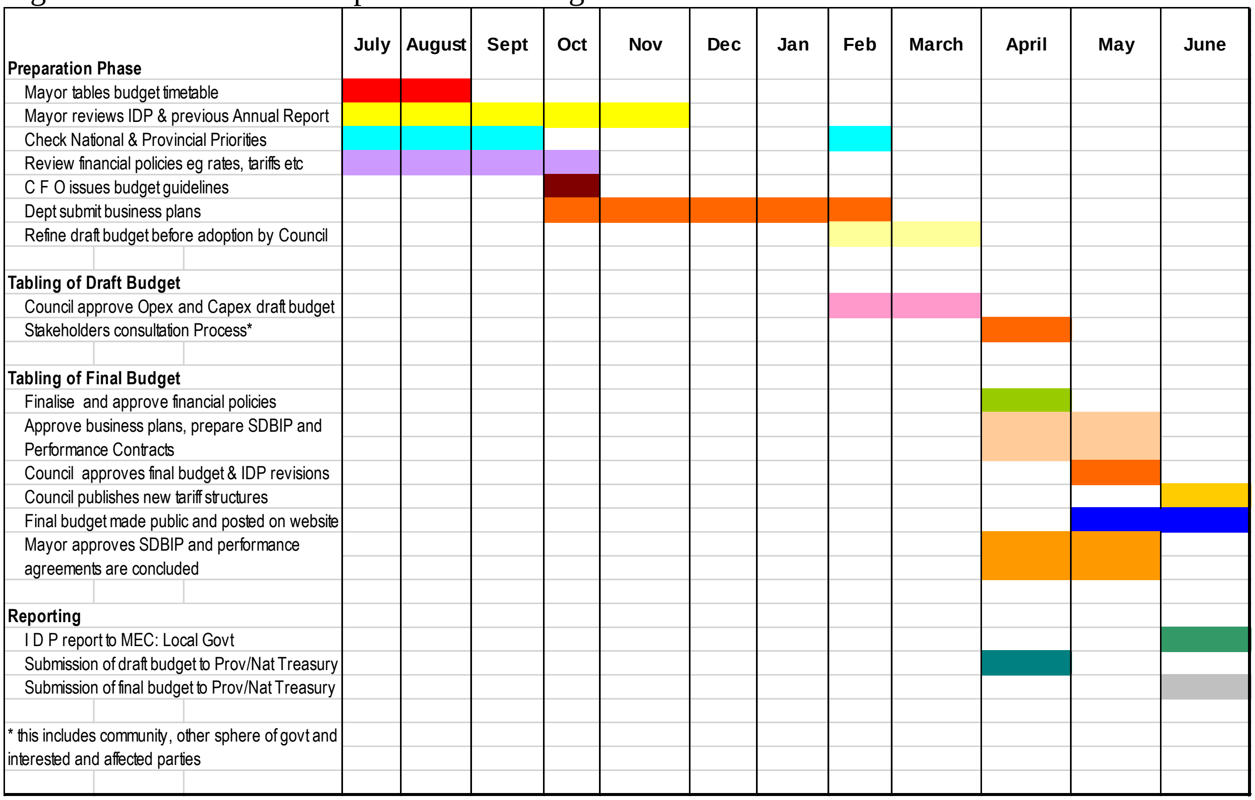
Section 24 of the MFMA, 2003 maintains that after the mayor has responded to the recommendations and made amendments to the draft budget, the full council must meet to consider the budget for approval no later than 30 days before the start of the budget year. Section 55 of the MFMA, 2003 states that should the municipality fail to approve the budget before the start of the budget year, the mayor must inform the MEC for Cooperative Governance and Traditional Affairs that the budget has not been approved for appropriate intervention. Ideally in this approving stage, council approves the budget and related policies before 1st July.

3.5.6 Finalising

This stage of the budget process involves the finalisation of plans to implement the budget, through the approval of the SDBIP and the performance agreements for the municipal manager and other senior managers for the coming financial year (Section 53 of the MFMA, 2003). While Section 53(1)(c)(ii) of the MFMA, 2003 requires the SDBIP to be approved within 28 days after the approval of the budget it is recommended that draft SDBIP and performance agreements be tabled with the budget and considered in conjunction with the budget approval. Once the budget is finalised, the process for implementation commences.

Section 24 of the MFMA, 2003 requires the municipal council to consider the approval of the annual budget at least 30 days before the start of the municipal financial year, in this regard Figure 3.3 provides a the generic municipal MTREF budget process timetable.

Figure 3.3: Generic Municipal MTREF Budget Process Timetable



If the municipality fails to approve the budget before the start of the budget year, it will have serious operational consequences for the municipality and could result in a Section 139(4) Constitutional intervention in terms of Sections 25 and 26 of the MFMA, 2003. The next section provides the functions of councillors in relation to the annual budget.

3.6 FUNCTIONS OF COUNCILLORS WITH REGARD TO THE ANNUAL BUDGET

Section 19 of the MSA provides general terms the jurisdiction of council and provides the legal structure and framework for municipal councils to provide governance and make decisions at a local level with flexibility for the needs of their community

- provide good government;
- provide services, facilities and other things that in the opinion of council are necessary and desirable for all or part of the municipality;
- develop and maintain a safe and viable community; and
- foster economic, social and environmental well-being.

3.6.1 Functions of Mayor and Councillors

Both the MSA, 2000 and MFMA, 2003 make common assumptions about the role of various stakeholders in the municipality.

Councillors also have the responsibility that the decisions they take must address past imbalances and access to services and opportunities. At the same time, councillors need to be conscious of the impact of these decisions on future generations. This is a large responsibility and needs to be made within a democratic framework that relies on frequent consultation with community members, ward committee members, organised interest groups, and close co-ordination amongst all levels of government from local to provincial to national. It should especially target those members and groups within communities that are most often marginalised and excluded, such as women, disabled people and the very poor. Section 155 of the Constitution, 1996 states that there are three categories of municipalities namely:

- Category A – A municipality that has an exclusive municipal executive and legislative authority in their areas.
- Category B – A municipality that shares municipal executive and legislative authority in their areas with a category C or district municipality.
- Category C – A municipality that has a municipal executive and legislative authority in their area that includes more one local municipality.

There are three different types of municipalities in which is determined by Section seven of the MSA, 2000. Depending on the category of municipality, these can be amplified by either a ward participatory system or a sub-council participatory system. Category C municipalities are restricted to three types of municipalities namely:

- Collective Executive System

This system allows for the exercise of executive authority through an executive committee in which executive leadership is collectively vested. Small group of councillors can be assigned to administer the municipality like a mini-cabinet.

- Mayoral Executive System

This system allows for the exercise of executive authority through an executive committee in which executive Mayor in whom the executive leadership of the municipality is vested. The Executive Mayor is assisted by a mayoral committee.

- Plenary Executive System

This system allows for the exercise of executive is limited to the municipal council itself. As such the municipal council is the only organ that has executive authority.

o Functions of the Mayor

Section 17 of the MFMA, 2003 requires the mayor to provide strategic leadership on the budget. The mayor must work closely with a municipal manager, the official who heads the administrative structure of the municipality. Section 16 of the MFMA, 2003 requires the mayor to table the draft budget and revised IDP to be tabled in council no later than 1 April (90) days before the start of the municipal budget year.

- Functions of the Speaker

Section 36 of the MSA, 1998 defines the speaker as a councillor to be the chairperson of a municipal council as envisaged in Section 160(1)(b) of the Constitution, 1996. The speaker is a member of council who upholds the basic rules that apply to all councillors. The key functions underlying the role of the speaker are:

- chair of council meetings,
- implementation of the Code of Conduct,
- exercise of delegated functions including -
  - facilitating public participation in legislative matters in relation to the municipal budget and other municipal responsibilities;
  - establishment and functioning of ward committees; and
  - support to Councillors.

- Functions of the Councillors

Councillors are representing their constituents in council in budget and other needs. Only those newly elected councillors represent different political parties. Councillors need to interact across party lines as every councillor is mandated by their respective voters. It can be a challenge for councillors to work together and co-operate in the interests of their municipality as a whole. Councillors help monitor the performance of the municipality as Councillors act as a key feedback mechanism for monitoring:

- whether the municipality's plans and programmes are achieving the intended objectives;
- whether services are being provided in a way that is efficient and fair; and
- whether capital projects as committed to in the IDP are actually being implemented and according to plan within the set timeframes

As ward councillors in particular often receive complaints from the public on specific problems they are in a good position to advise the public on how to resolve their issues in certain instances.

They can also assist their constituents in making formal complaints or petitions, as may be appropriate, for submission to the municipality, and can help follow up on the concerns brought to them. The councillor is also given reports on various service delivery issues and the progress of capital projects, and should pass this information on to the community.

Section 23 of the MFMA, 2003 empowers the mayor of a municipality to ensure transparency and accountability. She or he, with the support from council, provides political guidance and monitors municipal performance. The mayor is able to report to council on a quarterly basis how the municipality is doing in relation to the budget. The mayor is responsible for the following as determined by Section 23 of the MFMA, 2003.

The mayor of a municipality:

a) must provide general political guidance over the fiscal and financial affairs of the municipality.
b) in providing such general political guidance, may monitor and to the extent provided in this Act, oversee the exercise of responsibilities assigned in terms of this Act to the accounting officer and the CFO but may not interfere in the exercise of those responsibilities.
c) must co-ordinate the process for preparing the annual municipal budget and reviewing the municipal IDP. Supported by the municipal manager and the CFO, the mayor has to ensure that the budget and the IDP are mutually consistent and credible.
d) must take all reasonable steps to ensure that the municipality performs its constitutional and statutory functions within the limits of the municipality's approved budget.
e) must, within 30 days of the end of each quarter, submit a report to the council on the implementation of the budget and the financial state of affairs of the municipality.

Sections 79, 82 and 106 of the MFMA, 2003 creates clear lines of accountability between the council which must approve the policy, the mayor who must provide political leadership and manage the implementation of the policy, the municipal manager who is accountable to the mayor and council for implementing these policies.

According to the National Treasury MFMA, 2003 Circular 70 a new local government equitable share formula has been phased in from 2013/14. It provides funding for a package of free basic services for the 59 per cent of households with monthly incomes below the value of two state old age grants. Although no additional changes to the equitable share envelope are proposed, the local government equitable share will still grow at an average annual rate of 9.2 per cent over the MTEF.

Municipalities are reminded that the regulations apply to all municipalities and municipal entities as from 1 July 2009. All municipalities and municipal entities must prepare annual budgets, adjustments budgets and in-year reports for the 2014/15 financial year in accordance with the MBRR. In this regard, municipalities must comply with both:

- The formats set out in the Schedules to the MBRR, 2009 ; and
- The relevant attachments to each of the Schedules as per the MBRR, 2009 the Excel format schedules.

If a municipality fails to prepare its budget, adjustments budget and in-year reports in accordance with the relevant formats, actions the National Treasury will take include:

- The municipality will be required to resubmit their documentation in the regulated format by a date determined by the National Treasury;
- The municipality's non-compliance with the required formats will be reported to the Auditor-General; and
- A list of municipalities that fail to comply with the required formats will be tabled in Parliament and the provincial legislatures (National Treasury MFMA, 2003 Circular 70).

3.6.2 Alignment between Municipal Budget and IDP

Section 25 (1) of the MSA, 2000 states that:

Each municipal council must, within prescribed period after the start of its elected term, adopt a single, all inclusive and strategic plan for the development of the municipality which –

- Links, integrates and coordinates plans and takes into account proposals for the development of the community;
- Aligns the resources and capacity of the municipality with the implementation of the plan,
- Complies with the provisions of this chapter five of the MSA, 2000; and
- Is compatible with national and provincial development plans and planning requirements.

The IDP and budget are inseparably linked to one another. Section 21(1)(b) of the MFMA, 2003 determines that:

The mayor of a municipality must:

- At least 10 months before the start of the budget year, table in the municipal council a time schedule outlining key deadlines for:
    - The preparation, tabling and approval of the annual budget,
    - The annual review of –
        a) The integrated development plan in terms of Section 34 of the MSA, 2000, and
        b) The budget related policies,
    - The tabling and adoption of any amendment to the integrated development plan and the budget related policies, and
    - The consultative processes forming part of the IDP and Budget processes.

Furthermore the IDP review process is mainly geared towards identifying on early-warning sign for corrective action. The Performance Indicators are flow from the IDP and constitute the heart of the Performance Management System (PMS). The municipality must ensure the alignment of the IDP and budget preparation process, and the Performance Management System.

3.6.3 Role of Budget Steering Committee

Section four of the MBRR, 2009, requires the mayor of the municipality to establish a Budget Steering Committee. The function of the Budget Steering Committee is to provide technical assistance to the Mayor in discharging the responsibilities set out in Section 53 of the MFMA, 2003.

Section four of the MBRR, 2009 states the following officials should form part of the Budget Steering Committee:

- Councillor responsible for financial matters,
- Municipal Manager,
- Chief Financial Officer,
- All senior managers responsible for at least the three largest votes in the municipality,
- Manager responsible for budget,
- Manager responsible for planning, and
- Any technical experts on infrastructure.

The primary aim of the Budget Steering Committee is to ensure:

- that the process followed to compile the budget complies with legislation and good budget practices;
- that there is proper alignment between the policy and the service delivery priorities set out in the municipality's IDP and the budget, taking into account the need to protect the financial sustainability of the municipality;
- that the municipality's revenue and tariff setting strategies ensure that the cash resources needed to deliver services are available; and
- that the various spending priorities of the different municipal departments are properly evaluated and prioritised in the allocation of resources (Chapter 2 of the MBRR, 2009).

Table 3.6: Monthly Key Activities of IDP, Budget and Performance Management System

MONTH	ACTIVITIES				
	IDP	**PMS**	**BUDGET**		
			Mayor and Council / Entity Board	**Administration - Municipality and Entity**	**Budget Review Activities**
JULY	▪ Preparation of the Draft IDP / Budget and PMS Process Plan. ▪ Engagement with Budget Office and PMS for alignment purposes.	▪ Signing of new performance contracts for Section 57 Managers and submission to EXCO in July (Section 69 of the MFMA and Section 57 of the MSA). ▪ Roll out of the SDBIP ▪ Prepare Departmental Business/Sectional Plans for the financial year. ▪ Final Section 57 Managers' Performance Assessments. ▪ Preparation of Reports by various HOD's.	▪ Mayor begins planning for next three-year budget in accordance with co-ordination role of budget process (MFMA Section 53) ▪ Planning includes review of the previous year's budget process and completion of the Budget Evaluation Checklist	▪ Accounting officers and senior officials of municipality and entities begin planning for next three-year budget (MFMA Sections 68 and 77) ▪ Accounting officers and senior officials of municipality and entities review options and contracts for service delivery (MSA Sections 76 and 81)	▪ Approve and announce new budget schedule and set up committees and forums. ▪ Consultation on performance and changing needs.
AUGUST	▪ Tabling of IDP Process Plan to EXCO for comments ▪ IDP Process Plan tabled to Council for approval. ▪ Advertisement of the IDP Process Plan in order to meet AG audit requirements ▪ IDP preparation process initiated. ▪ Review of comments received on the IDP Review document. ▪ Self-assessment to identify gaps in the IDP process. ▪ Integration of information from adopted Sector Plans into the IDP Review document. ▪ Initiation of new sector plans into the IDP, if any. ▪ Updating and review of the strategic elements of the IDP in light of the new focus of Council. ▪ Convene IDP Representative Forum ▪ IDP Steering Committee Meeting	▪ Submission of Q4 SDBIP Reports (for last quarter of F/Y) MPPR Reg. 14 ▪ Submission of the Annual Performance Reports prepared in terms of Section 46 of MSA 2000 to Council ▪ Quarterly Audit Committee meeting on August (for the last quarter) MFMA Sect 166 & MPPR Reg. 14(3)(a) ▪ Evaluation Panel Audit Committee meeting (for evaluation of Sect 57 Managers final assessments) MPPR Reg. 14(3)(b)	▪ Mayor tables in Council a time schedule outlining key deadlines for: preparing, tabling and approving the budget; reviewing the IDP (as per Section 34 of MSA) and budget related policies and consultation processes at least 10 months before the start of the budget year (MFMA Section 21,22, 23; and Section 34 of MSA, Chapter 4 as amended) ▪ Mayor establishes committees and consultation forums for the budget process	▪ Accounting Officer to submit AFS to Auditor-General [Due by 31 August,(MFMA Section 126(1)(a))	▪ Consultation on performance and changing needs. ▪ Review performance and financial position. ▪ Review external mechanisms. ▪ Start Planning for next three years.
SEPTEMBER	▪ Integration of information from adopted Sector Plans into the IDP Review document if possible ▪ Review and updating of the IDP Vision, Mission and Objectives.	▪ Auditor General audit of performance measures ▪ Reminder to be sent to HOD's to submit their Q1 SDBIP Reports in terms of Section 41 of the MSA	▪ Council through the IDP review process determines strategic objectives for service delivery and development for next three-year budgets including review of provincial and national government sector and strategic plans	▪ Budget offices of municipality and entities determine revenue projections and proposed rate and service charges and drafts initial allocations to functions and departments for the next financial year after taking into account strategic objectives ▪ Engages with Provincial and National sector departments on sector specific programmes for alignment with municipalities plans (schools, libraries, clinics, water, electricity, roads, etc.)	▪ Update policies, priorities and objectives. ▪ Determine revenue projections and policies.
OCTOBER	▪ Integration of information from adopted Sector Plans into the IDP Review document.	▪ Submission of Q1 Reports by HOD's ▪ Q1 Reports tabled to Council (for first		▪ Accounting officer does initial review of national policies and	▪ Determine revenue

MONTH	ACTIVITIES				
	IDP	PMS	BUDGET		
	▪ Integration of Spatial Development Framework ▪ Updating and review of the strategic elements of the IDP in light of the new focus of Council. ▪ IDP Cluster Teams ▪ IDP Steering Committee Meeting	quarter) MPPR Reg. 14 ▪ Sect 57 Managers' quarterly informal assessments		budget plans and potential price increases of bulk resources with function and department officials (MFMA Sections 35, 36, 42 and MTBPS)	projections and policies. ▪ Engagement with sector departments, share and evaluate plans, national policies, MTBPS. ▪ Draft initial allocations to functions. ▪ Draft initial changes to IDP.
NOVEMBER	▪ Review of Municipal Strategies, Objectives, KPA's, KPI's and targets. ▪ Identification of priority IDP projects. ▪ Project alignment between the DM and LM's ▪ Convene IDP Representative Forum.	▪ Quarterly Audit Committee meeting (for the first quarter. MFMA Section 166 & MPPR Reg. 14(3)(a)		▪ Accounting officer reviews and drafts initial changes to IDP (MSA Section 34) ▪ Auditor-General to return audit report [Due by 30 November, (MFMA Section 126(4))	▪ Draft initial changes to IDP. ▪ Consolidation of budgets and plans. ▪ Exco. determines strategic choices for next three years.
DECEMBER	▪ Departments to comment on the reviewed Municipal Strategies, Objectives, KPA's, KPI's and targets. ▪ Project alignment between the DM and LM's. ▪ Identification of priority IDP projects.	▪ Compile annual report (MFMA Sect 121) ▪ Reminder to be sent to HOD's to submit their Q2 SDBIP Reports in terms of Section 41 of MSA	▪ Council finalises tariff (rates and service charges) policies for next financial year (MSA Section 74 and 75)	▪ Accounting officer and senior officials consolidate and prepare proposed budget and plans for next financial year taking into account previous year's performance as per audited financial statements	▪ Executive determines strategic choices for next three years. ▪ Finalise tariff policies.
JANUARY	▪ Review of Municipal Strategies, Objectives, KPA's, KPI's and targets. ▪ Identification of priority IDP projects. ▪ IDP Steering Committee Meeting ▪ IDP Cluster Teams	▪ Submission of Q2 Reports by HOD's ▪ Q2 Reports tabled to Council (for second quarter) MPPR Reg. 14 ▪ Mayor tables draft annual report for 12/13 MFMA Section 127(2) ▪ Make public annual report and invite community inputs into report (MFMA Section 127 & MSA Section 21a) ▪ Municipal Manager submits Midterm/Midyear Report to the Mayor (in terms Section 72 MFMA) ▪ Midterm/Midyear Report is published in the Local Newspaper	▪ Entity board of directors must approve and submit proposed budget and plans for next three-year budgets to parent municipality at least 150 days before the start of the budget year MFMA Section 87(1)	▪ Accounting officer reviews proposed national and provincial allocations to municipality for incorporation into the draft budget for tabling. (Proposed national and provincial allocations for three years must be available by 20 January) MFMA Section 36	▪ Prepare detailed budgets and plans for the next three years.
FEB UARY	▪ Continuous Review of Municipal Strategies, Objectives, KPA's, KPI's and targets. ▪ Identification of priority IDP projects. ▪ IDP Cluster Teams	▪ Quarterly Project Implementation Report (for second quarter) MPPR Reg. 14 ▪ Quarterly Audit Committee meeting (for the second quarter) MFMA Section 166 &	▪ Council considers municipal entity proposed budget and service delivery plan and accepts or makes recommendations to the entity	▪ Accounting officer finalises and submits to Mayor proposed budgets and plans for next three-year budgets taking into account	▪ Prepare detailed budgets and plans for the next three years.

MONTH	ACTIVITIES				
	IDP	PMS	BUDGET		
	▪ IDP Steering Committee Meeting	MPPR Reg. 14(3)(a) ▪ Submit draft annual report to AG, Provincial &DLGTA (MFMA Section 127) ▪ Section 57 Managers' formal quarterly assessments (for second quarter)	MFMA Section 87(2)	the recent mid-year review and any corrective measures proposed as part of the oversight report for the previous years audited financial statements and annual report	▪ Exco adopts budget and plans and changes to IDP.
MARCH	▪ Finalization of Municipal Strategies, Objectives, KPA's, KPI's and targets. ▪ IDP Steering Committee Meeting ▪ Convene IDP Representative Forum ▪ Adoption of draft IDP and Budget ▪ Publicise Draft IDP and Budget (Invite Local Community to make written comments in respect of the IDP and Budget) ▪ Conclusion of Sector Plans (if any) initiated for the financial year and integration into the IDP Review report.	▪ Council to consider and adopt an oversight report [Due by 31 March MFMA Section 129(1)] ▪ Council Adopts draft Annual Report for the year end. ▪ Publicise Annual Report and MPAC Report ▪ Draft SDBIP's for developed and for incorporation into draft IDP ▪ Reminder to be sent to HOD's to submit their Q3 SDBIP Reports in terms of s41 MSA ▪ Set performance objectives for revenue for each budget vote **(**MFMA Section 17)	▪ Entity board of directors considers recommendations of parent municipality and submit revised budget by 22nd of month MFMA Section 87(2) ▪ Mayor tables municipality budget, budgets of entities, resolutions, plans, and proposed revisions to IDP at least 90 days before start of budget year MFMA Section 16, 22, 23, 87 and MSA Section 34	▪ Accounting officer publishes tabled budget, plans, and proposed revisions to IDP, invites local community comment and submits to NT, PT and others as prescribed MFMA Section 22 & 37; MSA Ch 4 as amended ▪ Accounting officer reviews any changes in prices for bulk resources as communicated by 15 March MFMA Section 42	▪ Mayor tables budget, resolutions, plans and changes to IDP at least 90 days before the start of the financial year.
APR IL	▪ Review written comments in respect of the Budget and IDP ▪ Conclusion of Sector Plans initiated for the financial year and integration into the IDP Review report. ▪ IDP Steering Committee Meeting ▪ Public participation process launched through series of public hearings on the IDP and Budget. ▪ Prepare departmental business plans linked to the IDP strategies, objectives, KPI's and targets.	▪ Q3 Reports tabled to Council (for third quarter) **MPPR Reg. 14** ▪ Refinement of Municipal Strategies, Objectives, KPA's, KPI's and targets and inclusion into IDP Review report. ▪ Sect 57 Managers' **informal** quarterly assessments (for third quarter) ▪ Publicise Annual Report [Due by April MFMA Section 129(3)] ▪ Submit Annual Report to Provincial Legislature/MEC Local Government [Due by April MFMA Section 132(2)] ▪ Review annual organisational performance targets (MPPR Reg 11)	▪ MFMA Section 21	▪ Accounting officer assists the Mayor in revising budget documentation in accordance with consultative processes and taking into account the results from the third quarterly review of the current year	▪ Public hearings on the Budget, Council Debate on Budget and Plans.
MAY	▪ EXCO recommends adoption of the IDP to Council. ▪ Adoption of the IDP by Council. ▪ Publish IDP and Budget in the Local Newspaper. ▪ Convene IDP Representative Forum	▪ Community input into organisation KPIs and targets ▪ Budget for expenses of audit committee	▪ Council to consider approval of budget and plans at least 30 days before start of budget year. MFMA Sections 23, 24; MSA Chapter 4 as amended ▪ Entity board of directors to approve the budget of the entity not later than 30 days before the start of the financial year, taking into account any hearings or recommendations of the council of the parent municipality ▪ MFMA Section 87	▪ Accounting officer assists the Mayor in preparing the final budget documentation for consideration for approval at least 30 days before the start of the budget year taking into account consultative processes and any other new information of a material nature	
JUNE	▪ Submission of the Final IDP to COGTA	▪ Reminder to be sent to HOD's to submit	▪ Council must approve annual budget	▪ Accounting officer submits to the	▪ Publish budget

MONTH	ACTIVITIES				
	IDP	PMS	BUDGET		
		their Q3 SDBIP Reports in terms of Section 41 of MSA	by resolution, setting taxes and tariffs, approving changes to IDP and budget related policies, approving measurable performance objectives for revenue by source and expenditure by vote before start of budget year MFMA Section 16, 24, 26 and 53 Mayor must approve SDBIP within 28 days after approval of the budget and ensure that annual performance contracts are concluded in accordance with sect 57(2) of the MSA. Mayor to ensure that the annual performance agreements are linked to the measurable performance objectives approved with the budget and SDBIP. The mayor submits the approved SDBIP and performance agreements to council, MEC for local government and makes public within 14 days after approval. ▪ Council must Finalise a system of delegations. ▪ MFMA Sections 59, 79, 82 and MSA Section 59-65	mayor no later than 14 days after approval of the budget a draft of the SDBIP and annual performance agreements required by s 57(1)(b) of the MSA. MFMA Section 69; MSA Section 57 ▪ Accounting officers of municipality and entities publishes adopted budget and plans MFMA Sections 75 and 87	and plans. ▪ Finalise performance contracts and delegation. ▪ Council adopts budget, resolutions, capital implementation plans, objectives and changes in IDP.

3.7 MUNICIPAL BUDGET AND DEBT MANAGEMENT

Municipal operating budgets are generally made up of two broad parts; namely revenues and spending.

Section 64 of the MFMA, 2003 determines that revenues represent the various financial resources available to local governments. Local governments generally rely upon the local property tax, intergovernmental aid and charges for local services for the majority of their revenues. Spending by local governments reflect the array of services and facilities provided by local government.

The National Treasury: Local Government Budgets and Expenditure Review (2011b:71) further indicates that municipal consumer debt encompasses late payments for property rates, service and other municipal charges, as well as amounts that are deemed irrecoverable. In addition municipal consumer debt has a number of potential impacts National Treasury, (2011b:71). Firstly, it can cripple the cash flow of municipalities and, therefore, their ability to fulfill constitutionally mandated responsibilities. Municipal consumer debt can also reduce the finance available for the delivery of basic services, infrastructure, and maintenance and upgrading.

Lack of economic activities at local level has driven populations to migrate to towns and urban centre in anticipation of finding employment. The pressure brought by these migrations to municipal services has not been absorbed adequately by municipalities as their budgets are not able to meet the demand for services and may not be able fund the cost of increased services due to the diminished community income.

The underperformance of actual collections against billed revenue in the operating budget can be attributed to amongst others, the affordability of municipal services. The on-going economic slowdown and substantial increases in electricity tariffs are starting to impact on affordability and subsequently the ability of consumers to pay for services.

Fourie and Mazibuko (2013:141) and the National Treasury: State of Local Government Finances and Financial Management Report (2013d:18) is of the opinion that any one of the following events could push the municipalities that already have very low cash coverage into a negative cash position:

- A deterioration in revenue collections due to the impact of the economic recession
- and the rising rates and tariffs on the affordability of household budgets;
- Non- Payment to priority suppliers, especially contractors responsible for capital projects,
- Increased cost of bulk electricity and water; and
- Any major breakdown in service delivery resulting in non-supply (especially water
- and electricity).

It is important to note that the growth in the level of consumer debtors may also be attributed to the following:

- Failure on the part of mayors and municipal councils to provide political backing to revenue enhancement programmes (often councillors are in arrears with their own payments);
- Failure on the part of municipal managers to allocate sufficient staff/capacity to the revenue collection function, thus compromising implementation of policies to enhance revenue;
- Poorly designed revenue management, indigent and debtor policies;
- Resistance among certain communities to pay for certain types of services (or to be billed in a particular way); and
- Rate-payer boycotts, sparked by deteriorating service delivery, and perceptions that the municipality is unresponsive to community concerns. National Treasury: State of Local Government Finances and Financial Management (2013d:25).

3.8 SUMMARY

Municipalities are the custodians of public funds and it is imperative that the budgets are used as an instrument to grow the economy and the development of the local municipality, thus creating investment opportunities for investors.

In this regard a discussion is provided on the legislative and policy directives that make provision for municipal budgets. The requirements of the MFMA, 2003 and the National Treasury, MBRR, 2009 is extensively discussed with regards to compliance, alignment and credibility of the municipal budgets. Details are provided on the composition of the budget in compliance to the MBRR, 2009 regulation.

To contextualise the discussion the author provided a detailed discussion on the budget analysis done by Free State Provincial Treasury on the draft 2013/14 municipal budgets. The municipal annual budget cycle is discussed using six steps namely, planning, strategising, preparation, tabling, approving and finalisation.

In addition the functions of councillors with regards to the annual budgets is discussed in context of their role and oversight responsibilities. Section 25 of the MSA, 2000 and Section 21 of the MFMA, 2003 requires IDPs, Municipal Budgets and PMS to be aligned, Section 3.6.2 provides details on the alignment.

Poor debt collection and the increase in outstanding debts year on year is testament to the fact that municipalities have a challenge in the collection of outstanding debts. In this regard details are provided on the impact of non-collection have on municipal budgets. It is therefore imperative that the political and administrative leadership takes ownership of the debt management processes and enforce municipal policies. If municipalities are not able to collect the generated revenue from services, then rendering the services becomes unsustainable.

It is therefore incumbent upon the political and administrative leadership to rise to these challenges and ultimately provide quality governance and administrative practices. Chapter 4 outlines the debtor management cycle; the debtor control system and also includes an evaluation of municipal debt over three years in the Free State Province; socio economic impacts on debt and impacts on municipalities achieving the MDG goals. Finally chapter 4 concludes by providing debt challenges at municipalities and possible solutions.

CHAPTER FOUR :
MUNICIPAL DEBT MANAGEMENT

4.1 INTRODUCTION

Chapter 3 provided detailed financial requirements of the MFMA (RSA, 2003) and the National Treasury (2009) in preparation of the annual municipal budgets. Furthermore chapter three also discussed the municipal budget cycle, along with details of the functions of councillors with regard to the annual budget.

This chapter outlines the debtor management cycle and the debtor control system, with an evaluation of municipal debt over three years in the Free State Province, the socioeconomic impact of debt on municipalities' achievement of MDG goals, and the debt challenges at municipalities.

According to the Section 152 of the Constitution (RSA, 1996), local government exists for the following purposes:

- Providing a democratic and accountable government for local communities;
- Providing services to communities in a sustainable manner;
- Promoting social and economic development; and
- Encouraging the involvement of communities and community organisations in the matters of local government.

Broadly speaking, local government exists for two reasons, namely service provision and democracy. Firstly, the efficient and effective provision of services to the local communities is highly dependent on the ability of the local residents to pay for these services. Secondly, with regard to democracy, including civic consideration, local government must use its resources efficiently and manage its debtor book effectively. Misuse of public monies and ineffective debt management controls by local authorities, as specifically required by Section 64(2)(f) of the

MFMA (RSA, 2003), cannot be tolerated, as ineffective debt management generally leads to the disarray of finances and ultimately questions the sustainability of municipal councils.

Craythorne (2006:272) and Section 64(2)(a) of the MFMA (RSA, 2003) requires municipal managers to implement effective revenue collection systems and effective credit and debt control policies, consistent with Section 95 of the MSA (RSA, 2000a).

The Constitution (RSA, 1996) guarantees local government spheres an "equitable share of nationally raised revenues". This recognises that a fundamental imbalance exists between the expenditure functions assigned to them and the instruments they have available to generate their own revenues. The main purpose of the equitable share is to close the fiscal gap between national, provincial and local spheres of government. Nationally raised revenues, less debt repayment liabilities, are divided between the three spheres of government based on their expenditure responsibilities and the other revenue sources available to them. Thus, provincial governments, which have far fewer revenue sources than local governments, receive a commensurately larger portion of their resources from national transfers. In practice, the vertical division of revenue is an outcome of government's deliberations on policy and the associated expenditure priorities. It reflects government's balanced approach to meeting policy priorities over the medium term, considering the responsibilities, expenditure pressures, capacity and performance of each sphere of government (National Treasury, 2011b:53-54).

The National Treasury (2011b:36-37) maintains that municipalities are the custodians of public funds, whether raised from their own revenue sources or received through intergovernmental grants. Municipalities are therefore tasked with using these resources to respond to the needs of their communities for infrastructure, local services such as water, electricity and refuse removal, and the enabling and guiding of the spatial development of their localities. Although municipalities are entitled to a share of the national fiscus, this share is mostly used to sustain municipal administrations, rather than to fund service delivery projects. The National Treasury (2011b:38) indicates that the main sources of own revenue for municipalities are user charges and funds generated by the sale of water and electricity. In most cases, the local authority enters into agreements to supply goods and services and then bills the beneficiary based on the conditions of the contract (National Treasury, 2011b:41). According to the Free State Provincial Treasury (2014:14), in certain instances municipalities bill indigent households as full-paying customers. This contributes to the ever-escalating municipal debtor book (Fourie and Mazibuko (2013:141).

Section 229 of the Constitution (RSA, 1996) provides for the provision of basic services such as electricity, water and sanitation, refuse and waste removal – all critical services required by people living in the areas serviced by municipalities. However, municipalities will only be in a position to provide these services if they have sufficient revenue.

In light of the above, the National Treasury (2008:10) provides that municipalities make an important contribution to poverty alleviation and economic development, through the provision of free basic services (FBS) to poor households and investment in infrastructure and associated services that are critical for economic activity. According to Section 18 of the MFMA (RSA, 2003), to deliver services effectively, municipalities rely on two important sources of revenue: The leading source of revenue is from the national sphere (local government equitable share (LGES) allocation and conditional grants), while the other source of revenue is the municipality's own revenue, which is composed mainly of property rates and taxes and charges for the provision of water, electricity, refuse removal, sanitation and other services. A critical question that remains is what happens when the ability of municipalities to generate adequate levels of own revenue is constrained. The issue of non-payment, also referred to as municipal consumer debt, poses a serious threat to the financial health of municipalities in South Africa (National Treasury, 2011b:71).

In the context of South Africa, municipal consumer debt refers to the non-payment of property rates amd fees/charges for services provided by municipalities (for example water, sanitation, electricity and refuse removal) and various other financial obligations to municipalities (for example traffic fines and rental housing payments) (National Treasury, 2011b:62). The National Treasury, (2011b:71) further indicates that municipal consumer debt encompasses late payments for property rates, services and other municipal charges, as well as amounts that are deemed irrecoverable. In addition, municipal consumer debt has a number of potential impacts (National

Treasury, 2011b:71). Firstly, it can cripple the cash flow of municipalities and, therefore, their ability to fulfil their constitutionally mandated responsibilities. Municipal consumer debt can also reduce the finances available for the delivery of basic services, infrastructure, and maintenance and upgrading. In can prompt the need for greater cross-subsidisation from richer households/businesses, potentially overburdening the existing tax base. Outstanding payments also represent foregone resources that could be used to improve the living conditions of the poor. One possible reason for the debt increase could be poor performance by municipalities, such as inaccurate billing, weak credit control measures and poor customer service mechanisms, which may serve to reinforce non-payment, as those consumers able to pay become unwilling to pay. The fact that there is no integrated debt management model to assist municipalities to improve their debt management, the debt situation has deteriorated.

The FFC (2010:166) argues that consumers may be unable to pay for services as a result of unemployment and poverty. The causes of non-payment in the context of South African municipalities have been the focus of various studies, including those by Booysen (2001), Botes and Pelser (2001), Burger (2001) and Fjeldstad (2004). However, as most of these studies were carried out in the early to mid-2000s, changes in the local government sphere warrant a thorough and updated investigation of the factors driving this kind of debt.

- Findings of Previous Studies Concerning Debt Management

According to Booysen, (2001), Botes and Pelser, (2001) and Burger, (2001), the most common reason used to explain non-payment appears to be the inability to pay as a result of poverty. The term ‘inability to pay’ indicates that there is an income level below which people are unable to pay for the delivery of services.

Milne (2004:5) suggests using “core affordability indicators”, which, if properly monitored, can warn policymakers of early indications of changes in the affordability of services. A range of possible indicators is proposed by Milne (2004:5).

A study conducted by McPhail (1993:969) of five Moroccan states in a bid to determine whether the price charged for water was correctly set, or whether there was an opportunity to make individual house connections available to some of the indigent households at retail level, found that many low-income households, even those with access to a free stand-post water service, were willing to pay in excess of five per cent of their total household expenditure for individual water services (McPhail, 1993:969).

According to a study by Fjeldstad (2004), non-payment is not a given for those residing in poor areas, as significant variations in payment and non-payment exist across both poor and non-poor areas. These findings were confirmed by Booysen (2001), who analysed the income and expenditure of 1,600 households to determine the root cause of non-payment, finding that not only higher-income households, but also households experiencing relatively high levels of poverty, were paying for services. A second reason for non-payment is therefore the willingness (or not) to pay.

This is collaborated by Fjeldstad (2004) in concurring with the power of citizen perception, which is implicitly linked to the extent of trust that community members have in local government leadership.

However, since all these studies were carried out in the 1990s and mid-2000s, legislative changes in the local government sphere, and especially the promulgation of the MFMA (RSA, 2003) and other municipal legislation such as the MPRA (2004a), MFPFA (2007), annual DoRA, amendments to the MSA (RSA, 2000) and new municipal regulations that impact on municipal debt management, necessitates new research in this regard.

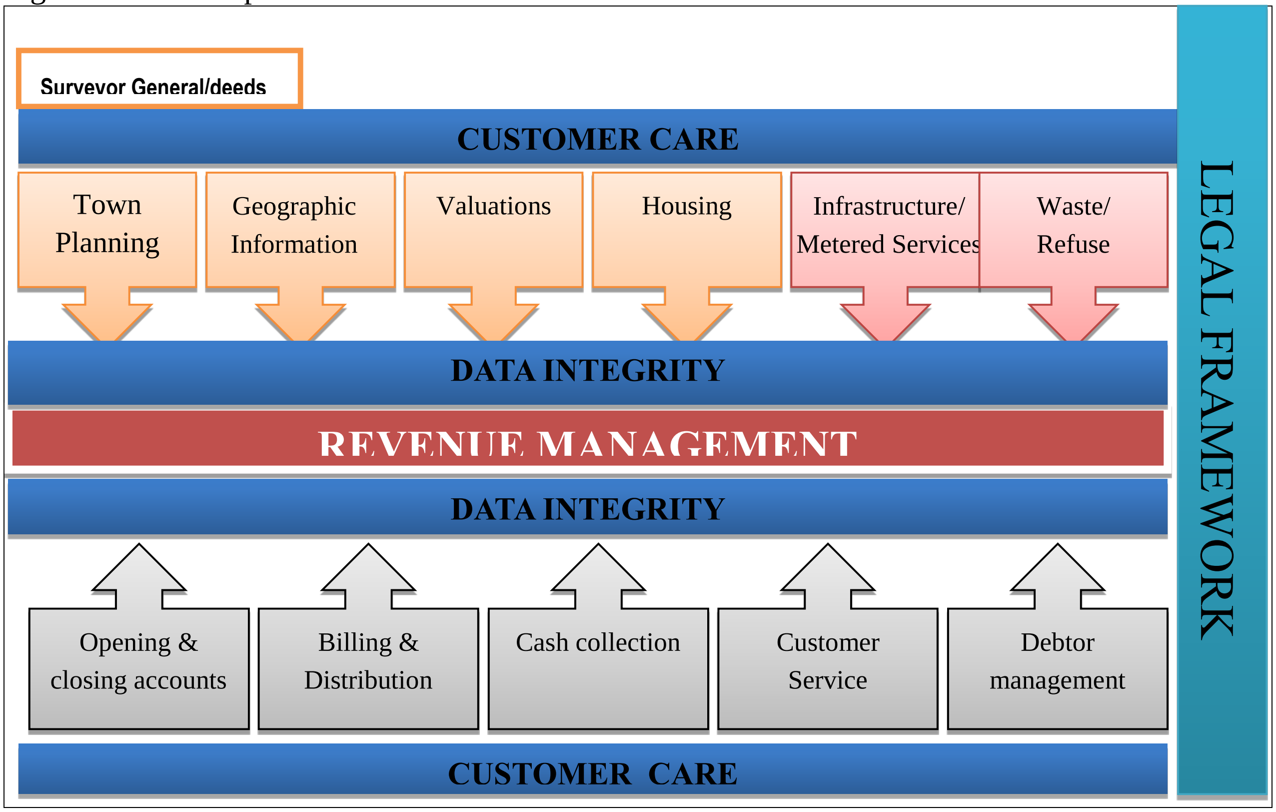
4.2 DEBTORS MANAGEMENT CYCLE

According to Fourie and Mazibuko (2013:141) and the National Treasury, MFMA Circular 64 (2012a:7) the debtors management cycle extends from the billing and invoicing of customers to the actual revenue collected for the municipal services provided. The major portion of any local municipality’s revenue is received from the provision of goods and services. To generate revenue, municipalities must bill their customers on a monthly basis. Furthermore, municipalities must implement controls to ensure that all revenue is recorded and properly accounted for on their financial systems. The CFO must see to it that systems are in place to ensure that billing is done correctly and thus avoid non-payment. Section 64 of the MFMA (RSA, 2003) indicates that the billing function is the principal mechanism that drives all cash flow, which is the main source of customer information and critically fundamental to the success of any municipality.

The Free State Provincial Treasury (2014:6) emphasises that during the opening of accounts data, integrity is critical to effective billing, which is the first vital stage of the revenue value chain. The ability to collect debt remains dependent on the accuracy of the debtor information. The Free State Provincial Treasury (2014:6) further determines that inaccurate debt information results in poor debt collection. It is only once this information is correct that municipalities can implement actions to collect the debt and communicate with the debtor. According to the Free State Provincial Treasury (2014:6), debt collection without accurate information may result in partial collections, if any, and a debtor that is not fully rehabilitated could continue to default. It is only once the debtor information has been verified and reconciled that it can be established that the customer does exist and will be able to pay the account. The municipality can then effectively implement a credit control policy and debt collection process.

Figure 4.1 below shows the municipal revenue value processes, from the taking on of a debtor, to the billing and management of debtors.

Figure 4.1: Municipal Revenue Value Chain



Source: Adapted from National Treasury (2012a)

Figure 4.1 above presents the municipal revenue value chain reflecting the inter-dependence of activities in the municipal revenue collection process. The National Treasury (2012a:11) and Craythorne (2006:272) determines that each customer should have their own water and electricity account, and customers cannot inherit an existing water and electricity account from a previous owner or tenant of a property. In addition, Figure 4.1 shows that credible debtor details are paramount to ensure billing efficiency, culminating in effective collections and debtor management processes.

The process and be explained as recommended by USAID, (2010:16), that when opening an account in terms of a contract for the supply of water and electricity, the following basic information must be a furnished by the customer:

- Copy of a valid South African identity document;
- Details of next of kin;
- Banking details;

- Contact details, including name, telephone and cellphone numbers, physical and postal addresses, and e-mail address;
- Deposit amount (cash, cheque or internet banking);
- Copy of offer to purchase or deeds document;
- Meter number/s and latest readings; and
- Completed application form for the supply of water and electricity.

This is emphasised in Section 64 of the MFMA (RSA, 2003) and Section 95 of the MSA (RSA, 2000a), requiring the municipality to have an effective system for revenue collections and a credit and debt collection policy respectively.

The opinion is held that the value of the above-mentioned information is heightened when it is assessed relative to equivalents for income groups, the median or some national norm/benchmark. McPhail (1993:969) suggests incorporating assessments of affordability and willingness to pay at the planning stage of a public good such as water or electricity, especially if the intention is to recover costs. McPhail (1993:969) further mentions that such information can provide insight into potential service usage patterns and, therefore, the tariff to be charged in order to maximise cost recovery.

Despite the obvious importance of having an indication of willingness to pay, McPhail (1993:969) argues that policymakers continue to make general assumptions about the population to be served and the per capita consumption rates. The end result is that tariff setting is based on the covering of operating, maintenance and capital costs, without considering what people are willing to spend, which could even exceed the set rate.

In a study of five Moroccan states in a bid to determine whether the price charged for water was set correctly or whether there was an opportunity to make individual house connections available to some of the indigent households at retail level, McPhail (1993:969) found that many low-income households, even those with access to free stand-post water services, were willing to pay in excess of five per cent of their total household expenditure for individual water services. The implication of these findings is that South Africa needs to re-examine the indigent policies determining which portions of the population cannot afford to pay for services.

4.3 COST RECOVERY OF MUNICIPAL SERVICES

According to Spencer (2006:30) various attempts have been made to recover the cost of municipal services and enforce payment for services delivered. For example, in the United States, non-payment of parking tickets, library fines, etc. has prompted various local authorities in the cities of New York, Miami and Chicago to hand over the collection of debts to private collection agencies, which can result in consumers being blacklisted. The effects can be far-reaching and may even affect the interest rate a consumer can demand when applying for a home loan or vehicle financing. As the cost of these effects may outweigh non-payment for services, compliance is more effective.

As cited by Spencer (2006:31), another tool that can be used to encourage payment is the cutting off/disconnecting of services. However, the use of this measure is politically contentious, and total cut-offs are not possible in the case of certain services such as water, which is considered a basic human right. Responses to service cut-offs also need to take into consideration the existing social conditions, such as high levels of unemployment and poverty, as per Section 27 of the Constitution (RSA, 1996). These social conditions might lead to, or exacerbate, negative reactions and/or resistance from communities. During 2001, South African communities responded to Eskom's 'massive' electricity cut-offs by resorting to illegal connections, some of which were carried out by former Eskom employees who were unemployed at the time (Khunou, 2002:61). Ruiters (2002:52-53) identifies four types of permanent cut-offs of basic services: shutting off services through the removal of cables and pipes; increasing reconnection fees, which are usually so severe that they effectively limit who can afford to reconnect; requiring residents to pay off outstanding payments before being able to reconnect; and self-disconnecting by means of prepaid meters. According to the FFC (2010:158), one method of cost recovery is the application of the principle of cross-subsidisation, where wealthier households are charged higher tariffs to subsidise services to poorer households. A study by Cointreau-Levine (2005) found that in the solid waste sector, the cost-subsidisation option works relatively well in light of, for example, better access for collection vehicles in wealthier areas, and less difficulty in collecting waste from large commercial establishments than from less-affluent areas where settlement patterns and road conditions hamper waste collection. Cost recovery can also come through voluntarism, where consumers who cannot afford the cost of a service, contribute their labour. This approach can bring unforeseen health/social costs and also add gender, race and class dimensions to cost recovery (FFC, 2010:158).

The FFC (2010:158) advises that prepaid meters present the ultimate cost-recovery mechanism, as the service is paid for prior to using it; in essence prepaid meters represent an effective means of preventing defaults on payments. MacDonald (2002a:20) further asserts that the use of prepaid meters, which does not require billing or meter reading, can avoid the pitfalls of non-payment due to poor administrative/financial management practices on the part of municipalities. In a study conducted at Makhaza Section, Khayelitsha, by Xali (2002:114-115), cost recovery was found to be unsustainable, leading to excessive spending in an attempt to recover costs from low-income households who, because of unemployment and a range of other social challenges, would not be able to pay for municipal services.

4.3.1 Factors Determining the Success of Municipal Billing

According to USAID (2010:14), the following are determining factors in effective billing:

- The customers' property information must be accurate and the municipality must have signed an agreement with customers for services to be provided to their residences.
- The municipal tariffs must be reflective of municipal policy and must comply with the National Treasury circulars. Property tariffs must be cost reflective, using variables such as land usage, debtor type (e.g. business or residence, etc.), land zoning, and service type.
- There must be accurate ward information included per property.
- There must be accurate adherence to the municipality's steps in the process of opening and closing accounts.

The above suggestion is also applicable to South African municipalities. USAID (2010:14) states that technology not only contributes to effective billing but also promotes financial integrity. Successful billing is therefore mostly a function of the accuracy of the data input into the system. Thus systems and controls need to supplement the financial software to ensure complete and accurate billing. Effective control systems are discussed hereunder.

4.3.2 Effective Financial Control Systems

According to USAID (2010:15) effective financial control systems are critical to an efficient billing process. Factors required in this regard include the following:

- Financial staff must have access to certain functionalities on the software system, such as passwords;
- A password or biometric protection system is required; and
- Supervisors should be given the authority to open and close accounts and to change an account status.

In light of the above, USAID, (2010:15) maintains that prior to the final billing run and processing, certain areas must be examined, namely customer accounts not billed or valued, and abnormal consumption and billing.

In addition, the National Treasury (2011a:41) holds that the municipal billing process requires a number of processes to be completed, including the finalisation of each billing run, the capturing of all receipts, meter readings and electronic fund transfers (EFTs) from financial institutions, as well as journals and credit notes. Further information technology processes to be followed include the compilation of pre-billing reports, variance reports and backup bills, the production of audit reports, the verification of reports, and the preparation of files for bill printing and rollover to next period (USAID, 2010:16).

USAID (2010:16) suggests that once the billing administration processes have been completed, the municipality should activate a billing account run at the end of each month. Furthermore, the municipality should test for correctness of customer details, meter readings, numerical accuracy and interest calculations. Journals should be printed for the month, ensuring that all supporting documents are attached along with complementary journal entries. USAID (2010:16) further suggests that all the totals for the control accounts (regarding revenue and debtors) should be reflected in the general ledger, and the control accounts and general ledger should be reconciled and reviewed. On the valuation roll, the supplementary valuation roll totals should match the billing totals.

USAID (2010:15) also advises that the municipal billing process can be broken down into three separate components, namely customer, tariff, and usage/service. Another requirement for effective and accurate municipal billing is that each of these components must be interrelated. These suggested controls would improve accountability and billing efficiency at South African municipalities that are struggling to collect revenue.

4.3.2.1 Customer Details

According to USAID (2010:16) the accuracy of customer details is paramount to effective billing.

Customer details to be included on customer forms and processed by municipal billing practitioners on the financial system include:

- Name of customer/tenant/owner/company;
- Physical and postal addresses;
- ID/company registration/CC/trust number;
- Classification;
- Owner/company/tenant (ownership or lease); and
- Bank account information of company or customer (depending on method of payment).

Thus, municipalities should ensure that the billing information relating to all new customers is accurate.

4.3.2.2 Tariff Charges

According to the National Treasury (2013c), the tariff charges must be aligned to the MFMA circulars and referred to regulatory bodies such as NERSA for consultation. The tariff charge to the customer must be in line with Section 74 of the MSA (RSA, 2000a) and the tariff policy adopted by the Municipal Council. Section 74 of the MSA (RSA, 2000a) provides that municipalities must include the following salient areas in their tariff policy:

- General principles of tariff determination for major municipal services such as electricity, water, refuse removal and sewerage;
- Tariff uniformity and application;
- Tariffs for services provided to indigents, in accordance with the municipality's indigent relief programme;
- Service consumption metering and readings (if not possible monthly, the policy must indicate when meters are to be read); and
- Billing to be done in consolidated format.

Section 75 of the MFMA (RSA, 2003) requires the tariff policy to be approved annually by the council and then implemented.

USAID (2010:16) further argues that if a customer is incorrectly classified, the wrong tariff could be used, which may result in incorrect billing.

4.3.3 Meter-Reading Routes

According to USAID (2010:58), the municipal jurisdiction should be divided into zones for meter-reading purposes. As a best practice, a presentation done on 10 February 2014 at the eThekwini Metropolitan Municipality indicated that it distributes electricity transmitted and distributed for use by the full spectrum of customers ranging from the large, sophisticated industrial and commercial sector, to the rural and peri-urban informal community using conventional and prepaid meters.

Conventional meters are read once every three months and the meter readings are done using electronic handsets.

The municipal capture clerk captures the meter readings onto the Coin financial system. Furthermore, exception reports list excessive consumption, no readings and negative readings, while billings are reviewed during the reading months and on-site assessments are done to detect any tampering with the meters. If outsourcing the function of meter reading, the municipality must ensure that the above aspects are included in the contractual agreements and there must be a monitoring process at the municipality to ensure efficiency and value for money.

4.3.4 Reporting and Resolving Pitfalls in Meter Reading

The National Treasury (2012a:11) states that all problems reported and identified by the meter reader, such as broken meters, leaking meters and inaccessible meters, must be reported to the technical department to ensure a follow-up process. Furthermore, municipalities should identify faulty meters and rectify them monthly. The changes must be recorded against the debtor’s account.

Sections 95(d) and (e) of the MSA (RSA, 2000a) require municipalities to take reasonable steps to ensure that the consumption of services by individual users is measured through accurate and verifiable metering systems and that persons liable for payments receive regular and accurate accounts that indicate the basis for calculating the amounts due.

4.4 DEBTOR CONTROL SYSTEM

Burger (2001:2) states that all municipalities in South Africa derive an income from households, businesses and industries for services rendered and revenues from property taxes. However, many municipalities face severe budget constraints as a result of increased expenditures and costs on the one hand, and decreasing levels of payment for services provided on the other. The National Treasury (2011b:71) sees the debt burden as a threat not only to the effectiveness of service delivery but also to the very existence of most municipalities in South Africa. This implies that effective credit control is imperative to promote effective debt control in all municipalities.

According to the Free State Provincial Treasury (2014:7), effective credit control is a disciplined process aimed at obtaining payment from consumers for services rendered by the municipality, with the key steps in the process of effective credit control being as follows:

- Ensuring that all municipal accounting data is correct and reconciled;
- Ensuring that current and accurate customer records are kept;
- Ensuring that appropriate and accurate tariffs are in place;
- Ensuring that all billings are accurate;
- Ensuring that effective debt collection processes have been implemented; and
- Ensuring the implementation of proper processes for service cut-offs.

4.4.1 Advantages of Effective Credit Control

As indicated by the Free State Provincial Treasury (2014:7), some of the advantages of effective credit control for a municipality are:

- Revenue certainty – more accurate and ambitious budgeting;
- Visible action against defaulters;
- More credible and effective municipal debtor information systems;
- More meaningful progress and performance reporting;
- Improved compliance with municipal key performance; and
- Improved capacity building of municipal staff through a more constructive focus.

4.4.2 Credit Control Actions

Section 64 of the MFMA (RSA, 2003) places the responsibility of revenue management on the accounting officer of a municipality. The accounting officer must ensure that the municipality has effective revenue collection systems in place, consistent with Section 95 of the MSA (RSA, 2000a) and the municipality's credit control and debt collection policy. Furthermore, the accounting officer has an obligation to collect all money that is due and payable to the municipality. According to the Free State Provincial Treasury (2014:7), failure by municipalities to collect revenue results in reduced cash flows, which has a negative impact on their ability to budget and spend as planned, resulting in interrupted service delivery and threatening the continued viability of the municipalities.

In the next section, various credit control actions that can be undertaken by municipalities are discussed.

4.4.3 Disconnection of Municipal Services

USAID (2010:33) points out that an effective credit control process must include the following aspects to promote efficiency in terms of collection:

- Final Demand Notice: This is a legal notice informing the consumer that payments are in arrears and making a final demand for the payment of all outstanding amounts. The final demand notice also informs the consumer that if the demand is not met or an arrangement made with the municipality within seven days, the supply of that service will be disconnected (USAID, 2010:33).

- Electricity Disconnection – Level One: A first-level electricity disconnection is normally undertaken simply by switching off the electricity in a lockable distribution box situated remotely from where the consumption takes place. Should the final demand notice be ignored and payment not made within the prescribed time, the first-level electricity disconnection would normally be effected immediately.

- Water Restriction – Level One: A first-level water-restricting device is an instrument/gadget installed on the incoming side of the water meter to restrict the supply to a consumer's home. This device ensures that the consumer has access to at least the basic minimum quantity of water to which he/she is entitled in accordance with the free basic services policy of the municipality. Should payment not be received after the restriction of electricity, a first-level water restriction is normally executed.

- Illegal Consumption Inspection: If the consumer still fails to make payment, it is likely that the services have been illegally reconnected. The municipality should undertake an on-site inspection to determine whether the services have been illegally reconnected. If illegal reconnection or tampering is detected, the consumer becomes subject to a much stricter disconnection/restriction process.

- Electricity Disconnection – Level Two: A second-level electricity disconnection normally involves the removal of the circuit breaker, generally within two days of an illegal consumption inspection having established that an illegal electricity connection has been made.

- Action to Remove Installation Permanently: Should illegal consumption continue, the consumer's account is referred to a special committee for 'remove installation permanently' (RIP) action, with the recommendation that the supply installation be permanently removed.

In terms of Section 27 of the Constitution (RSA, 1996), all citizens have the right to a water supply, and as such the water supply may be limited but not disconnected entirely in the case of non-payment by consumers. Municipalities may disconnect the electricity supply, however.

4.4.4 Illegal Reconnection

According to the Free State Provincial Treasury (2014:12) the following steps should be taken in the event of illegal reconnections:

- Immediate termination or restriction of service;
- Reporting thereof to the South African Police Service;

- No reconnection or reinstatement until all arrears, interest, charges for notice (if any), charges for reconnections and reinstatements, and all other penalties have been paid in full;
- Full payment for consumption (estimated or actual) since the illegal reconnection took place; and
- Consideration of compulsory conversion to prepaid meters in certain instances.

Section 96 of the MSA (RSA, 2000a) provides for legal action to be taken if no payments are made or arrangements entered into within a specified period after services are terminated or restricted. This means that the account of such a consumer should be handed over to attorneys, with all legal expenses payable by the defaulting account-holder.

4.4.5 Principles in Establishing a Sound Credit Control Policy

Section 64 of the MFMA (RSA, 2003) places the responsibility of revenue management on the accounting officer of a municipality. The accounting officer must ensure that the municipality has effective revenue collection systems in place, consistent with Section 95 of the MSA (RSA, 2000a) and the municipality's credit control and debt collection policy. Furthermore, the accounting officer has an obligation to collect all money that is due and payable to the municipality. Failure by municipalities to collect revenue results in reduced cash flows, which has a negative impact on a municipality's ability to budget and spend as planned, resulting in interrupted service delivery and threatening the continued viability of the municipalities. With all municipalities in South Africa required to have credit and debt control policies in place, the following principles should be considered when developing such policies:

- The constitutional obligation to develop the local economy and to provide acceptable services to residents and simultaneously extract payment for such services by means of legitimately levied taxes.

- When notice of default is to be served on delinquent account-holders, advising that if payment is not made or payment arrangements not honoured, the municipality may terminate or restrict services. If no separate notice is to be served, the arrears account itself must serve as the notice.

4.5 EVALUATION OF DEBT OVER THREE YEARS AT FREE STATE MUNICIPALITIES (MUNICIPAL RATES AND TAXES)

This section focuses on which category of municipality has the highest level of outstanding debt, who is responsible for the debt, and which sectors represent the bulk of the debt for Free State municipalities. According to the consolidated Auditor-General's report for the 2011/12 financial year (Free State Provincial Treasury, 2012a), Free State municipalities recorded an amount of R6.5 billion in their debtors' books, which is a massive debt growth of R4.6 billion or 240 per cent when compared to the 2009/10 financial year. Table 4.1 shows municipal consumer debt reporting for 2009 to 2012.

Table 4.1: Municipal Reporting on Consumer Debt, 2009/10 to 2011/12

Municipal Category	2009/10	2010/11	2011/12
Metropolitan municipality	12	12	12
District municipality	48	48	48
Local municipality	212	222	235

Source: Adapted from the Local Government Database (National Treasury, 2013a)

From Table 4.1 it is clear that municipalities in the Free State have improved their reporting in compliance with Section 71 of the MFMA (RSA, 2003). Table 4.1 also shows that consumer debt submissions to monitoring departments, i.e. national and provincial treasuries are in general improving significantly across the majority of municipal categories.

4.5.1 Aggregate Municipal Consumer Debt Over Three Years

Table 4.2 reflects the real average municipal consumer debt between 2009/10 and 2011/12.

Table 4.2 Real Average Municipal Consumer Debt per Municipal Category, 2009/10 to 2011/12 (R'000)

Municipal Category	2009/10	2010/11	2011/12
Metropolitan municipality	1,154,546	1,270,120	1,747,300
District municipality	10,968	11,081	6,105
Local municipality	3,675,297	3,570,006	4,762,346
Total	4,840,811	4,851,207	6,515,751
Real Year-on-Year Growth			
Municipal Category	**2009/10**	**2010/11**	**2011/12**
Metropolitan municipality	-	10 %	37.6%
District municipality	-	1%	- 44.9%
Local municipality	-	0.2%	34.3%

Source: Adapted from the Local Government Database (National Treasury, 2013a)

Table 4.2 further depicts that in general, consumer debt is escalating significantly for metropolitan and local municipalities, with the outstanding debt of district municipalities, which have limited fiscal powers to leverage revenue for services, declining between 2009/10 and 2011/12.

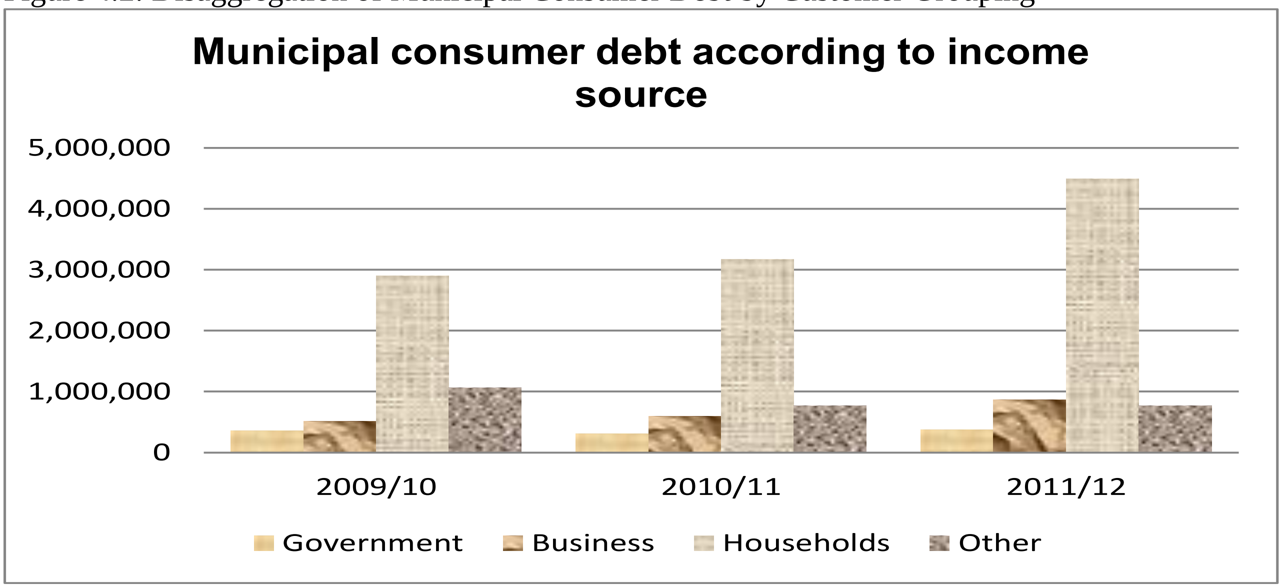
This regression can be attributed to material losses of water due to burst pipes, non-metering and unauthorised consumption (theft), while for electricity the loss may be due to theft and the bypassing of meters (theft) (Pongoma, 2013:7). Improvement is confirmed when consumer debt is assessed relative to municipal operating revenue. Table 4.2 further shows that consumer debt of district municipalities (with no major powers) declined significantly by 44.9 per cent in the 2011/12 financial year. This decline is attributable to the limitation of the powers of district municipalities in the Free State Province in terms of providing municipal services.

4.5.2 Disaggregation of Municipal Consumer Debt by Customer Grouping

The National Treasury (2013b) points out that the disaggregation of municipal debt is clustered into households, government, businesses, and a category referred to as 'Other', while the manner in which debtor data is reported means that it is not possible to factor out the effects of reporting variances by averaging the amounts recorded across the different types of municipalities. The data on customer groupings responsible for debt is reported at a real aggregate level. The National Treasury (2013b) further indicates that the term 'Other' is in the process of being phased out, and municipalities will be required to be explicit about items within this category in future.

Figure 4.2 shows the disaggregation of municipal consumer debt by the government, business, household and other customer groups.

Figure 4.2: Disaggregation of Municipal Consumer Debt by Customer Grouping



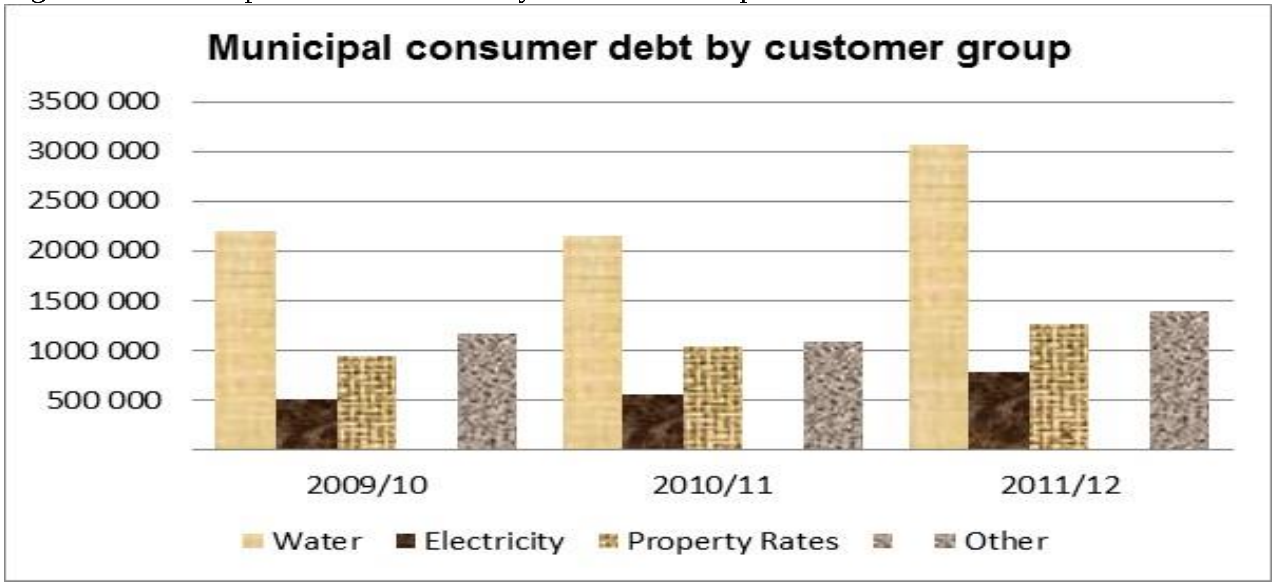
Source: Adapted from the Local Government Database (National Treasury, 2013a)

The debt data of municipalities shows that households are responsible for the largest share of municipal consumer debt, while non-payment by government departments grew significantly between 2009 and 2012. The growing debt of metropolitan and local municipalities is a matter of concern, and the municipal managers and CFOs of metropolitan and local municipalities must implement debt management and reduce the debt to ensure that consumer debt does not affect the financial effectiveness of municipalities the Free State Province (Cloete and Thornhill, 2014:112).

4.5.3 Disaggregation of Total Municipal Consumer Debt by Income Source

The annual revenue of a country is derived from taxes (indirect and direct), duties and other means of payment for goods. Section 74 of the MSA (RSA, 2000) requires municipalities to adopt and implement a tariff policy on levies for municipal services, own revenue sources such as electricity, water, sanitation, and various other and smaller sources such as fines. Section 12 of the MFPFA (RSA, 2007) states that Regional Services Council (RSC) levies used to represent a source of income for metropolitan and district municipalities, but were phased out in July 2006. Since then, district municipalities receive the RSC portion via the annual DoRA. In the Free State, district municipalities are reliant on an equitable share for their sustainability, because they do not provide essential municipal services to raise tariffs. Figure 4.3 shows the municipal consumer debt by customer group.

Figure 4.3: Municipal Consumer Debt by Customer Group



Source: Adapted from the Local Government Database (National Treasury, 2013a)

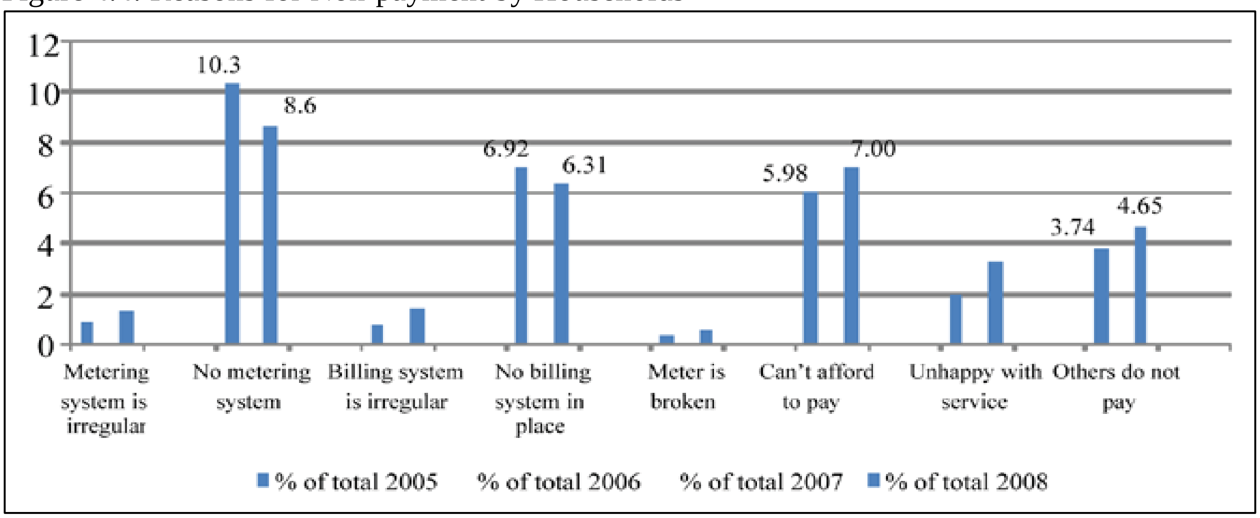
Figure 4.3 shows the outstanding amounts of all municipalities in respect of water, electricity and property rates dominating over the period 2009 to 2012. Figure 4.3 further shows that the average collections from water services in all Free State municipalities poses a challenge, as it is considered an essential basic service. Therefore, as provided in Section 27 of the Constitution (RSA, 1996), non-paying households cannot be completely disconnected from the water supply.

Most of the debt arising from non-payment of property rates emanates from government departments, which is the result of government devolving the payment of property rates from the Department of Public Works to provinces in 2008. This shift has created a bottleneck in payments, as well as disputes over who is responsible for historical amounts owing to municipalities. Once municipalities start reporting on what ‘Other’ entails, it will be possible to comment more substantively on this category. However, the significant increase in the debtors’ book of water debt will have an impact on the future viability of municipalities in the Free State.

4.5.4 Reasons for Non-Payment

According to Figure 4.2, households, government and businesses are the main defaulters. This section looks at the possible reasons why these three categories do not pay for services. A good starting point is to demonstrate the reasons for non-payment by households, as indicated by Stats SA, shown in Figure 4.4.

Figure 4.4: Reasons for Non-payment by Households



Source: FFC (2010:162)

Figure 4.4 depicts some of the reasons for non-payment by households. Non-metering and affordability are the major causes of non-payment by households. According to the FFC (2010:162) the absence of a metering system seems to be a strong motivator driving non-payment. Another prominent reason is a lack of billing systems, although this situation appears to be improving. In 2008, affordability issues emerged strongly, which could be the result of the slowdown in the South African economy.

4.5.4.1 Reasons for Non-Payment by Government

According to the National Treasury (2011a:11), non-payment by government departments to municipalities has grown rapidly. Across the various municipalities in the Free State Province, the provincial departments of Public Works and Education are responsible for the highest levels of non-payment. The underlying reasons for such high levels of non-payment are, on the one hand, the devolution of assets and payment of property rates from the National Department of Public Works to its provincial counterparts, which has created many bottlenecks in payments to municipalities (National Treasury, 2011a:20). A conditional grant, namely the Devolution of the Property Rates Grant to Provinces, was established to assist provinces to pay for this acquired function. However, the extent to which this will translate into relief for municipalities is based on the efficacy with which provincial departments transfer funds to municipalities.

Furthermore, the Free State Provincial Treasury (2012b:11) maintains that the Section 21 schools, i.e. schools that have been granted the right to manage their own budgets/financial affairs through their respective governing bodies and to pay for municipal services, are the source of many problems. The researcher suggests that in a bid to address this issue, municipalities should install prepaid water and electricity meters at all Section 21 schools.

In addition to the above, government departments also note the following factors as contributing to the high level of non-payment: slowness in generating invoices or property rates schedules, inaccurate verification and reconciliation from other municipalities, inappropriate billing systems and unreasonable interest rate charges. To this end, the Free State Provincial Treasury has established an Intergovernmental Debt Steering Committee, with members including the Provincial Treasury, the Provincial Department of Cooperative Governance and Traditional Affairs, the Provincial Department of Education, and the South African Local Government Association. The purpose of this committee is to resolve disputes on municipal accounts for government departments and to make a concerted effort to find an urgent solution to bottlenecks, so as to ensure that the financial effectiveness of municipalities is not unnecessarily jeopardised (Free State Provincial Treasury, 2013b:1).

While in some instances departments are disputing the amounts owed, the increase in government departments owing money to municipalities appears to be partly due to systemic issues. In view of this situation, calling for punitive action against non-paying departments would not be prudent, because South African government spheres need to work within the ambit of the intergovernmental framework.

4.5.4.2 Reasons for Non-payment by Businesses, and Possible Solutions

Business Unity South Africa (BUSA, 2011:13) lists the following factors, in order of importance, as the main reasons driving non-payment/late payment of property rates and/or utility bills:

- Irregular billing;
- Incorrect billing;
- Dissatisfaction with service/economic slowdown;
- High tariffs; and
- Others not paying.

BUSA (2011:20) suggests the following to promote the delivery of high-quality services in municipalities, namely:

- Increased efficiency (as opposed to increased regulation);
- Qualified people filling key positions/jobs, particularly in the areas of finance, and technical and human resources; and
- Adherence to good governance.

Thus, in the Free State, it is important that municipalities note the suggestions of BUSA to concretise a strong relationship with business and to promote efficiency in payments.

4.6 MEASURES TO ENFORCE PAYMENT FOR MUNICIPAL SERVICES

A study conducted by Spencer (2006:30) in the USA concerning the enforcement of payment of municipal services found that various attempts have been made to enforce payment for services delivered. Spencer (2006:158) argues that the handing over of debts to private collection agencies, which can result in consumers being blacklisted, could have far-reaching effects, even in terms of the interest rate a consumer can demand when applying for a home loan or vehicle financing, and so where the cost of such effects may outweigh non-payment for services, compliance will be greater.

Another measure or tool that can be used to encourage payment is the cutting off/disconnecting of services. However, the use of this measure is politically contentious. Total cut-offs are not possible in the case of water services, since water supply is considered a basic human right in terms of Section 27 of the Constitution (RSA, 1996). As such, the response to service cut-offs must also be managed, as existing social conditions, including high levels of unemployment and poverty, can lead to or exacerbate negative reactions and/or resistance from communities. Khunou (2002:61) explains that during 2001, the Soweto community responded to Eskom's 'massive' electricity cut-offs by resorting to illegal connections, some of which were effected by former Eskom employees who were unemployed at the time. This led to a number of incidents of violence in some communities as a result of the cut-offs. Ruiters (2002:52-53) adds that there are four types of permanent cut-offs of basic services, namely; shutting off services through the removal of cables and pipes; increasing reconnection fees, which are usually so severe that they effectively limit who can afford to reconnect; requiring residents to pay off outstanding payments before being able to reconnect; and self-disconnecting by means of prepaid meter.

According to the FFC (2010:159) one method of cost recovery is to apply the principle of cross-subsidisation, where wealthier households are charged higher tariffs to subsidise services such as solid waste to poorer households. In the case of solid waste, the cost-subsidisation option works relatively well, taking into account that access for collection vehicles is easier in wealthier areas, and it is more convenient to collect waste from a large commercial establishment than from a less affluent area where settlement patterns and road conditions make collection more difficult.

Another strategy for facilitating the delivery of services to poorer households is cross-subsidisation using block tariffs (National Treasury, 2012b:14). Therefore, policymakers need to ensure that the extent of cross-subsidisation does not lead to unduly high prices for households that pay more.

Prepaid meters present the ultimate cost-recovery mechanism, as the service is paid for prior to use (FFC, 2010:159). Prepaid meters represent an effective means of preventing default on payments. The use of prepaid meters does not require billing or meter reading, and the pitfalls of non-payment due to poor administrative financial management practices on the part of municipalities can be avoided. Xali (2002:114) points out that in a case study conducted in Makhaza Section, Khayelitsha, it was found that cost recovery is unsustainable in that it leads to excessive spending in an attempt to recover costs from low-income households who, because of unemployment and a range of other challenges, will not be able to pay for municipal services. Xali (2002:114-115) further articulates that cost recovery has the following effects:

- Cost recovery can limit access to social services, and the consequence of cost recovery implies that those with money will have access to services, thereby limiting or denying access to low-income households/individuals and exacerbating inequalities;
- It could further increase the burden on the working class;
- It could have an impact in terms of lack of access to clean water and exposure to fumes and fires from using alternative forms of energy; and
- To a certain extent, cost recovery can undermine constitutional gains because of deficiencies in the national allocation of resources.

Pape (2002:183) suggests that the prepaid system could be modified by extending the use of pre-paid technology to businesses/bulk consumers. These users would be required to pre-pay for their consumption, generating significant income that could be used for cross-subsidisation. In addition, using this system for bulk users would be more manageable than attempting to extract money that low-income households do not have. Prior to determining the sanctions to be applied, the root cause of non-payment must be identified. Pape (2002:183) points out that billing and payment methods are important to low-income households. Therefore decisionmakers in municipalities need to ensure that services of a high quality are being delivered, and that proper billing processes and suitable payment options are available to low-income households.

In order to improve revenue collection in the Free State Province, the Free State Provincial Treasury has established revenue committees in each of the following 10 municipalities: Mohokare, Tokologo, Masilonyana, Mantsopa, Nkeotana, Moqhaka, Phumelela, Dihlabeng, Kopanong and Nala. In the next section, the socio economic impact of debt is discussed.

4.7 SOCIO-ECONOMIC IMPACT OF DEBT

This section presents an analysis of the recent socioeconomic landscape of the Free State district municipalities (DMs), followed by a review of some of the key Provincial Spatial Economic Development Strategy (PSEDS) targets.

The current global economic downturn presents new economic and administrative challenges over and above the historical challenges faced by municipalities (National Treasury, 2013c:2). It is against this backdrop that more than ever before, municipalities need to closely examine the socioeconomic factors to be able to respond appropriately to these challenges. The South African economy was reported to have sunk into its first official recession in 19 years with a contraction in the Gross Domestic Product (GDP) of a massive 6.4 per cent in the first quarter of 2011, from a decline of 1.8 per cent during the fourth quarter of 2010 (IHS Global Insight, 2012). When one compares the economic situation of all the provinces, the Free State Province has been the biggest casualty of this economic downswing with the contraction in its GDP.

Undoubtedly, the current economic meltdown has had serious consequences for the performance of the DMs' economies. A well-designed socioeconomic profile can provide vital information that policymakers need to allocate funds and improve the delivery of services. Service delivery has a considerable influence on the quality of life: Apart from providing a basis for rational decision-making, a well-designed socioeconomic profile can also assist municipal policymakers in terms of effective and efficient budget allocation (FFC, 2010:157).

4.8 SOCIO-ECONOMIC OUTLOOK OF DISTRICT MUNICIPALITIES

In times of economic contraction, one of the key elements of economic policy is to readjust government infrastructure investments (National Treasury, 2013c:2). Provided that infrastructure planning is done properly and its implementation is professional, such investments tend to have the maximum multiplier effect on economic recovery. According to the FFC (2010:168), a combination of investments well attuned to local needs and conditions can enable African economies to break out of the poverty trap. These interventions need to be applied systematically, diligently and jointly, since they strongly reinforce one another.

This is the main idea behind the UN Millennium Development Goals, in which the Accelerated Supported Growth Initiative of South Africa (ASGI-SA) is embedded. Burger (2001:2) states that should society wish to see poor households benefiting from essential social services, the solution may be the redistribution of income or wealth in the short to medium term. In the longer run, the solution is to increase national and household income to such a level that poverty is eradicated. Thus, in the short to medium term, poverty in essence concerns the redistribution function of government, while in the long run it concerns the macroeconomic policy function of government. The highest prevalence of poverty in the Free State Province is in the Xhariep and Thabo Mofutsanyane districts, with an aggregate poverty level of 55.7 and 55.6 per cent respectively. Similarly, unemployment figures in the Xhariep and Thabo Mofutsanyane district municipal areas are currently at 25 and 30 per cent respectively.

According to the National Treasury (2011c:71) the growth in the level of consumer debtors pre-dates the slowdown of the economy in 2009, and thus the slowdown can only be a partial explanation. The National Treasury (2010a:30) identifies the following causes of debt:

- A failure on the part of mayors and municipal councils to provide political backing to revenue enhancement programmes (with councillors often in arrears with their own payments);

- A failure on the part of municipal managers to allocate sufficient staff/capacity to the revenue collection function, thus compromising the implementation of policies to enhance revenue;
- Poorly designed revenue management, indigent and debtor policies;
- Resistance among certain communities to paying for certain types of services (or to being billed in a particular way); and
- Ratepayer boycotts, sparked by deteriorating service delivery, and perceptions that the municipality is unresponsiveness to community concerns.

Thus socioeconomic ratios can be interrelated to the high debtors' books in these districts. The possibility of achieving the 2014 provincial targets depends much more on the DMs' socioeconomic performance and actual revenue collections to progress municipal basic services infrastructure. In the next section the impact of debt on the millennium development goals is discussed.

4.9 IMPACT OF DEBT ON ACHIEVEMENT OF MILLENNIUM DEVELOPMENT GOALS (MDGs)

According to the Millennium Development Goals Report (Stats SA, 2013a:3), in 2000 the leaders of 189 nations made a phenomenal promise to rid the world of extreme poverty and the many forms of deprivation that have been haunting all societies for millennia. Since then, each passing year has witnessed remarkable gains made by South Africa in this historical and global push to achieve the eight MDG goals. There are MDGs that can only be achieved with demonstrated commitment by all parties. The MDGs are as follows:

- To eradicate extreme poverty;
- To achieve universal primary education;
- To promote gender equality and empower women;
- To reduce child mortality;
- To improve maternal health;
- To combat HIV/Aids, malaria and other diseases;

- To ensure environmental sustainability; and
- To develop a global partnership for development.

It is important that South Africa has always been a willing signatory to the MDGs in terms of demonstrating their achievement (Stats SA, 2013a:2). This same commitment applies in the case of Vision 2030, as it is espoused in the National Development Plan, i.e. that by 2030, South Africa aims to eliminate poverty and reduce inequality, with a plan to change the life chances of millions of our people, especially the youth, which have remained stunted by history (RSA, 2012b:5). Stats SA (2013a:2) has confidence in South Africa's ability to deal effectively with the goal of reducing extreme poverty by half, but remains deeply concerned that relative inequality remains high, as measured by the Gini coefficient. This is so partly because of the high unemployment rate and the low rate of labour force participation in South Africa.

The rising poverty rate will make it ever more likely that households will be unable to afford to pay for services. This study attempts to show that households receiving poor services appear to feel less accountable and less obliged to pay for services. In addition, the high levels of dissatisfaction with customer services seem to strengthen the inclination to sacrifice payments. Thus non-payment due to socioeconomic realities could impact on the attainment of the MDGs.

4.10 RISKS POSED BY THE CURRENT STATE OF MUNICIPAL FINANCES

According to the National Treasury (2011c:20), the risks associated with the current state of municipal finances fall into the categories of service delivery and fiscal risks.

4.10.1 Service Delivery Risks

Possible service delivery risks, should the pattern of non-payment continue, are listed below (National Treasury, 2010b:10):

- Staff do not get paid and thus refuse to work;
- Bulk service providers do not get paid and therefore services are suspended;

- Contractors and suppliers do not get paid; and
- Repairs and maintenance are invariably among the first expenditure cuts placing service delivery at risk, along with future revenues.

4.10.2 Fiscal Risks

Possible fiscal risks, should the pattern of non-payment continue, are listed below (National Treasury, (2010b:20):

- Poor financial management processes and systems expose municipalities to corruption;
- Municipalities are failing to properly utilise the resources available to them by failing to collect available revenues; and
- Poor financial management increases the cost of borrowing to municipalities.

Therefore, when a municipality fails financially, it poses a serious risk to the national fiscus, with the impact felt from the effects of service delivery protests and deflation of the South African rand.

4.11 DEBT PROBLEM AS A CHALLENGE TO MUNICIPALITIES

The debt challenges faced by municipalities include the culture of non-payment, unaffordability, and the impact of demographics on debt, as discussed below.

4.11.1 Culture of Non-Payment

While there are many factors possibly contributing to the escalating municipal debt, media statements have always attributed the under-collection of outstanding municipal revenue to a "culture of non-payment" without any regard to the quality and quantity of services rendered. Non-payment for services was first reported during the political turmoil of the 1970s through the 1980s, when communities in mostly African townships expressed their dissatisfaction with municipal administrations organised along racial lines (FFC, 2010:166). The situation persists today and is inflamed by poor services and political loyalties.

4.11.2 Unaffordability

As the majority of citizens derive their income from employment, it can be argued that part of the problem is attributable to the high levels of poverty resulting from the high unemployment rate. According to Burger (2001:24), an increase in poverty reduces the ability of people to pay for services, including municipal services. Thus, the increase in poverty contributes to the worsening financial situation of local authorities.

A survey conducted by McDonald (2002b) in a number of South African townships found that 53 per cent of participants were able to pay for municipal services, while 17 per cent could pay for services if they reduced their expenditure on food and clothing, and 18 per cent could not afford to pay for municipal services at all, meaning that out of every one million adults receiving bills for municipal services, 170 000 had to decide between essentials such as water and food. This finding is supported by the FFC (2010:157), in that affordability is the greatest concern when it comes to the payment of service bills, with 57 per cent of their sample earning less than R1000 per month in household income. Therefore, unaffordability is identified as a contributing factor in terms of residents paying for essential municipal services.

Burger (2001:24) found that non-payment is primarily an issue of inability to pay. It is argued that poverty makes households unable, rather than unwilling, to pay – hence the need to subsidise the cost of services to poor households. According to Burger (2001:24), the inability to pay, rather than a culture of non-payment, is at the root of the payment crisis. A rate for the poor should be considered.

4.11.3 Impact of Demographics on Debt

The purpose of analysing demographics and the impact thereof on debt is that it provides a link between the migration of the large indigent population from rural to urban areas. The population migration of so many indigent clients to these DMs further strains the aged infrastructure for services and forces municipalities to increase tariffs for paying consumers.

The following events could contribute to a negative cash position (National Treasury, 2011c:7):

- Deterioration in revenue collections due to the impact of the worsening economic situation and rising rates and tariffs on household budgets;
- The need to pay suppliers, especially contractors responsible for capital projects (whose billings are often lumpy and come at year-end);
- The need to finance the cash flow difference between paying for the increased cost of bulk electricity/water and the collection of revenues from customers;
- Any major breakdown in service delivery resulting in non-supply (especially water and electricity), thus preventing the receipt of revenue; and
- A ratepayer/consumer boycott.

Thus above could result in the municipality being unsustainable and could possible lead to the collapse of the municipality.

4.12 KEY CHALLENGES FOR SERVICE DELIVERY

A total of 52 municipalities countrywide reported negative closing cash positions at the end of the 2012/13 financial year (i.e. their cash position as at 30 June 2013), reflecting a slight increase from the 44 municipalities that reported negative closing cash positions at the end of the 2011/12 financial year (National Treasury, 2013d:13).

Although many municipalities in the Free State Province experience temporary cash flow problems (National Treasury, 2013d:13), where such problems persist over a number of months it is a strong indicator of severe underlying financial problems. The deteriorating state of local government finances and financial management can largely be ascribed to the following (National Treasury, 2011c:71):

- Poor financial management capacity in the budget and treasury offices of municipalities, as well as key municipal service delivery departments; and
- Mayors and municipal councils making decisions and acting in ways that are inconsistent with the principles of good governance, also compromising the sustainability of their municipal finances.

The National Treasury (2011c:71) adds that political interference in the financial management and procurement operations of a municipality invariably undermines the capacity of the budget and treasury offices, resulting in the deterioration of municipal financial management.

Another key challenge for service delivery is the fact that the political leadership is supporting service delivery and investment programmes that are unsustainable, for very understandable reasons. The short-term prognosis is also very worrying in light of the approaching 2016 local government elections, with mayors and councils pushing for increased spending on visible capital projects, particularly housing projects. Besides the fact that housing is not a local government function, it would seem that many municipalities are seeking to finance these projects by drawing down on their reserves and increasing borrowing, thus placing the sustainability of municipal finances at risk. Such ineffective management of municipal finances will have a significant impact on the delivery of essential services where they are most needed.

4.12.1 Poor Billing and Collection Activities

Poor billing and collection is not specific to smaller, less-resourced municipalities, as shown in recent reports of public discontent with the poor billing practices of the City of Johannesburg. Yet, improvements in billing and collection activities have the potential to bring about immediate enhancements to the revenue bases of municipalities. According to the World Bank (2008:31), achieving and maintaining accurate and efficient billing and collection processes depends on a number of factors, including accurate customer databases, effective and regular metering of service consumption, adequate staff capacity, and convenient facilities for customer payments. Furthermore, Stats SA (2011a:50) identifies some possible reasons for household non-payments, including aspects such as poor and irregular metering systems.

Some municipalities have managed to successfully implement creative measures to improve their billing and collection systems (World Bank, 2008:31). For example, eThekwini Municipality has developed a geographic information system to facilitate enhanced management of water and sanitation services, using aerial photographic surveys carried out annually to produce maps that indicate, for example, recently constructed properties and which can show the precise location of all connected and unconnected properties (World Bank, 2008:42). The eThekwini Municipality also employs dedicated staff to focus on the recovery of government departments and top debtors. Another example of a municipality that has successfully managed to implement creative measures to improve its billing and collection systems is the City of Cape Town, which employs a similar strategy, with a dedicated section focusing on the top 1,000 debtors in the city.

In cases where municipalities do not have the financial and human capital resources to upgrade and employ more sophisticated administrative and billing systems, it is suggested that consideration be given to either outsourcing the function – permissible in terms of Section 76(b) of the Municipal Systems Act (RSA, 2000a) – or establishing an internal municipal service district to facilitate improved performance – permissible in terms of Section 85 of the Municipal Systems Act (RSA, 2000a). In less severe cases, municipalities should explore the relatively less complicated solution of leveraging the experience of their counterparts who are capably managing their billing and collection functions. Finally, an appropriate weight should be attached to the role of sound and efficient billing and collection processes in municipalities, as part of the specific key performance indicators (KPIs) of municipal managers' performance contracts. These KPIs should include, for example, reductions in the average time between meter reading and invoicing. Thus, in addressing the billing and collection challenge, municipalities need to determine the root cause of poor performance.

4.13 MUNICIPAL DEBT MANAGEMENT IN OTHER COUNTRIES

Barata, Bennett, Cain and Routledge (2001:11) cite the case of the Otjiwarongo Municipal Council as a second-tier local authority in Namibia, which is subject to the Local Authorities Act of 1992 and the National Archives Act of 1992. The Town Treasurer's Department is responsible for financial management and operates a very basic computerised financial system specific to the government department.

Barata *et al.* (2001:45) found the organisational structure to be adequate, with the Strategic Executive: Finance having overall responsibility for the efficient operation of financial systems. These systems were found to be well documented, with all changes to the systems being recorded. Moreover, manuals were found to be readily available to users in both paper and electronic form, with training also being readily available and in-house training facilities being well resourced. Barata *et al*. (2001:49) found the links between the paper and computerised parts of the financial management system to be good, particularly in the billing section, with an installation number being allocated to each application for water or electricity, for example. Subsequently each customer would be allocated a customer reference number, generated by the computerised system, and reproduced on the statements in a bar-coded format, with expenditure vouchers linked to the computerised system by cheque number.

Barata *et al.* (2001:46-47) referred to the Namibian municipalities' use of a computerised integrated financial management system (IFMS) to control their finances. This IFMS was developed in-house, making use of a progress database and programming language, and sharing a single platform, namely Windows NT 4.x, thus allowing the systems to be highly integrated and reducing data duplication. At the time of that study (Barata *et al.*, 2001), the financial systems were being upgraded to operate in a Windows environment, with any new developments to the financial systems being done in conjunction with users. The computerised financial systems include the following:

- Budget: Providing the facility to produce financial year budgets, extracting actual figures from the costing system;
- Costing (General Ledger): Operating the council's general ledger system, including the cashbook;
- Nominal Accounts: Updating the general ledger to provide the annual financial statements;
- Bank Reconciliation: Reconciling bank statements and transactions on the council's cashbook;

- Procurement (Creditors): Managing council's inventory, including the ordering, receiving, distributing, payment and reconciliation of all stock items;
- Municipal Billing System: Managing bills and collecting all charges for services rendered by the council (i.e. electricity, water, refuse removal and so on);
- Cashier System: Receiving money and issuing receipts for all payments made to the council for services rendered;
- Salaries/Human Resource Services: Covering the entire spectrum of functions, including appointments, leave planning, event recording, budgeting, salaries and performance appraisals; and
- Asset Register: Recording all assets of the council, as well as the inventory of items, and controlling the provision of funding for the replacement of items (Barata *et al.*, 2001:46-47).

National and provincial departments in South Africa make use of the basic accounting system, with approximately 20 different financial systems in use at the 278 municipalities in the country. This could be one of the contributory factors in terms of poor debt management.

Within South African municipalities, the budget and treasury office structures at national, provincial and municipal level are not regulated and this contributes somewhat to the billing and revenue collection failures. Municipalities have varying financial structures, with the metropolitan municipalities seeming to be adequately staffed, but with the peri-urban and rural municipalities experiencing challenges in terms of attracting staff with the required skills, rendering their structures inadequately staffed to function effectively.

McPhail (1993:969) conducted a study of five Moroccan states in a bid to determine whether the price charged for water was correctly set, or whether there was an opportunity to make individual house connections available to some of the indigent households at retail level.

Mathur (2003:1) conducted a study at the Indore Municipal Corporation (IMC) of Indore City, the largest city in the Madhya Pradesh state in India, with a population of 1.64 million in 2001. Since 1997, the city's growing size required significantly higher levels of expenditure on services and amenities, with IMC simultaneously facing an extreme financial situation. IMC subsequently prepared a modernisation plan for the city by introducing management innovations within their existing structure to improve efficiency and strengthen the municipal revenue base. IMC also forged a partnership with the Indo-USAID Financial Institutions Reform and Expansion (FIRE) project, which assists municipal officials to increase the city's revenues in various ways, including making optimal use of existing assets, and to build their capacity to better govern the city through the provision of training and technical assistance.

Mathur (2003:1) identified several steps taken by IMC to improve resources. With regard to improved property tax, IMC shifted to a simpler, mass assessment method and introduced self-assessment of properties by taxpayers. Property records were computerised, and IMC undertook a survey to identify unregistered properties. Internally, in order to strengthen its revenue collection efforts, IMC brought all billing and collection functions together within a single department, introduced cash-collection counters, and decentralised revenue operations to zonal offices, with bills being printed automatically on a quarterly basis and sent by private courier to consumers, and payment being made at cash counters. IMC recently reorganised its Revenue Department, separating survey and assessment, billing and collection, and vigilance functions, to further improve efficiency and ensure an effective revenue collection system.

IMC has launched a special drive to recover property taxes and water charges. Special teams have been formed to increase the revenue, and the municipal commissioner has bestowed on the zonal officers the power to disconnect water supplies and attach properties. Specific targets for the collection of outstanding debt or revenue have been set for the recovery teams. The same principles can be used to improve revenue collection within Free State municipalities.

IMC also introduced new information technologies to provide reliable and improved urban services to the people. Data on major revenue sources, including property tax and water supply charges, as well as the beneficiaries of schemes benefiting the urban poor, is posted on the IMC website for all citizens to see. In addition, citizens submit suggestions and grievances to the city and receive responses via e-mail.

The lessons learned here that could benefit South African municipalities in terms of reorganising management innovations to improve efficiency and strengthen the municipal revenue base, with most municipal disconnections to go through municipal courts and information technology to be used to improve monitoring and control.

Municipal consumer debt is a complex challenge that requires multi-faceted solutions. Addressing the challenge requires not only interventions aimed at promoting greater levels of payment by consumers, but also – and perhaps more importantly – improvements to municipal service delivery and administrative processes. Based on the key issues discussed, the following recommendations are proposed based on international best practices:

- Introduce a uniform billing system in the local sphere of government;
- Set up a centralised provincial property database;
- Continuously track the affordability of basic services, with indigent thresholds to be updated accordingly; and
- Introduce the repossession of properties for owners who continuously default on payments.

From the above South African Municipalities could benefit by improving communications, having an effective financial system and committed human resource to improve revenue.

4.14 SUMMARY

Municipalities are tasked with using resources to respond to the needs of their communities for infrastructure, local services such as water, electricity and refuse removal and enabling and guiding the spatial development of their localities. Municipalities must use the ambit of the law and ensure that reasonable steps are taken to recover the costs of municipal services and enforce payment for services delivered. Municipal consumer debt is a complex challenge that requires multi-faceted solutions. Addressing the challenge requires not only interventions aimed at promoting greater levels of payment by consumers, but also – perhaps more importantly – improvements to municipal service delivery and administrative processes.

Until one begins to see more intensity and the redoubling of efforts towards the reduction of their debt position, municipalities will not meet the targets set for 2014. Although there is growth potential, more rigorous effort is necessary in making this growth accessible to the poor. In addition, performance contracts for top management at the municipality must be monitored by the municipal council on a monthly basis to limit service delivery and fiscal risks.

The Free State Province should take advantage of the large number of young people in terms of future economic benefit by providing them with more education and training. By making young people active in the economies of municipalities, this may contribute to a possible increase in the municipal revenue base in order to turn around the municipalities' debt burden. Top managers at Free State municipalities must consider appointing qualified graduates from the Central University of Technology, Free State and the University of Free State to narrow the skills gap.

This will evidently lead to the closing of the gap between the first economy, which refers to an economy that is sophisticated and well-adjusted to global economies, boasting a highly skilled labour force, advanced technology, elaborate infrastructure, information and communication technology, and the second economy, which comprises a high unemployment rate of people locked in rural, semi-rural and peri-urban areas without the skills needed by the economy. However, some initiatives by provincial government departments are noted, with the monitoring and enhancing of such initiatives sure to benefit municipalities.

Poor debt collection and the increase in outstanding debts year on year is testament to the fact that municipalities are facing a challenge in the collection of outstanding debts. It is therefore imperative that the political and administrative leadership takes ownership of the debt management processes and enforces their policies. If municipalities are not able to collect the revenue generated from services, then the rendering of the services becomes unsustainable. Municipalities should be able to recoup the maintenance costs of revenue-generating assets from the consumers of the assets.

If a culture of non-payment persists, local government will not succeed in its mandate to deliver basic services to communities. It is therefore incumbent upon the political and administrative leadership at municipalities to be vigilant with regard to early identification of financial problems that would threaten their service delivery obligations. The ability of municipalities to rise to these challenges will ultimately be determined by the quality of their governance and administrative practices. Stronger and more participatory governance practices will only have a meaningful effect if municipalities provide stable and attractive work environments. One ingredient for the success of municipal councils is to ensure that they appoint the right people with the right qualifications and experience to lead their municipalities. In addition, the best practices from both developed and developing countries should be considered to strengthen and customise process of improving municipal collections. This chapter also provided a brief insight into the international situation in Namibia, Morocco, the USA and India in respect of debt management, with recommendations on financial systems and human capital requirements to enhance debt management. However, for some of these proposals to be implemented, the South African government needs to make some changes to national and local legislation.

Chapter 5 outlines the comparative study, using secondary data from the Local Government Database (National Treasury, 2013a), on the debt position of Free State municipalities comparative to the municipalities in the other eight provinces and the impact thereof on service delivery.

CHAPTER FIVE :
DEBT PROFILE OF FREE STATE MUNICIPALITIES

5.1 INTRODUCTION

The previous chapter discussed the debtor's management cycle and the debtor's control system, municipal debt over three years in the Free State Province, the socio economic impact of debt on municipalities' achievement of MDG goals, and the debt challenges at municipalities.

This chapter provides a comparative study, using secondary data from the Local Government Database (National Treasury, 2013a), on the debt position of Free State municipalities comparative to municipalities in the other eight provinces.

Section 229 of the Constitution (RSA, 1996) provides municipal fiscal powers to municipalities. Section 229(1)a of the Constitution (RSA, 1996) and Section 2 of the MPRA (RSA, 2004a) further provide that municipalities should impose rates on property and surcharges of fees for services. Where citizenry are unable to pay for services due to affordability constraints, this can be termed 'inability to pay'. This raises the central question of affordability. The FFC (2010:166) suggests using "core affordability indicators", which, if properly monitored, can warn policymakers of early indications of changes in the affordability of services. Municipalities must profile municipal consumer debt by the source of the debt, i.e. either household, government or business) and the nature of the debt (including the proportion of the debt that is historical). In addition, municipalities must investigate what drives non-payment for services.

The chapter also identifies the socioeconomics data on Free State municipalities and the impact thereof on the municipalities' debt position. Socioeconomic data is vital in supporting municipal managers to implement effective revenue collection systems and effective credit and debt control policies, as required by Section 64(2)(a) of the MFMA (RSA, 2003) and Sections 96(a) and (b) of the MSA (RSA, 2000a). Therefore this chapter attempts to identify debt management and its consequences in the development of a debt integrated management model for municipalities in the Free State Province. The chapter also provides a debt profile of municipalities in the Free State Province.

5.2 DATA GATHERING TECHNIQUE

Struwig and Stead (2001:12) cite numerous ways of collecting data. This chapter reflects secondary data extracted from the Local Government Database (National Treasury, 2013a). According to Welman *et al.* (2008:149) secondary data refers to information collected by individuals or agencies and institutions other than the researcher himself or herself. In this regard, from the population of 278 municipalities in the nine provinces of South Africa, the debt data from 2009 to 2012 was extracted from the Local Government Database (National Treasury, 2013a).

In addition, socioeconomic data for Free State municipalities was extracted from the ReX Database for 1996 to 2011 (IHS Global Insight, 2012) in order to assess the debt profile of municipalities in the Free State.

5.3 DEBT OF FREE STATE MUNICIPALITIES OVER FOUR FINANCIAL YEARS (2008/09, 2009/2010, 2010/2011, 2011/12)

According to the National Treasury (2011a:11) the accounting treatment of debtors varies across municipalities. This mainly ranges from the recognition of revenue to the inadequate writing off of irrecoverable debt, which artificially inflates the amounts outstanding and leaves inadequate provision for bad debt. There is also little uniformity in terms of the level of interest charged on outstanding amounts. Debt outstanding for over 90 days is significant, but debt outstanding for over one year has started to dominate in recent years. This is an indication of the ineffective implementation by municipalities of Sections 96 and 97 of the MSA (RSA, 2000a), which provide for the debt collection responsibility of municipalities, as well as their ability to adopt, maintain and implement a credit control and debt collection policy. Furthermore, a municipality is empowered by the MSA (RSA, 2000a) to levy and recover fees, charges or tariffs in respect of any function or service of the municipality, and to recover collection charges and interest on any outstanding amount, subject to the provisions of the National Credit Act, 2005 (Act 34 of 2005) (RSA, 2005b).

Table 5.1 below disaggregates total consumer debt in each year by the period for which it was outstanding and provides an indication of just one aspect of poor debt management.

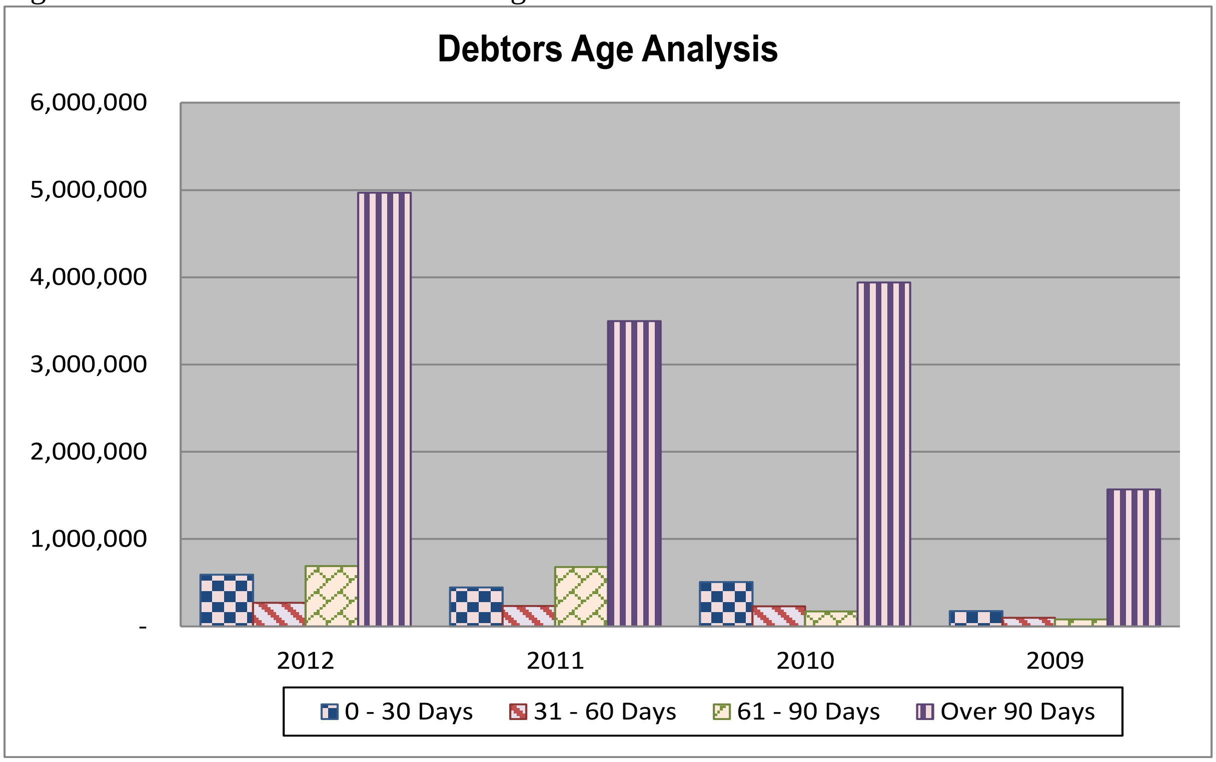
Table 5.1: Age Analysis of debtors by customer group for the financial years 2009 to 2012

R'000	0 - 30 Days	31 - 60 Days	61 - 90 Days	Over 90 Days	Total	%
2012						
Government	153 946	30 328	64 943	126 568	375 785	5.8
Business	205 966	70 275	128 694	465 745	870 680	13.4
Households	181 671	146 585	461 989	3 710 970	4 501 215	69.1
Other	48 577	21 646	34 276	663 572	768 071	11.8
Total	**590 160**	**268 834**	**689 902**	**4 966 855**	**6 515 751**	**100.0**
2011						
Government	39 195	23 035	146 807	98 519	307 556	6.3
Business	145 756	51 011	68 955	329 946	595 668	12.3
Households	210 276	133 268	317 465	2 515 921	3 176 930	65.5
Other	49 311	24 402	145 287	552 053	771 053	15.9
Total	**444 538**	**231 716**	**678 514**	**3 496 439**	**4 851 207**	**100.0**
2010					-	-
Government	60 444	24 247	30 678	240 621	355 990	7.4
Business	134 060	43 516	23 366	312 632	513 574	10.6
Households	196 211	137 712	93 332	2 479 455	2 906 710	60.0
Other	113 489	22 987	21 933	906 128	1 064 537	22.0
Total	**504 204**	**228 462**	**169 309**	**3 938 836**	**4 840 811**	**100.0**
2009						-
Government	8 583	10 092	6 828	98 838	124 341	6.5
Business	56 858	22 040	15 121	110 418	204 437	10.7
Households	77 884	42 492	37 234	824 155	981 765	51.3
Other	30 214	22 202	19 447	532 248	604 111	31.6
Total	**173 539**	**96 826**	**78 630**	**1 565 659**	**1 914 654**	**100.0**

Source: National Treasury Local Government Database - Unaudited figures

Of the total amount owed to municipalities in 2009, R981 million was contributed by households. Table 5.1 shows that the total debt owed to municipalities in the Free State grew significantly by R292.6 billion from 2009 to 2010. All debtor groups have shown outrageous increases, with household debt increasing significantly by 196 per cent and other debt by 76 per cent. For 2012, Free State municipalities recorded an amount of R6.5 billion in their debtor's books, which is a massive debt growth of R4.6 billion or 240 per cent compared to 2009. However, the limitation on the identification of the real debt position could be due to the fact that several municipalities are using different financial systems, with some grouping a major proportion of the debt in the customer category ‘Other’. Table 5.1 shows that for the 2012 financial year, a large proportion of the debt (69.1 per cent) was owed by households, with government and businesses owing 5.8 per cent and 13.4 per cent respectively. The remainder of the debt is attributed to the category ‘Other’, which accounts for 11.8 per cent. Figure 5.1 shows the municipal consumer debt outstanding for the period 2009 to 2012.

Figure 5.1: Consumer Debt Outstanding for the Period 2009 to 2012



Source: Own calculations based on data from the National Treasury (2013a)

Table 5.1 shows that of the total recorded debt of R6.5 billion, an amount of R4.9 billion is likely to be irrecoverable, as there is a possibility that the debt might be prescribed. The government debt of R376 million owed to municipalities is made up of R153.9 million in the category 0-30 days, R30.3 million in the category 31-60 days, R64.9 million in the category 61- 90 days, and R126.6 million in the category over 90 days. This pattern, where a significant portion of the debt is reflected in the category over 90 days, is prevalent in all four years for the respective customer groups, as illustrated in Table 5.1.

With regard to the level of interest charged on outstanding amounts, some municipalities peg the rate to the prevailing prime rate, whereas others charge a rate set at the discretion of the CFO. Although these aspects are at the discretion of municipalities and their councils and should be based on location-specific conditions, formal debt management guidelines for different categories of municipalities could assist government to deal with this challenge. These guidelines could be provided in terms of Section 168 of the MFMA (RSA, 2003), which allows the Minister to establish national regulations or guidelines applicable to municipalities.

According to the National Treasury (2011c:11), it is due to poor financial management processes and systems that municipalities do not accurately reflect their debtor information and overstate the expected income. The National Treasury (2011c:11) states that Free State municipalities not only provide an unrealistic rand value of their financial position, but also place their financial viability at fiscal risk. The Free State Provincial Treasury (2012b) consistently raises concerns about insufficient and insignificant bad debt write-offs at Free State municipalities.

5.4 ACCURATE ACCOUNTING FOR INDIGENTS

According to the DPLG (2005a:12) the term 'indigent' means 'lacking the necessities of life '. Section 27(1) of the Constitution (RSA, 1996) determines that the following goods and services are considered as necessities for an individual to live a decent and healthy life:

- Healthcare services, including reproductive health;
- Sufficient food and water; and
- Social security, including appropriate social assistance to deserving persons.

In terms of Section 27(2) of the Constitution (RSA, 1996) the state must take reasonable legislative and other measures within its available resources to achieve the progressive realisation of each of these rights. In the case of Soobramoney v Minister of Health (Kwazulu-Natal), dated 27 November 1997, the relevance of Section 27(2) of the Constitution (RSA, 1996) was argued, first by the High Court and then by the Constitutional Court, and in both instances judgment was given in favour of the Minister of Health. In both instances the court decided that if a person has no funds available, then he/she could be refused medical treatment despite having a life-threatening disease (such as kidney failure in this case). The patient in this case, Mr Soobramoney, eventually passed away due to lack of medical treatment.

The above are some of the responsibilities that municipalities are required to perform within their respective communities. The DPLG (2005a:3) states that the indigent policy is aimed at including those currently excluded from access to basic services, through the provision of a social safety net. The indigent policy is directed at poor households in South Africa with a need to access affordable basic services that would facilitate their productive and healthy engagement in society. The indigent policy provides a framework for municipalities in this regard. According to the DPLG (2005a:3), indigents are exempted from having to pay for basic services below a certain threshold. The rollout of the indigent policy within municipalities is funded via the Local Government Equitable Share (LGES) allocation in the annual DoRA, and to a certain extent from the municipalities' own revenue. As a result, the issue of indigents is intricately related to non-payment for basic services, which puts further pressure on the amount raised from own-revenue sources at a municipality's disposal and thus its ability to extend access and deliver free services to the poorest of the poor.

In the case of water, which is the service where most non-payment occurs, the majority of municipalities use the targeted approach and the indigent register tool. The problem is that municipalities do not regularly update this information, which means that indigents may be counted as defaulters and thus falsely inflate the extent of consumer debt. According to the Free State Provincial Treasury (2014:14) municipalities must have controls in place to ensure that they update and maintain indigent-related information. These controls should be recognised as an integral component of revenue management, as per Section 64 of the MFMA (RSA, 2003). In addition, the quality and accuracy of data and information about indigents can assist in addressing a range of challenges, from better targeting of the indigent, to better quantification of consumer debt and more credible revenue and expenditure estimates.

5.5 MONITORING THE AFFORDABILITY OF BASIC MUNICIPAL SERVICES

Related to the issue of indigents is the need to monitor the affordability of basic services such as water, electricity, sanitation and refuse removal. According to the National Treasury (2013c:3), in times of economic recession or excessive tariff escalation, municipalities need to be sensitive to the impact on vulnerable households of the margins that may be become eligible for free basic services (FBS). According to Milne (2004:5) municipal policymakers have to monitor affordability through consumption-related indicators such as percentage of total household expenditure devoted to a commodity, or per capita consumption of a commodity. These indicators should assist municipalities in becoming more sensitive to potential increases in consumer debt and retrospectively enable them to adjust municipal indigent thresholds.

5.6 POOR BILLING AND COLLECTION ACTIVITIES

Improvements in billing and collection activities have the potential to bring about immediate enhancements to the revenue bases of municipalities. According to the FFC (2010:163) households, businesses and government confirm that incorrect billing issues continue to negatively affect the integrity of local authorities.

The World Bank (2008:31) reports that achieving and maintaining accurate and efficient billing and collection processes depends on a number of factors, including accurate customer databases, effective and regular metering of service consumption, adequate staff capacity, and convenient facilities for customer payments. Stats SA (2011a:50) gives possible reasons for household non-payment, including inaccurate and irregular metering systems in municipalities.

In light of the above, one could argue firstly that in order to address the billing and collection challenge, municipalities need to determine the root cause of poor performance. In instances where municipalities do not have the financial and human capital resources to upgrade and employ more sophisticated administrative and billing systems, consideration should be given to outsourcing the function.

5.7 MUNICIPAL POWER TO RECOVER OUTSTANDING AMOUNTS

Through Section 75 of the MSA (RSA, 2000a), municipalities are given the power to pass by-laws giving effect to the implementation and enforcement of their tariff policies, while Section 75A of the MSA (RSA, 2000a) further empowers municipalities to levy and recover fees, charges and tariffs in respect of any function or service of the municipality, and to recover collection charges and interest on any outstanding amount. The Demarcation Board needs to take a differential approach when expanding the powers of municipalities to exercise more punitive recovery measures. This approach should not be based on municipal category only, but also on the municipality's performance, including consumer debt as one of the variables, and the general management of debt in terms of trends on indigent numbers.

5.8 PRESENTATION OF ANALYSIS FROM NATIONAL TREASURY DATA FOR FREE STATE MUNICIPALITIES OVER THREE MUNICIPAL FINANCIAL YEARS (2009/2010, 2010/2011, 2011/12)

Table 5.1 depicts the total consumer debt in each year by the period for which it was outstanding. Debt outstanding for over 90 days is significant, but debt outstanding for over one year has started to dominate in recent years in Free State municipalities. The following is a summary analysis of municipal debt in the Free State per financial year.

5.8.1 2009/2010 Municipal Financial Year

The total amount owed to municipalities in the Free State Province at the end of June 2010 amounted to R4.8 billion, including the debt of the former Mangaung Local Municipality, a non-delegated municipality in the province. This debt constitutes R504.2 million in the category 0-30 days, R228.5 million in the category 31-60 days, R169.3 million in the category 61-90 days, and R3.9 billion lies in the category over 90 days. Debt outstanding for over 90 days constitutes 81.4 per cent of the total debt.

5.8.2 2010/2011 Municipal Financial Year

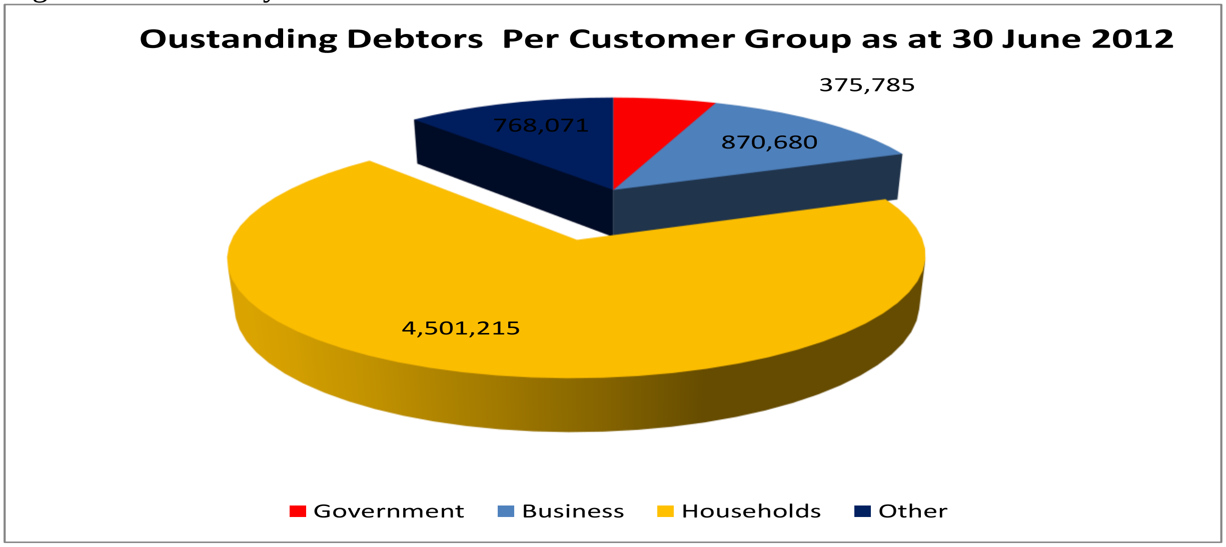
The total amount owing to municipalities in the Free State Province at the end of June 2011 amounted to R4.8 billion, including the debt of the former Mangaung Local Municipality, a non-delegated municipality in the province. This debt is made up of R444.5 million in the category 0-30 days, R231.7 million in the category 31-60 days, R678.5 million in the category 61-90 days, and R3.4 billion in the category over 90 days. Debt outstanding for over 90 days constitutes 72 per cent of the total debt, a decrease from the previous year.

5.8.3 2011/2012 Municipal Financial Year

The total amount owing to municipalities in the province at the end of June 2012 amounted to R6.5 billion, including the debt of the former Mangaung Local Municipality, a non-delegated municipality in the province. This debt is made up of R590 million in the category 0-30 days, R268.8 million in the category 31-60 days, R689.9 million in the category 61-90 days, and R4.9 billion in the category over 90 days. Debt outstanding for over 90 days constitutes 76 per cent of the total debt.

The debt over 90 days regressed by 9.4 per cent in the 2010/11 financial year. However, in the 2011/12 financial year, the debt over 90 days increased by four per cent or R1.47 billion. Figure 5.2 provides a summary of debt across the Free State Province.

Figure 5.2: Summary of Debt across the Free State Province



Source: Adapted from the Local Government Database (National Treasury, 2013a)

5.8.4 Comparison between Free State Municipalities and Municipalities in Other Provinces of Outstanding Debt for 2009 to 2012

Table 5.2: Outstanding debt per province for the financial years 2009 to 2012

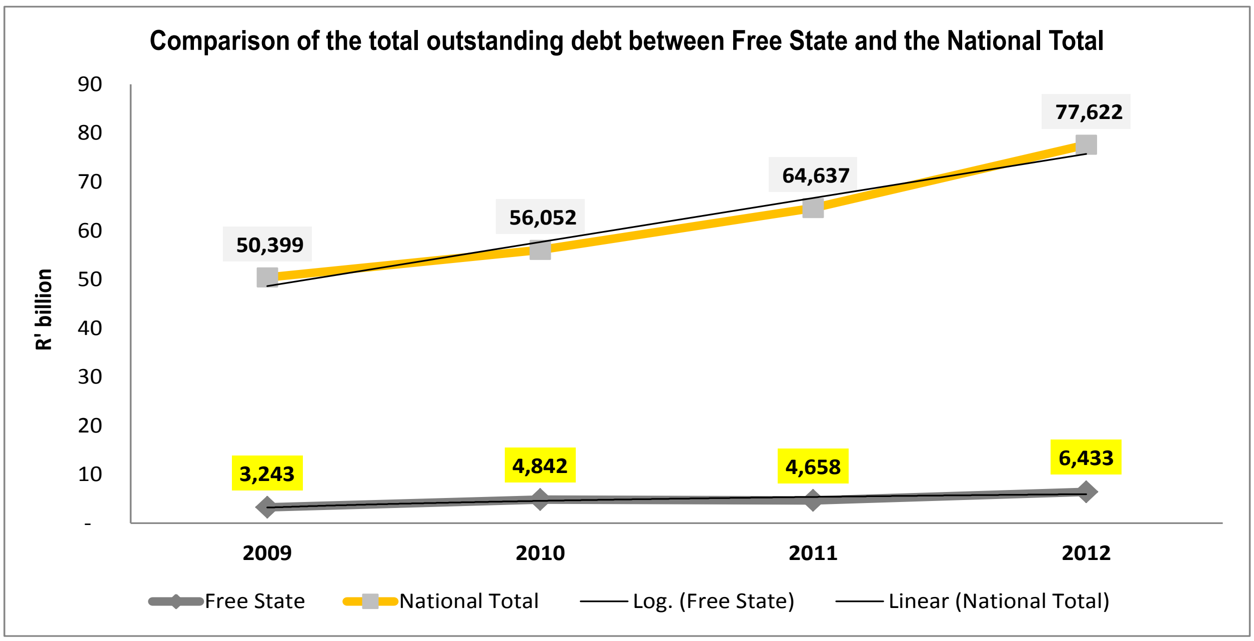
R'000	2009	2010	2011	2012
Eastern Cape	3 236 384	4 060 883	4 487 091	5 405 536
Free State	3 242 821	4 842 233	4 658 412	6 433 484
Gauteng	22 597 251	23 405 466	29 357 606	35 443 516
KwaZulu-Natal	6 824 375	7 962 327	8 776 785	9 924 415
Limpopo	2 491 280	2 020 315	2 294 236	3 238 085
Mpumalanga	2 005 532	2 155 709	2 216 020	2 432 473
North West	3 579 486	4 074 889	4 440 716	5 339 773
Northern Cape	440 205	1 195 210	1 129 396	1 531 455
Western Cape	5 981 918	6 335 168	7 276 595	7 873 205
National Total	**50 399 252**	**56 052 200**	**64 636 857**	**77 621 942**

Source: National Treasury Local Government Database - Unaudited figures

Table 5.2 shows the total outstanding debt owed to municipalities in each of the nine provinces over the period 1 July 2009 to 30 June 2012. Gauteng Province has the highest debt owed to municipalities at R35 billion, followed by KwaZulu-Natal with R9.9 billion owed. The total amount owing to municipalities in Free State grew from R3.2 billion in 2009 to R6.4 billion in 2012, representing an increase of 98.3 per cent from 2009/2010 to 2011/2012, compared to a 54 per cent increase in the national total over the same period. Similarly, the 38 per cent increase in outstanding debt for the KwaZulu-Natal Province from 2010/2011 to 2011/2012 was significantly (20 per cent) higher than the national total of 18 per cent. This is further illustrated in Figure 5.3, where the increase for KwaZulu-Natal over the period 2009/2010 to 2011/2012 is reflected by a steeper line compared to the national total. Figure 5.3 shows that Free State municipalities are owed R6.4 billion, compared to the total debt of R77.6 billion owed to municipalities in South Africa. The FFC (2010:158) maintains that the general willingness or unwillingness to pay can stem from dissatisfaction with the services delivered by government, which can lead to a cycle of non-payment. The National Treasury (2011c:71) states that persistently high debt levels are an indication that most municipalities' efforts to collect billed revenues are deficient. Figure 5.3 below provides a comparison of outstanding debt in the Free State compared to the national total.

The National Treasury (2014b:1) indicates that the majority of debt owed to secondary cities is attributed to households, at R12.1 billion or 70.8 per cent of the total outstanding debt. Out of the total debt of R17.1 billion, R14.3 billion or 83.6 per cent is outstanding for more than 90 days. This represents an increase of R8 million from the R16.3 billion reported in the third quarter.

Figure 5.3: Comparison of Total Outstanding Debt in the Free State compared to the National Total



Source: Adapted from the Local Government Database (National Treasury, 2013a)

5.8.5 Changes in the Debtor Position for Free State Municipalities over the Financial Years 2008/09 to 2011/12

The percentage increase in debt within Free State municipalities, as shown in Figure 5.3, is the result of the inability of municipalities to constantly collect revenue for services rendered. According to the National Treasury (2013d:21) this inability could emanate from the following:

- Late and inaccurate billing of consumers;
- Failure to formulate a credit control policy, or inefficient enforcement thereof;
- Councillors' interference in the implementation of municipal credit control policy;
- Lack of capacity, both human and technical, within the budget and treasury offices of municipalities; and
- Legitimate cases of poverty where consumers cannot afford to pay for services.

As the majority of citizens derive their income from employment, it could also be argued that part of the problem is attributable to the high levels of poverty resulting from high unemployment rates.

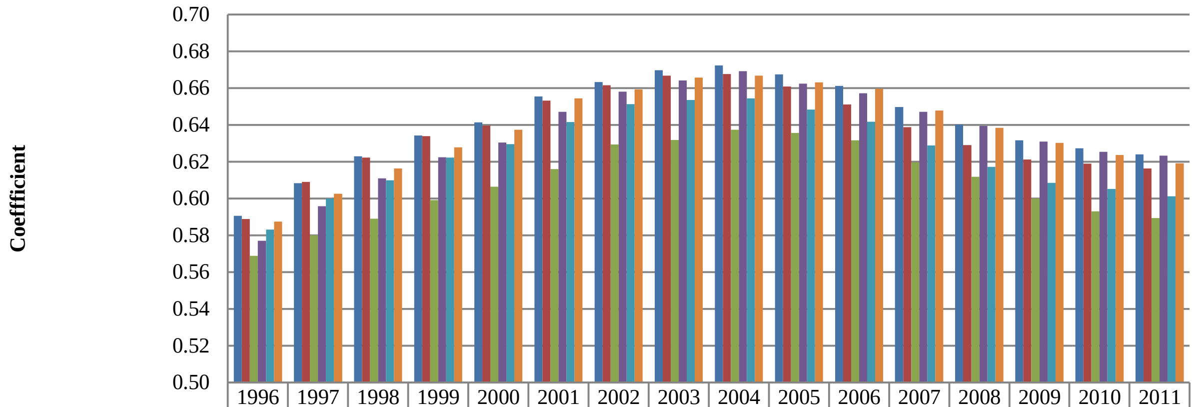
It is argued that the poverty of many households makes them unable rather than unwilling to pay, hence the need for free basic services to the poorer segments of the population and/or a lowering of the rates. This argument is supported by McDonald (2002b), amongst others. It is assumed that an understanding of the relationship between payment and the provision of services is a critical factor for compliance.

5.9 INEQUALITY AND POVERTY AND THE IMPROVEMENT OF SERVICE DELIVERY

According to the National Treasury (2011c:12-13), unemployment and poverty in South Africa continue to be a hurdle for both government and society in general. The unemployment rate is well above 25.3 per cent, whilst poverty continues to expand, thus exacerbating job creation and impacting the country negatively (National Treasury, 2011c:12-13). Although the country's

Gini-coefficient was expected to increase in 2009, it stabilised at 0.62. Figure 5.4 shows the Gini-coefficient from 1996 to 2011 for Free State municipal districts, as well as the former Manguang Local Municipality.

Figure 5.4: Free State Provincial and Municipal Gini-Coefficient – 1996 to 2011



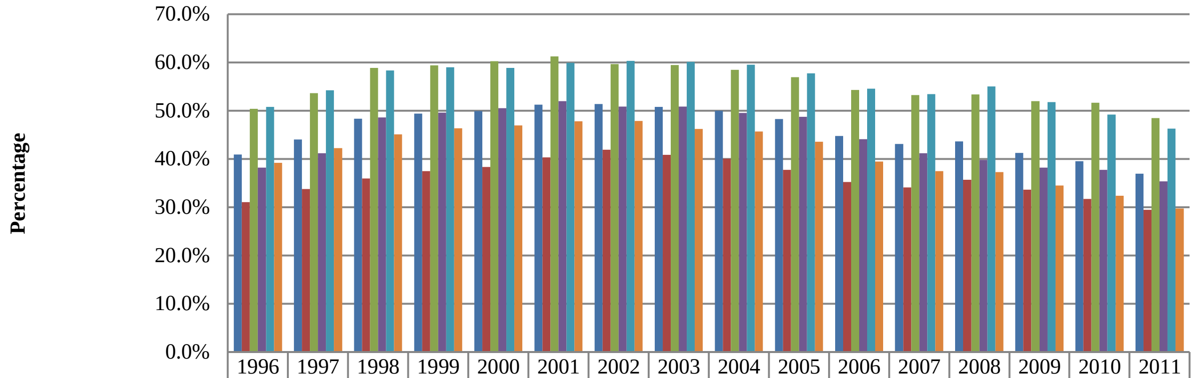
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Free State	0.59	0.61	0.62	0.63	0.64	0.66	0.66	0.67	0.67	0.67	0.66	0.65	0.64	0.63	0.63	0.62
Mangaung	0.59	0.61	0.62	0.63	0.64	0.65	0.66	0.67	0.67	0.66	0.65	0.64	0.63	0.62	0.62	0.62
Xhariep	0.57	0.58	0.59	0.60	0.61	0.62	0.63	0.63	0.64	0.64	0.63	0.62	0.61	0.60	0.59	0.59
Lejweleputswa	0.58	0.60	0.61	0.62	0.63	0.65	0.66	0.66	0.67	0.66	0.66	0.65	0.64	0.63	0.63	0.62
Thabo Mofutsanyana	0.58	0.60	0.61	0.62	0.63	0.64	0.65	0.65	0.65	0.65	0.64	0.63	0.62	0.61	0.61	0.60
Fezile Dabi	0.59	0.60	0.62	0.63	0.64	0.65	0.66	0.67	0.67	0.66	0.66	0.65	0.64	0.63	0.62	0.62

Source: IHS Global Insight (2012)

Figure 5.4 indicates that the Free State provincial Gini-coefficient measure averaged 0.64 over this period. This implies that ten per cent of the richest people in the Free State Province share roughly about 64 per cent of the wealth of the province. By means of the district analysis, Figure 5.4 indicates that the most unequal society in the Free State can be found in the Mangaung Municipality and the Lejweleputswa and Fezile Dabi district municipalities, with the least unequal society in the Free State found in the Xhariep District, averaging 0.62. Thus, according to the Gini-coefficient data, the municipalities' indigent basis and municipal debt should have declined significantly.

However, this could not be correlated to the significant rise in household debt by R3.5 billion between 2009 and 2012, as depicted in Figure 5.1 and Table 5.1. Figure 5.5 below shows that the Free State Province's poverty rate stood at 37 per cent, in 2011, a decline of 3.9 per cent since 1996.

Figure 5.5: Free State Provincial and Municipal Poverty Rate – 1996 to 2011

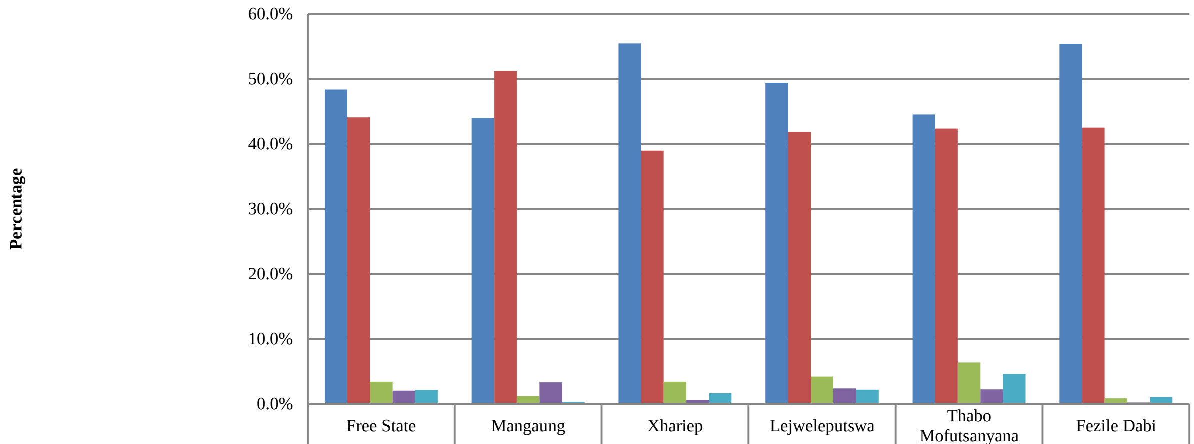


	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Free State	40.9%	44.0%	48.4%	49.4%	49.9%	51.3%	51.4%	50.8%	50.0%	48.2%	44.8%	43.1%	43.6%	41.3%	39.5%	37.0%
Mangaung	31.1%	33.8%	36.0%	37.5%	38.3%	40.3%	41.9%	40.9%	40.0%	37.7%	35.3%	34.1%	35.7%	33.6%	31.7%	29.5%
Xhariep	50.4%	53.7%	58.8%	59.4%	60.2%	61.3%	59.6%	59.4%	58.5%	57.0%	54.3%	53.3%	53.3%	52.0%	51.6%	48.5%
Lejweleputswa	38.2%	41.2%	48.6%	49.6%	50.5%	52.0%	50.8%	50.8%	49.5%	48.7%	44.1%	41.2%	39.8%	38.2%	37.8%	35.4%
Thabo Mofutsanyana	50.8%	54.2%	58.3%	59.0%	58.9%	59.9%	60.3%	60.1%	59.5%	57.7%	54.6%	53.4%	55.0%	51.8%	49.2%	46.3%
Fezile Dabi	39.2%	42.2%	45.1%	46.3%	47.0%	47.8%	47.9%	46.2%	45.7%	43.6%	39.4%	37.5%	37.3%	34.5%	32.4%	29.7%

Source: IHS Global Insight (2012)

Figure 5.5 shows that the Xhariep and Thabo Mofutsanyana district municipalities have the highest prevalence of poverty in the Free State Province, with an average poverty level of 55.7 and 55.6 per cent respectively. The least poverty-stricken regions in the province remain the Mangaung Metropolitan Municipality and the Fezile Dabi District Municipality, at 29.5 and 29.7 per cent respectively for 2011. This can also be traced to the economic significance of the regions, with the poverty levels in the Xhariep and Thabo Mofutsanyana districts consistent with the rise in the debtors' position. This indicates that in order to be sustainable and viable, the municipalities need to increase their investments, as required by the 12 government priorities and the role of local government highlighted by the National Treasury (2011c:19). The National Treasury (2011c:16) furthermore states that the government's national fiscal policy continues to recognise that municipal expenditure makes a significant contribution towards alleviating poverty and improving economic development. Thus, municipalities should contribute to the provision of free basic service to poor households. Figure 5.6 below shows the Free State provincial and municipal water infrastructure for 2011.

Figure 5.6: Free State Provincial and Municipal Water Infrastructure – 2011

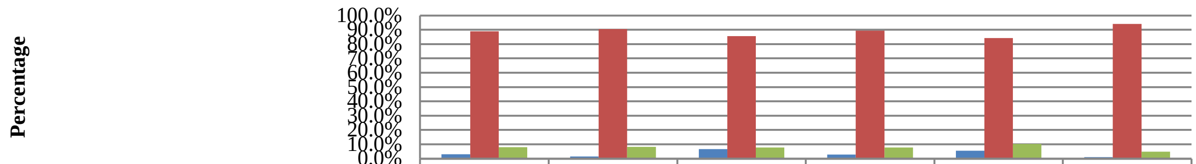


	Free State	Mangaung	Xhariep	Lejweleputswa	Thabo Mofutsanyana	Fezile Dabi
Piped Water inside Dwelling	48.4%	44.0%	55.4%	49.4%	44.5%	55.4%
Piped Water in yard	44.1%	51.2%	38.9%	41.9%	42.4%	42.5%
Communal Piped Water - RDP level	3.4%	1.2%	3.4%	4.2%	6.4%	0.8%
Communal Piped Water - Below RDP	2.0%	3.3%	0.6%	2.4%	2.2%	0.2%
No_Formal Piped Water	2.1%	0.3%	1.6%	2.2%	4.6%	1.0%

Source: IHS Global Insight (2012)

As depicted in Figure 5.6, the Thabo Mofutsanyana District Municipality has a backlog of 4.6 per cent of households without formal piped water to their yards or dwellings, whilst the Mangaung Metro could be seen as taking great strides in terms of only 0.3 per cent of its population without formal piped water. Furthermore, the National Treasury (2011c:16) explains that infrastructure investment contributes to total fixed capital formation by the public sector and the provision of associated services that are critical for economic activity and household welfare. Municipalities must improve their water infrastructure as articulated in Section 152 of the Constitution (RSA, 1996) in order to strengthen their revenue base. Figure 5.7 classifies the Free State Provincial Government and various municipalities by type of electricity usage in 2011.

Figure 5.7: Free State Provincial Government and Various Municipalities by Type of Electricity Usage – 2011



	Free State	Mangaung	Xhariep	Lejweleputswa	Thabo Mofutsanyana	Fezile Dabi
Elctricity for lighting only	3.1%	1.4%	6.6%	2.8%	5.5%	0.9%
Elecvtricty for Lighting and Other purposes	88.9%	90.4%	85.6%	89.4%	84.2%	94.2%
Not Using Electricity	8.0%	8.2%	7.8%	7.8%	10.3%	4.9%

Source: IHS Global Insight (2012)

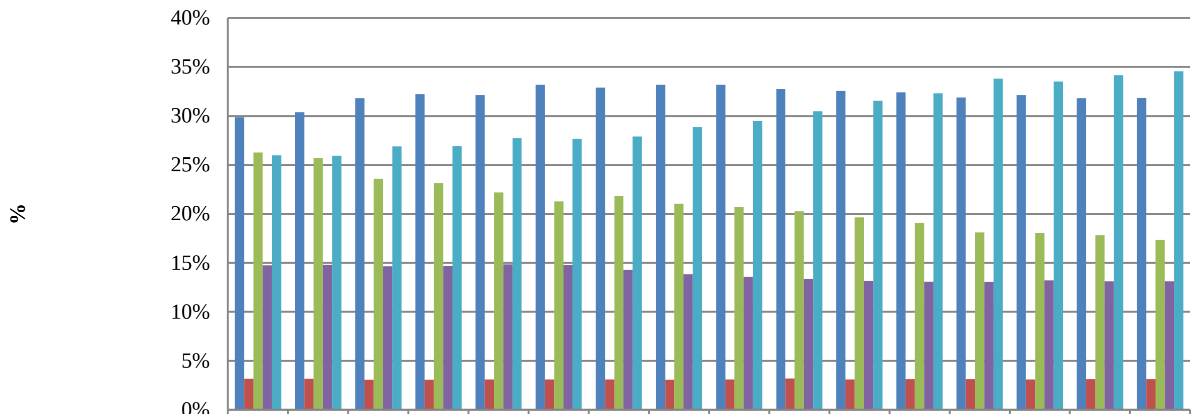
Figure 5.7 shows that in 2011/12, the Free State Province reported 88.9 per cent of households using electricity for purposes other than lighting alone. Figure 5.7 further shows that the Fezile Dabi District Municipality and the Mangaung Metropolitan Municipality reported the highest frequency of households using electricity, either for lighting or other purposes, at a combined 91.8 and 95.1 per cent respectively. Figure 5.7 indicates that 10.3 per cent of households in the Thabo Mofutsanyana District Municipality were still not being supplied with electricity in 2011/12, and indications are that a greater effort needs to be made to electrify these households.

5.10 ECONOMY AND LABOUR SITUATION IN THE FREE STATE PROVINCE

Historically, the economy in the Free State Province has largely been supported by agriculture and mining. Conversely, both pillars of agriculture and mining have over time relinquished their stronghold since the advent of a democratic South Africa. Therefore municipalities in the Free State Province should become pillars of both economic growth and job creation in the province.

As illustrated by Figure 5.8 below, the Fezile Dabi District Municipality and the Mangaung Metropolitan Municipality have contributed to the provincial economic trajectory to the extent of 35 per cent and 32 per cent respectively. The least-dominant district is the Xhariep District Municipality, contributing an average three per cent over the period 1996 to 2011. Therefore, municipalities must include economic growth in their IDPs in order to sustain their jurisdiction and improve their sustainability. Figure 5.8 shows the contribution made by Free State district municipalities and the metropolitan municipality to the provincial economy during the period 1996 to 2011.

Figure 5.8: Contribution of District Municipalities and Metropolitan Municipality to the Provincial Economy – 1996-2011

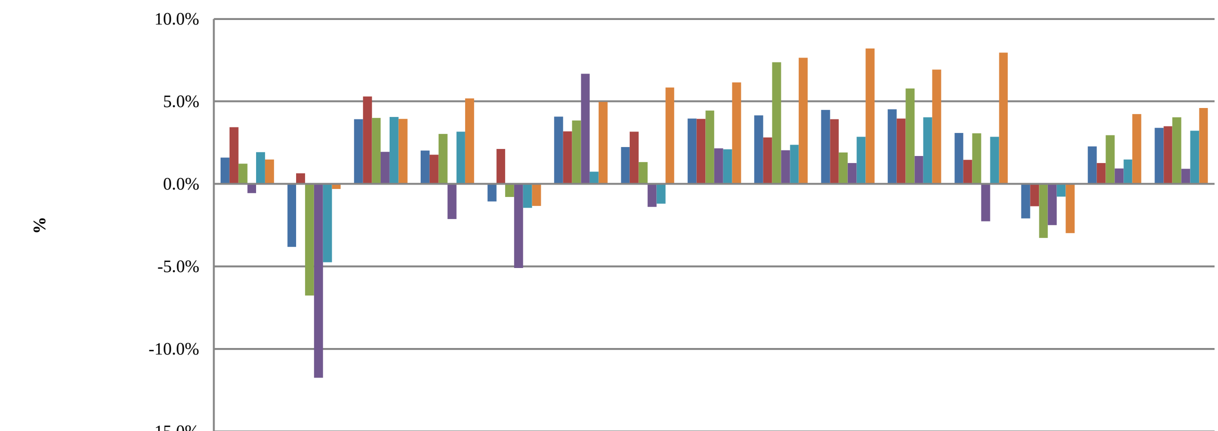


	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Mangaung	30%	30%	32%	32%	32%	33%	33%	33%	33%	33%	33%	32%	32%	32%	32%	32%
Xhariep	3%	3%	3%	3%	3%	3%	3%	3%	3%	3%	3%	3%	3%	3%	3%	3%
Lejweleputswa	26%	26%	24%	23%	22%	21%	22%	21%	21%	20%	20%	19%	18%	18%	18%	17%
Thabo Mofutsanyana	15%	15%	15%	15%	15%	15%	14%	14%	14%	13%	13%	13%	13%	13%	13%	13%
Fezile Dabi	26%	26%	27%	27%	28%	28%	28%	29%	29%	30%	32%	32%	34%	34%	34%	35%

Source: IHS Global Insight (2012)

Figure 5.8 indicates that the mining sector is dominated by the Lejweleputswa District Municipality (64.6 per cent) and the Fezile Dabi District Municipality (29.9 per cent), with the other two districts and metropolitan municipal areas contributing a combined 5.5 per cent. The dominance of the Lejweleputswa District Municipality can be attributed to the goldmines prevalent in Welkom, while the Fezile Dabi District can be said to make a larger contribution in terms of coal and diamond mining. While mining activities are concentrated in the Lejweleputswa and Fezile Dabi districts, there are also diamond mining activities in the Xhariep District, which could account for the 3.2 per cent Gross Value Added (GVA) contribution of the district – the largest contribution of all three remaining regions. The National Treasury (2011b:71) suggests that the scope for improving own revenues can be broadened by ensuring the payment of current bills and collecting outstanding debts. The Lejweleputswa and Fezile Dabi district municipalities have shown growth trends in this regard; however, this cannot be correlated to the debtor books of these municipalities, and there needs to be greater efficiency in billing and collections. The National Treasury (2011c:11) explains that the local government fiscal framework must differentiate between urban and rural municipalities in allocating taxing powers and designing and targeting transfers from national government. Figure 5.9 shows the annual provincial and municipal economic growth in the Free State from 1997 to 2011.

Figure 5.9: Annual Provincial and Municipal Economic Growth in the Free State – 1997-2011



	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Free State	1.6%	-3.8%	3.9%	2.0%	-1.1%	4.1%	2.2%	4.0%	4.2%	4.5%	4.5%	3.1%	-2.1%	2.3%	3.4%
Mangaung	3.4%	0.6%	5.3%	1.8%	2.1%	3.2%	3.2%	3.9%	2.8%	3.9%	4.0%	1.5%	-1.4%	1.3%	3.5%
Xhariep	1.2%	-6.8%	4.0%	3.0%	-0.8%	3.8%	1.3%	4.4%	7.4%	1.9%	5.8%	3.1%	-3.3%	2.9%	4.0%
Lejweleputswa	-0.6%	-11.7%	1.9%	-2.1%	-5.1%	6.7%	-1.4%	2.2%	2.0%	1.3%	1.7%	-2.3%	-2.5%	0.9%	0.9%
Thabo Mofutsanyana	1.9%	-4.8%	4.0%	3.2%	-1.4%	0.7%	-1.2%	2.1%	2.4%	2.9%	4.0%	2.9%	-0.8%	1.5%	3.2%
Fezile Dabi	1.5%	-0.3%	3.9%	5.2%	-1.3%	5.0%	5.8%	6.2%	7.6%	8.2%	6.9%	8.0%	-3.0%	4.2%	4.6%

Source: IHS Global Insight (2012)

Figure 5.9 indicates that the inconsistent Gross Domestic Product (GDP) growth and decline in the Lejweleputswa District Municipality could be due to the sectorial composition: With gold-mining at the core of its economy, and with gold being a commodity whose value is determined externally, and in an industry rife with socioeconomic problems, the occurrence of poor and volatile GDP growth in that district is understandable. The below-average GDP growth in the Thabo Mofutsanyane District Municipality can be attributed to the prevailing poverty and unemployment in the region, as well as the lack of secondary and tertiary sector industries, but this is merely a general deduction in respect of which more research is required.

The above-average GDP in the Fezile Dabi District Municipality could be due to its strength in producing secondary and tertiary goods, which yield more value per output, while the average-level GDP growth in the Xhariep District Municipality, which is still above the provincial growth rate, may be attributed to the agricultural sector where food prices have been steadily increasing over the years, as well as government's community services aimed at bringing the regional economy to life. According to the National Treasury (2011c:11) these differences underscore the need for individual municipalities to pursue vastly different infrastructure investment and service delivery strategies. Any decline in one of the economic sectors can have an impact on household spending, which ultimately impacts on municipal revenues.

5.11 SUMMARY

The chapter dealt with the comparative study, using secondary data from the Local Government Database (National Treasury, 2013a), on the debt position of Free State municipalities comparative to municipalities in the other nine provinces, and the impact thereof on service delivery, as well as the interpretation of the results of the study, linked to Chapter 6.

The total amount owing to municipalities in the Free State Province at the end of June 2012 was R6.5 billion, including the debt of the former Mangaung Local Municipality as a non-delegated municipality in the province. This debt is made up of R590 million in the category 0-30 days, R268.8 million in the category 31-60 days, R689.9 million in the category 61-90 days, and R4.9 billion in the category over 90 days. Debt outstanding for over 90 days constitutes 76 per cent of the total debt. These findings support the notion that economic investment and development contribute to municipalities' debt problems, mainly in terms of consumers' ability to pay for services. The problem of debt and its impact on municipalities can be related to affordability, management and service delivery. Furthermore, a survey conducted by the FFC (2010:157) indicates that many people are in a position to pay but opt for non-compliance. This further strengthens the argument that municipalities are experiencing severe cash flow problems. Therefore this chapter also discussed the socioeconomic data and district unemployment rate in understand the growth in the debtor books of Free State municipalities.

An economic analysis was also done, aligned to the growth in the debtor position at municipalities in the Free State Province. There are indications that the indigence rate is growing, but this could be attributed to the slow or low growth rates at municipal district level.

However, it could be deduced that for consumers, the main contributors to non-payment are apathy, non-affordability, and poor management of municipal revenue systems.

The National Treasury (2011c:20) states that municipal debtor levels are increasing at a significant rate in the majority of municipalities. There is a strong indication that these municipalities are at serious financial risk, especially where there is an ongoing deteriorating trend.

Chapter 6 presents a statement of the findings and analysis of data gathered through the interviews at selected municipalities. The data is presented and analysed by means of tables and graphs, with a discussion of the reasons for the findings.

CHAPTER SIX :
EMPIRICAL RESEARCH: METHODOLOGY AND FINDINGS

6.1 INTRODUCTION

The preceding chapters have outlined the theoretical framework for the study. An in-depth literature study and an empirical study were conducted, with the aim of achieving the research objectives and answering the research problem outlined in Chapter 1, paragraphs 1.3 and 1.5 respectively. This chapter focuses on the results obtained from the empirical research, discusses the findings of the empirical research, and subsequently interprets the findings in order to make recommendations on the effective management of debt in municipalities of the Free State Province.

This chapter seeks to articulate the processes involved in conducting the research. The main aim of the study is to identify debt management, its consequences, and the development of an integrated debt management model for municipalities in the Free State Province. The study further assessed the implications of non-payment of debt in relation to unemployment, poverty, culture of non-payment and impact on service delivery. Finally, the researcher compiled an integrated debt management model for municipalities in the Free State Province.

A survey was conducted based on the available literature, which formed the theoretical basis for the relationship between the variables of the study. The information obtained from the theoretical framework was used to draw up a structured questionnaire, which was used in the empirical study. This chapter examines the research design, methodology and approaches used in dealing with the data that was captured for this study. All data was obtained from the completed research questionnaires distributed to municipal managers and CFOs in the selected municipalities in the Free State Province. This chapter further presents a statement of findings and an analysis of data obtained from the interviews at selected municipalities. The research design is outlined in the next section, followed by a discussion of the data analysis and subsequently the empirical research findings.

6.2 RESEARCH DESIGN

In order to achieve the research objectives outlined in Chapter 1, data was gathered through a literature study, followed by an empirical study. The study followed both a qualitative and a quantitative approach. A research design, most applicable to the purpose, techniques and context of the study, was developed.

A research design is a general plan of how the researcher goes about answering the research question (Saunders *et al.* 2009:136). According to Cooper and Schindler (2003:149), a research design is regarded as the blueprint for collecting, measuring and analysing data. Mouton (2005:55) agrees with this statement by arguing that a research design refers to a plan on how the researcher intends to conduct the research. As such the research design focuses on the kind of study being planned and the type of results being sought. Therefore, the research design directs the research activities to ensure that valid conclusions are attained.

Welman *et al.* (2008:188) state that qualitative research can be described as an approach rather than a particular design. It involves the use of interpretive techniques that seek to describe and evaluate the meaning of phenomena in social worlds (Mouton, 2005:161). Welman *et al.* (2008:188) are further of the opinion that the qualitative approach is fundamentally a descriptive form of research. By using descriptive methods, researchers try to understand the central tendency and measures of variability or dispersion. The goal of descriptive methods is to explain phenomena such as human behaviour in the business and administrative sciences by indicating how variables are related to one another and in what manner one variable affects another. This is pertinent to this study, which is concerned with information that may resolve the challenges of debt management in municipalities in the Free State Province. This method was chosen to describe the implications of non-payment of debt in relation to unemployment, poverty, culture of non-payment and the impact on service delivery. Another qualitative method chosen for data collection was the interpretive paradigm, used to explain the subjective reasons and meanings behind municipal managers' and CFOs' perceptions about debt management in the selected municipalities.

The purpose of quantitative research is to objectively evaluate numerical data and to emphasise the measurement and analysis of causal relationships between variables (Welman *et al.,* 2008:8). According to Brynard, Hanekom and Brynard (2014:39) quantitative research is underpinned by a distinctive theory and requires methods such as experiments and surveys to describe and explain phenomena. Brynard *et al.* (2014:39) further argue that these methods could include techniques such as observations, preliminary investigations, quantitative analyses and questionnaires. A quantitative method was also chosen for data collection in this study, mainly extracted from secondary sources, namely the Local Government Database (National Treasury, 2013a) and ReX Database (IHS Global Insight, 2012). For this purpose the survey technique, by means of a structured questionnaire, was used for data to be analysed to identify the relationships between variables such as debt management, service delivery, financial systems and controls, and municipal policies.

Another consideration in the development of the research design was the context in which the study took place. Variables connected to the context of this study are debt management as the independent variable, whereas service delivery, financial systems and controls, and municipal policies are the dependent variables.

This study focuses on a two-pronged approach, namely a literature study and a questionnaire used during structured interviews. An empirical study, by a process of interviews and a questionnaire, was administered to municipal managers and CFOs at the selected municipalities in the Free State Province. To offset limitations in the study, the researcher used techniques such as proper questionnaire design, convincing the respondents of the sincere intent as well as the importance of the study.

6.2.1 Sampling and Research Population

The research population or universum refers to the entire group of people that is the object of research and about which some specific data is required (Bless & Higson-Smith, 1995:85-86). Bless and Higson-Smith, (1995:86) further explain that the subset of the whole population that is investigated and whose characteristics will be generalised to the entire population is called a sample. In this study, the universum (population) is made up of the combined management staff complement in South African local government. A target population refers to a group of elements that possess certain characteristics that are of relevance to the study. Therefore, for purposes of this study, the target population comprises municipal managers and CFOs in selected municipalities within the Free State Province.

Sampling is defined as the process of choosing a small group of respondents from a larger defined target population, assuming that the results discovered about the small group will allow the researcher to draw conclusions concerning the larger group (Hair *et al.* 2003:333). For this study, two sampling techniques, namely the convenience sampling method and the simple random sampling method, were used. In convenience sampling, respondents are selected on the premise that they are readily available or easily accessible (Welman *et al.* 2008:69-70). Simple random sampling as a probability random sampling method was used to select municipal managers and CFOs from selected municipalities in the Free State Province. Brynard and Hanekom (1997:43) and Leedy (1985:154) are of the opinion that randomisation means selecting a sample from the whole population in such a way that the characteristics of each of the units of the sample approximate the characteristics of the total population. Welman *et al.* (2008:59) maintain that in the case of simple random sampling, each member of the population has the same chance of being included in the sample, and each sample of a particular size has the same probability of being chosen.

In order to ensure that the sample remains representative of the population, a stratified sample was taken, based on budget size and debtors book value, and this was combined with the random sample.

The sample size of 10 municipalities is a representative sample of 41.6 per cent of the 24 municipalities in the Free State Province. The selection of 10 municipalities provided a practical measure of the debt problem and implications for service delivery, given the commonality of the debt situation across municipalities in the Free State.

The following municipalities in the Free State Province were selected:

- Mohokare Municipality;
- Kopanong Municipality;
- Masilonyana Municipality;
- Tokologo Municipality;
- Dihlabeng Municipality;
- Letsemeng Municipality;
- Mantsopa Municipality;
- Ngwathe Municipality;
- Metsimaholo Municipality; and
- Matjhabeng Municipality.

The questionnaire was distributed amongst 10 municipal managers and 10 CFOs, one in each of the respective municipalities listed above.

6.2.2 Research Instrument

According to Saunders *et al.* (2009:395), there are two types of questionnaire administration, namely self-administered and interviewer-administered. A self-administered questionnaire, in the form of a structured questionnaire, is a data collection strategy where respondents are expected to read the questions and choose their preferred answer and then record it in the absence of the interviewer (Hair *et al.*, 2003:265).

A structured questionnaire consisting of six categories was developed to elicit information during the structured interviews with the municipal managers and CFOs of the relevant municipalities. The questionnaire comprised closed and open-ended questions. Closed questions were used to determine the respondents' perceptions of their municipality, their cash flow challenges, the impact of debt on service delivery, IT solutions, internal controls, and municipal policies. Open-ended questions were also directed at the debt and cash flow challenges.

The researcher ensured that the questionnaire was prepared in accordance with the following questionnaire design and layout principles, as cited by Dillon, Madden and Firtle (1990:304):

- Clarity and precision;
- No overlap in choice of answers;
- Use of familiar and natural language;
- No bias shown in words and phrases;
- Avoidance of double-barrelled questions;
- Explicit statement of alternatives; and
- Meeting of the validity and reliability criteria by the questions.

The questionnaire was distributed through electronic mail to the selected municipalities. In certain instances, on-site meetings were conducted for those interviewees who needed more clarity on the questions. All 10 municipal managers and all 10 CFOs completed the questionnaire.

Thus, the research is a fair reflection of the perceptions of the respondents. The questions were constructed in English and the questions were short for easy understanding. A five-point Likert scale was used, which is a widely used means for measuring attitudes. Respondents indicated their own perceptions by stating how strongly they agree or disagree with statements. A covering letter explaining the purpose of the research accompanied the questionnaire.

6.2.3 Literature Review

According to Mouton (2005:179) a literature review provides an overview of the scholarship relating to a specific discipline or field of study that entails an analysis of trends and debates in the area in which the researcher is working. It provides the researcher with an in-depth understanding of the theoretical thinking, definitions, trends and debates on the topic, as well as previous studies and their results.

A review of related literature was conducted, using both national and international sources, to examine municipal financial management, municipal budgets and municipal debt management. The literature review involved the use of primary sources such as government reports, legislative frameworks and government databases, as well as secondary sources such as journal articles, books, conference papers, dissertations, theses, internet sources and data from the Local Government Database (National Treasury, 2013a).

The review of related literature made an important contribution to the study, by outlining the theoretical frameworks of the most important variables in the study and enabling the researcher to view the empirical results in the context of these frameworks, so as to gain a clear understanding of what research had already been done in the chosen field, including the strengths and weaknesses of existing studies. In order to contribute to the scholarly knowledge in the field, it is necessary to be updated on the current state of knowledge and its limitations (Mouton, 2005:86-91). The literature review also enabled the researcher to identify shortcomings in the literature concerning debt management in municipalities. The literature review provided the researcher with insight and theoretical knowledge used in the development of the questionnaire.

6.2.4 Validity

Validity is essential for the researcher to comply with sound research principles and to make certain deductions, draw conclusions and arrive at findings. According to Van der Riet and Durrheim (2009:90), "validity refers to the degree to which the research conclusions are sound". When research produces credible results that can be used to make certain generalisations, it can be regarded as valid (Van der Riet & Durrheim, 2009:90). Results obtained from the questionnaire can be regarded as valid, as they reproduced the occurrence of debt management.

Babbie and Mouton (2004:122) further indicate that results are valid when they provide the real and precise meaning of the concept they are intended to measure. Particular trends and inter-relatedness between municipal managers and CFOs with regard to debt management, service delivery, municipal policies, financial systems and controls on implementation and monitoring could be identified through reliability indications and validity.

Convergent validity is the ability of scale to correlate with other scales that purport to measure the same concept (Agresti & Finlay, 2008:71). The logic behind convergent validity is that two or more measurements of the same concept should agree. Results obtained from the municipal managers and CFOs can be regarded as valid, since similar trends and patterns of responses were observed in the questionnaire (see section 6.2.5). Therefore, certain deductions and some generalisation could be drawn from the results, qualified by the statistical probability of their level of significance.

6.2.5 Reliability

Reliability of research is obtained when a specific technique, applied repetitively to the same object, would produce the same result (Babbie & Mouton, 2004:119). However, Van der Riet and Durrheim (2009:93) explain that in interpretive research, such as this study, it is acknowledged that the researcher is not investigating a stable and static reality and is therefore not anticipating exactly the same results over and over. Interpretive researchers rather anticipate that the actions and views of individuals, groups and organisations may alter and vary in changing contexts (Van der Riet & Durrheim, 2009:93). This means that the responses of municipal managers and CFOs may not be similar because of reliability contradictions, validity, and the changing local government environment.

According to Welman *et al.* (2008:147), the reliability of a measuring instrument is determined by using the internal consistency method, whereby the researcher administers the measurement test only once to a large, representative sample. Cronbach's coefficient alpha is a measure of the internal consistency of the measurements.

Cronbach alpha provides a measure of the extent to which the items on a measurement scale or test provide consistent information. In addition, Cronbach's alpha is often considered a measure of item homogeneity, i.e. large alpha values indicate that the items are tapping a common domain. It can be written as a function of the number of test items and the average inter-correlation among the items. The formula for the standardised Cronbach's alpha is presented below:

$$a = \frac{N \cdot \bar{c}}{\bar{v} + (N-1) \cdot \bar{c}}$$

Here N is equal to the number of items, c-bar is the average inter-item covariance among the items, and v-bar equals the average variance. One can see from this formula that if one increases the number of items, one increases Cronbach's alpha. Additionally, if the average inter-item correlation is low, alpha will be low. As the average inter-item correlation increases, Cronbach's alpha increases as well (holding the number of items constant).

The scale in Cronbach's reliability test ranges from zero to one; scores that are close to one indicate that the instrument has high reliability, while scores close to zero indicate that the reliability of the instrument (questionnaire) is very low (Wells & Wollack, 2003:4).

6.2.6 Data Analysis

Data analysis can be referred to as the conversion of raw data into useful information that will provide the most value to the organisation – in this case, municipalities (Brassington & Pettit, 2003:1). In its raw form, this information can be extremely useful, but also overwhelming. In the course of organising the data, trends or contradictions may emerge, and these must be highlighted for readers to note and for the researcher to follow up.

The researcher was assisted by a statistician experienced in quantitative research, who provided guidance on the results from the applicable data collection instrument or characteristics of the questionnaire, as well as suitable data analyses obtained after the survey. The data was prepared and entered for computer analysis using Microsoft Excel spreadsheets, and strict quality control ensured that the results were based on accurately captured data. The Excel document was imported into STATISTICA where it was coded in preparation for data analysis. According to Welman *et al.* (2008:231-232), descriptive statistics are concerned with the description or summary of the data obtained for a group of individual units of analysis. Various descriptive statistics were used to portray the findings. Simple graphs, bar charts, tables and percentages were used so that data could be viewed from different perspectives, to enable anomalies to be identified and pursued.

6.2.7 Limitations of the Study

The following factors contributed to the limitations of this study:

Some municipalities may be implementing debt collection strategies and credit policies effectively, and are more likely to receive positive responses, whereas other municipalities may not be so effective. As such, the results may not be reflective of all 278 municipalities in South Africa. Other provinces may face different challenges and circumstances in terms of debt and the impact thereof on service delivery.

6.2.8 Ethical Considerations

There was no express request to exclude the name of any municipality from the study. However, the anonymity of the employees was paramount, as the researcher had access to their confidential data. In order to ensure the success of the study, municipal managers and CFOs could remain anonymous to ensure their protection from harm or coercion.

6.3 FRAMEWORK FOR DATA ANALYSIS

This section presents information on debt management, service delivery, municipal policies, and the financial systems and controls on the data gathered during the research. There is a total population of 278 municipalities in South Africa, but for purposes of this study a sample of 10 municipalities was selected from the population of 24 municipalities in the Free State. Tables reflecting the information from the relevant diagrams serve to depict the findings of the research process. This chapter provides an explanation of the contents of such tables and diagrams. In this regard, the analysis and interpretation of the data contribute to the development of an integrated debt management model for municipalities in the Free State Province.

6.3.1 Empirical Research Findings

As explained in paragraph 6.3, the data for the empirical research component of this study was collected through a self-administered questionnaire distributed via electronic mail to 10 municipal managers and 10 CFOs in the Free State Province. The response rate of the 10 municipalities was 100 per cent, for all the municipalities listed in paragraph 6.2.1.

- **Reliability Test**

In Section 3 of the data collection instrument (questionnaire), which comprised 30 questions, the responses were used to calculate Cronbach's alpha, using the software package R, which is an open-source programming language, with experts from all fields of study contributing to analysis packages, statistical analyses in this case, and even providing 95 per cent confidence intervals for this alpha. A comprehensive statistical package, namely STATISTICA, which provides an arsenal of the most powerful statistical tools available, was also used for descriptive and other purposes.

To calculate the alpha, all answers must be in the same direction, e.g. highest value to lowest value. If, for some of the observations, the scale was applied the other way around, then the results from the questions for the 20 observations would have had to be swapped. Therefore, the alpha calculations in Section 3 of the data collection instrument (questionnaire) were done by four groups separately, i.e. debt management, service delivery, municipal policies, and financial system and controls, each with a homogeneous theme and similar direction of scale within each group. Unfortunately, this aspect is often ignored when statistical packages are applied automatically.

The estimated summative reliability alpha value for Section 3, in the four groups (i.e. debt management, service delivery, municipal policies, and financial system and controls), was 0.91. This alpha value proved unreliable, however, because there were more variables (30 questions) than respondents (20 observations). Therefore, the alpha calculations in Section 3 were also done in the individual groups.

In the debt management group, calculating the perceptions of financial sustainability, eight questions applied, with a calculated reliability value of 0.86 in the form of Cronbach's alpha. The 95 per cent confidence intervals from the eight observations in the debt management group ranged from 0.69 to 1.00. For Question 3.8, namely “The municipality is utilising conditional grants to fund the operational deficit”, 11 observations of the 20 disagreed and nine agreed. These responses were inconsistent with the pattern of responses to the other seven questions, and impacted negatively on the Cronbach’s alpha value.

In the service delivery group, the researcher calculated the perceptions of the impact of debt management on service delivery. Based on the eight questions in this group, Cronbach's alpha was at 0.92. The 95 per cent confidence interval from the eight observations in the service delivery group was 0.78 to 1.00. The anomaly in this group was Question 3.12, namely “Community protests have increased because of service delivery backlogs in your municipality”, where five of the 20 respondents agreed and 14 disagreed. This was contradictory to the pattern of responses to the other seven questions, which may then have yielded a greater indication of reliability.

In the financial systems and controls group, calculating the perceptions of debt management on financial systems and controls, six questions applied. This group yielded a Cronbach's alpha of 0.61. For the 95 per cent confidence interval, the highest reliability boundary was 0.95, which is high. However, there were inconsistent patterns of responses to three questions, namely Question 3.18 (“The municipality has changed its financial system within the last year”), where 16 of the 20 respondents disagreed, as well as questions 3.19 and 3.20, where participants might have not been truthful in their responses. The researcher subsequently reached the conclusion that these questions might have been better suited to Yes and No answers, which may have resulted in a stronger reliability value for this section.

In the municipal policies group, calculating the perceptions of the impact of debt management on municipal policies, eight questions applied. Cronbach’s alpha was calculated as 0.77, falling within the 95 per cent confidence interval of 0.54 to 1.00. With regard to Question 3.25, namely

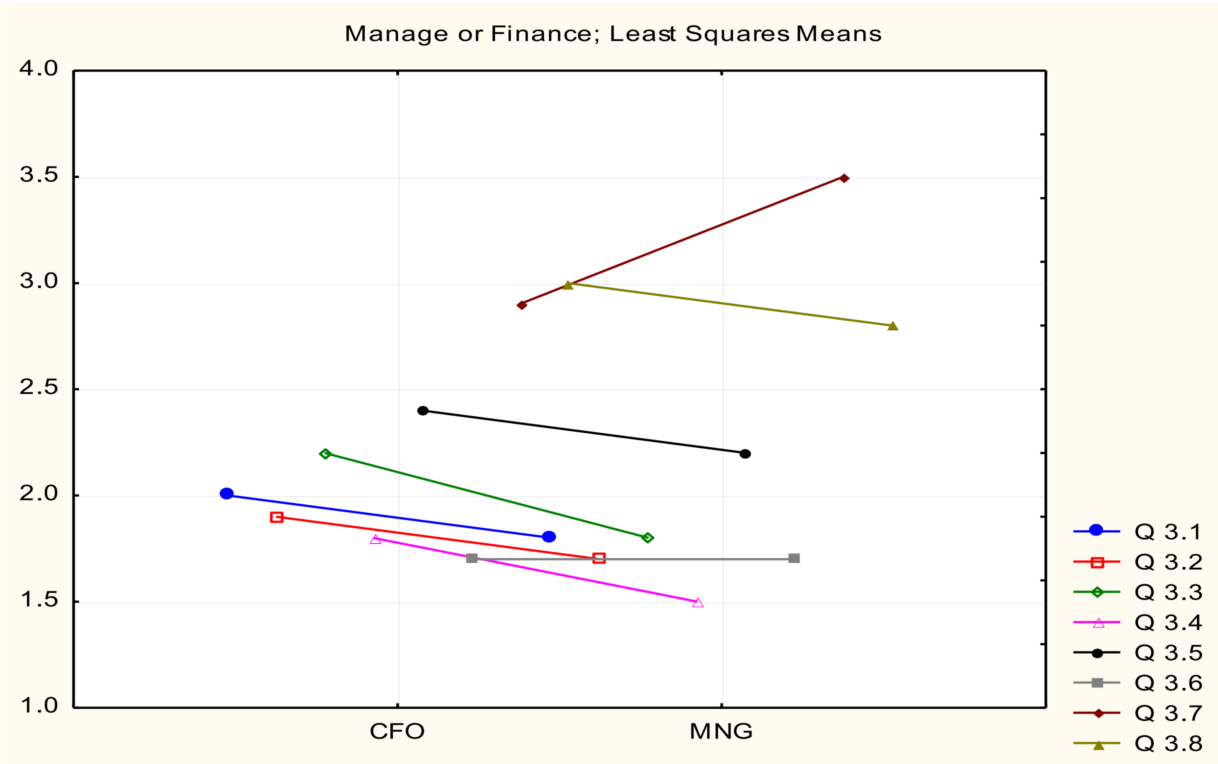
"The municipality has the capacity to implement credit and debt control policies effectively", nine of the 20 respondents agreed while 11 disagreed. The responses of the latter 11 might not have been truthful, given the current status of the debtor's book (See Chapter 5, paragraph 5.3), thus influencing the reliability value.

Within the groups of debt management, service delivery, municipal policies, and financial systems and controls, contained in Section 3, the observations from the responses of the municipal managers and CFOs yielded the following respective sample means, which were plotted for each of these groups. However, there were no significant differences between the municipal managers and CFOs in terms of their mean responses to each question (alpha =0.05).

6.3.1.1 Debt Management

Figure 6.1 below shows the means derived for municipal managers and CFOs on debt management, per question.

Figure 6.1: Sample Means from Municipal Managers and CFOs on Debt Management

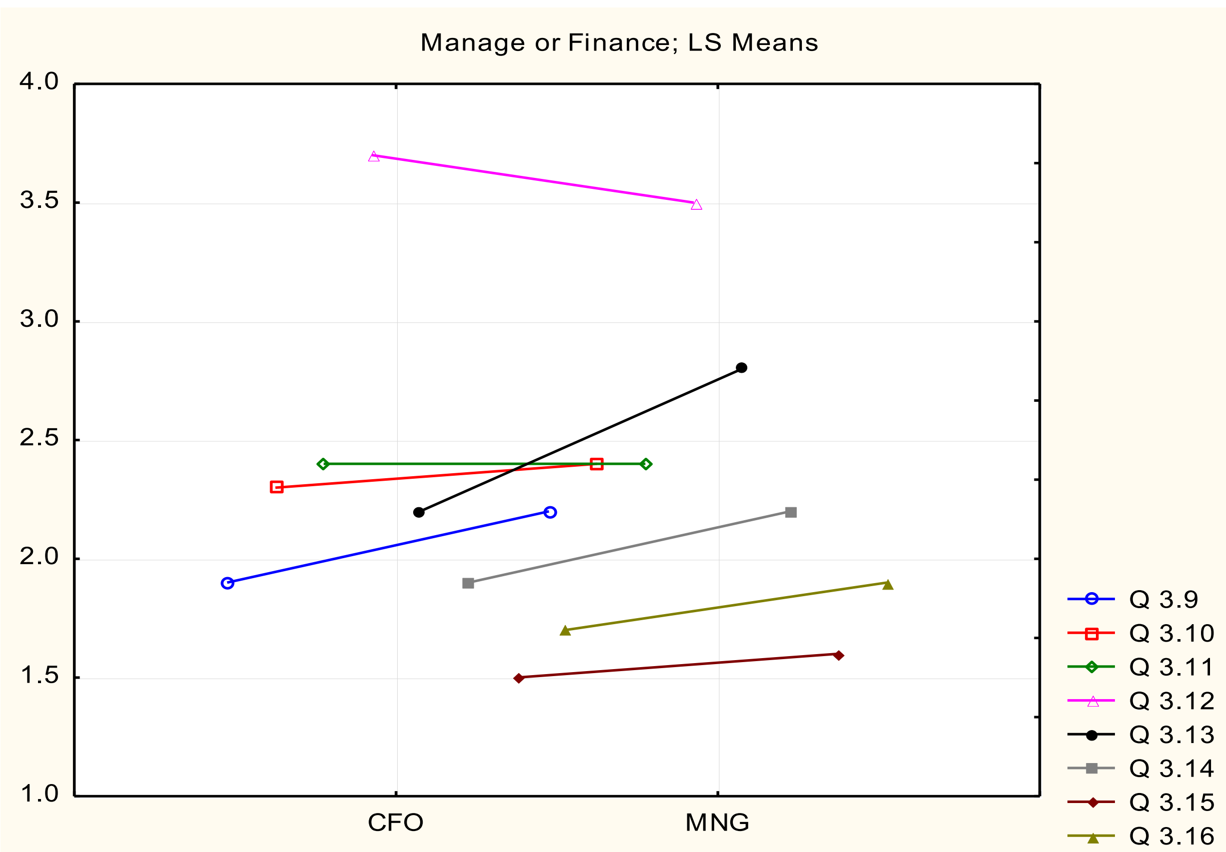


Figures 6.1 to 6.4 illustrate the sample means per set, and also between the municipal managers and CFOs. It is reiterated that these differences, tested at alpha=0.05, did not differ significantly. Of the eight questions relating to debt management, only question 3.7, namely "The municipality is utilising conditional grants to fund the operational deficit", yielded a sampled difference of approximately 0.05 between municipal managers and CFOs. The gap seen for Question 3.7 is still not significant, however, and hence the graphs are for display purposes and may facilitate the choice of further tests.

6.3.1.2 Service Delivery

Figure 6.2 below illustrates the means for municipal managers and CFOs in terms of service delivery, per question.

Figure 6.2: Sample Means from Municipal Managers and CFOs for Respective Questions on Service Delivery

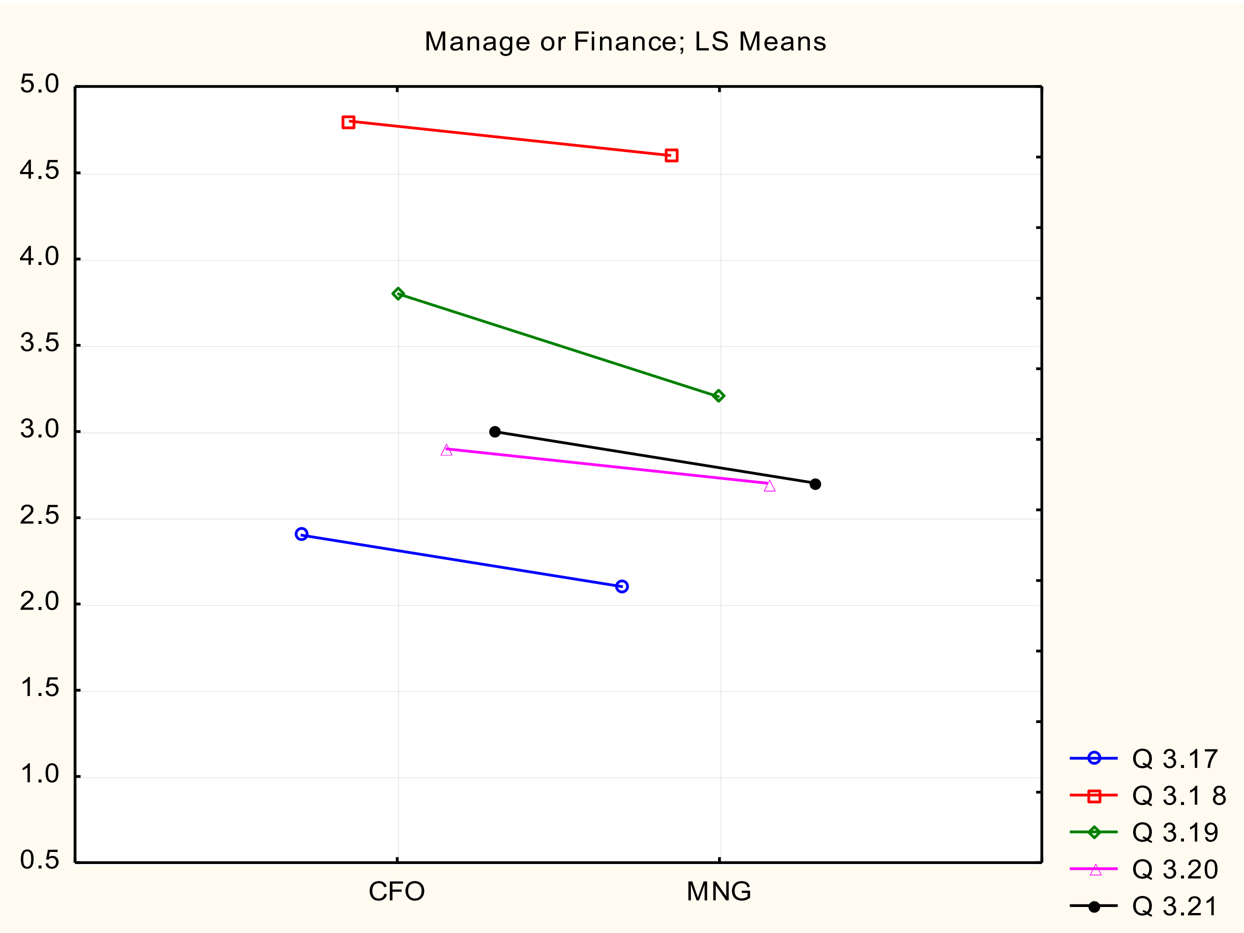


Of the eight questions relating to service delivery, it was only for Question 3.13, namely "The debt problem is caused by a growing indigent base at the municipality", that a difference of approximately 0.06 was found between the two sample means for municipal managers and CFOs. This could perhaps be attributed to the fact that Question 3.13 was more suited to a dichotomous question format.

6.3.1.3 Financial Systems and Controls

Figure 6.3 below portrays the sample means for municipal managers and CFOs in terms of individual items relating to financial systems and controls.

Figure 6.3: Sample Means from Municipal Managers and CFOs for Respective Questions on Financial Systems and Controls

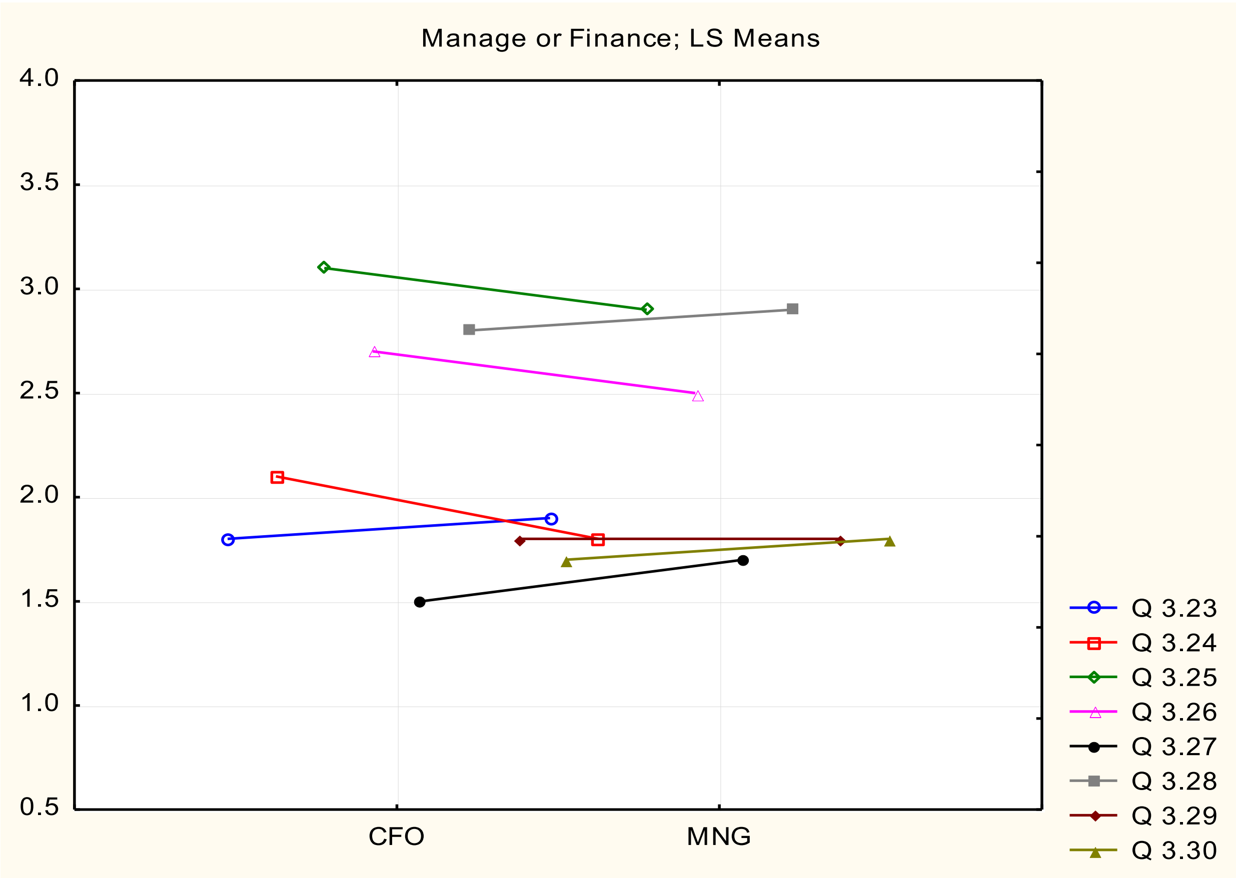


Of the six questions relating to financial systems and controls for service delivery, only Question 3.19, namely “The municipality has adequate capacity to manage its IT systems”, showed a distance of approximately 0.06 between the responses of municipal managers and of CFOs, while the other five questions were at an alpha level of 0.05. The gap revealed in the case of Question 3.19 is still not significant, however, at an alpha level of 0.05.

6.3.1.4 Municipal Policies

Figure 6.4 below shows the sample means for municipal managers and CFOs in terms of municipal policies, per individual question.

Figure 6.4: Sample Means from Municipal Managers and CFOs for Respective Questions on Municipal Policies



Of the eight questions relating to municipal policies, none showed means that differed significantly, with an alpha of 0.05.

The results obtained from the questionnaire, per individual section, are discussed below.

6.3.2 Section 1: Biographical Information

Respondents were asked to indicate the following attributes:

- Name and ID number (the provision of their surname and ID number was optional for participants);
- Population group;
- Gender;
- Language most commonly used;
- Age group; and
- Highest academic qualification.

The purpose of including such biographical information on respondents is to possibly explain certain trends in their preferences or behaviours. However, the anonymity of the employees had to be ensured, as they allowed the researcher to access their confidential data. The aforementioned characteristics are discussed individually below.

6.3.2.1 Population Group

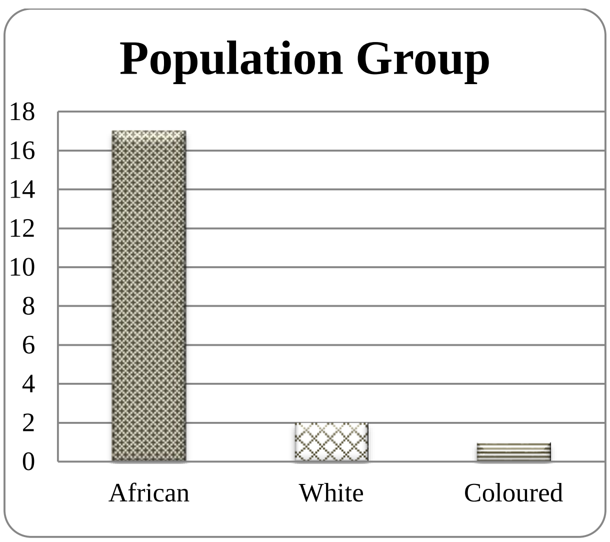
The frequencies and percentages pertaining to the respondents' population group are illustrated in Table 6.1 and Figure 6.5.

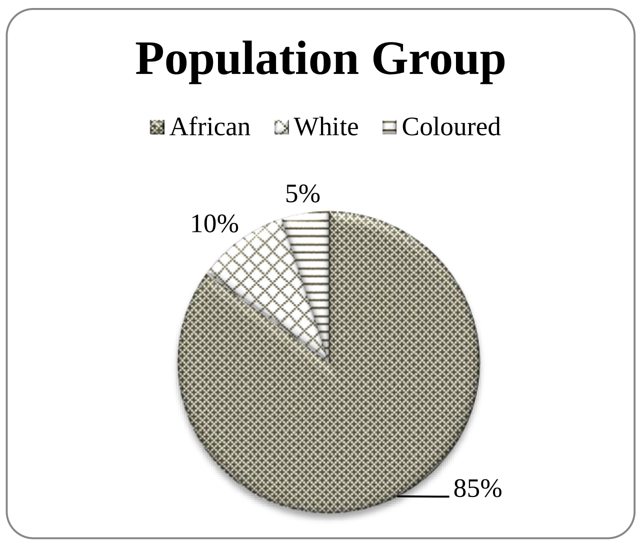
Table 6.1: Frequencies and Percentages Pertaining to Respondents' Population Group

Variable	Categories	N	n	%
Population group	African	20	17	85
	White	20	2	10
	Coloured	20	1	5

Table 6.2 describes the sample of municipal managers and CFOs. These ratios are in line with the division between the different racial groups comprising the population of 2.7 million in the Free State Province (Stats SA, 2013b:3). However, this should not be the only criterion used to fast-track the development needs of the province as a whole. Other indicators, including qualifications and skills, and a balanced approach to setting a vision and strategy for municipalities, should also be considered. Leadership and organisation can have a critical impact on the execution of strategy and the delivery of outcomes. Cognisance should also be taken that leadership does not stop with the person at the very top, but also cascades down the levels of the organisation, from the municipal council to top management and down to team leaders.

Figures 6.5: Population Group of Respondents





6.3.2.2 Gender

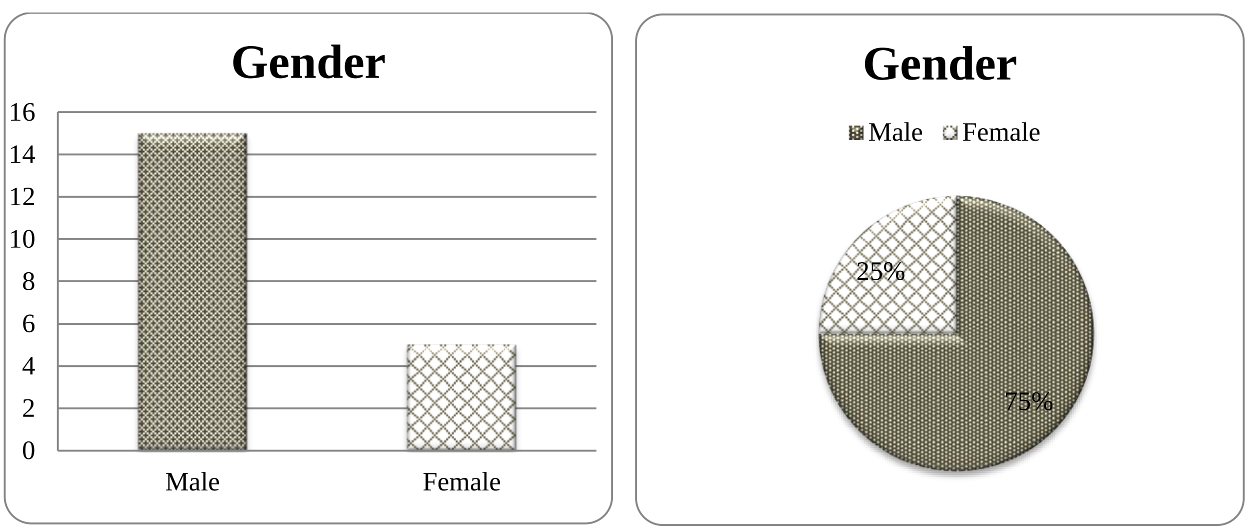
The frequencies and percentages pertaining to the respondents' gender are illustrated in Table 6.2 and Figure 6.6.

Table 6.2: Frequencies and Percentages Pertaining to Respondents' Gender

Variable	Categories	N	n	%
Gender group	Male	20	15	75
	Female	20	5	25

The gender profile ratio of the sample was three to one, males to females, respectively. The gap in the sample indicates that there may be a gender imbalance in top management positions within the municipal sphere in the Free State. This sphere of government in the Free State Province is not operating within the recommendations of the constitutional framework (RSA, 1996) and the Commission for Gender Equality (Hicks, 2008) in that insititutions in South Africa should take steps to eliminate all traces of patriarchal domination and inequality within them. Studies also offer fact-based insights supporting the notion that organisations in which women are strongly represented are also the best performers.

Figures 6.6: Gender Group of Respondents



6.3.2.3 Age Group

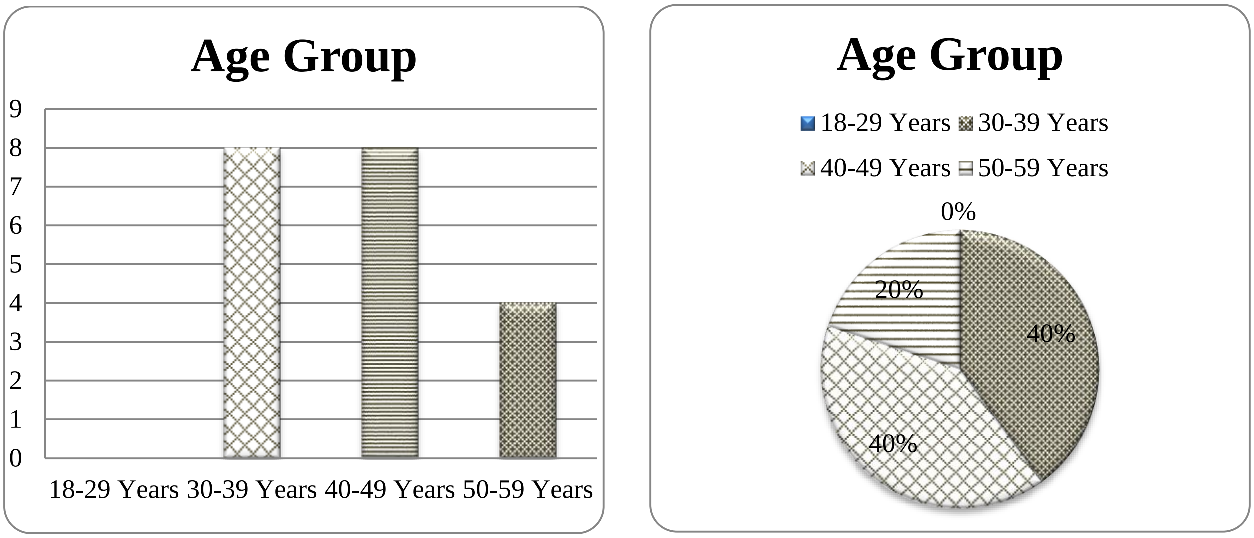
The frequencies and percentages pertaining to age group of the sample were grouped as illustrated in Table 6.3 and Figure 6.7.

Table 6.3 Frequencies and Percentages Pertaining to Respondents' Age Group

Variable	Categories	N	n	%
Age group	18-29 years	20	0	0
	30-39 years	20	8	40
	40-49 years	20	8	40
	50-59 years	20	4	20

The age distribution of respondents within the selected municipalities was even at n=8 for the age groups of 30-39 years and 40-49 years; however, for the age group 50-59 years, distribution was at n=4 or 20 per cent. Studies have found that younger people tend to offer intelligence, creative thinking and a valuable outlook on the world. This further adds to the notion that young people can enliven an organisation's atmosphere, in addition to working energetically and enthusiastically, thereby enhancing organisational performance. However, it is important that in addition to other core attributes, municipal managers and CFOs should also have the necessary experience to be considered for appointment, given the strategic nature of their positions and the current delivery challenges being experienced.

Figure 6.7: Age Group of Respondents



6.3.2.4 Educational Level

The frequencies and percentages pertaining to the educational level of the respondents are illustrated in Table 6.4.

Table 6.4: Frequencies and Percentages of Respondents' Educational Level

Variable	Categories	N	n	%
Educational Level	Secondary	20	1	5
	Diploma	20	1	5
	Degree	20	13	65
	Honours	20	4	20
	Master's	20	1	5

A mere five per cent of respondents indicated their highest qualification as secondary. Approximately 14 respondents were found to hold a degree or diploma, while five respondents had a postgraduate qualification. In light of the above, the selected municipalities' officials were found to consist of academically qualified employees. Performance is generally higher in organisations that have appropriately qualified employees than in those where employees do not possess the necessary skills, experience and qualifications.

The descriptive component of the findings is discussed in terms of the means profile and the biographical summation of the responsibilities involved.

6.3.2.5 Test of Dependence between Debt Management and Other Individual Items in Section 3 of the Questionnaire

Table 6.1 illustrates the test for a relationship between the 29 respective items in Section 3 of the questionnaire and Question 3.1, namely “The municipality has experienced debt problems in the last three years”. If the p-value is less than 0.05, then the correlation between the two questions' responses is significant, for an alpha specified as 0.05. In this case, a Chi-squared test, which essentially compares the observed with the expected frequencies in the cells of a cross-table of a single pair of items, applies.

Since the research focused on debt management, the researcher concentrated on testing for a correlation between Question 3.1, namely “The municipality has experienced debt problems in the last three years”, and the other 29 items in Section 3 of the questionnaire. In this case, the null hypothesis states that the two questions are independent. When one rejects this hypothesis, it indicates that there is a relationship or correlation between the two items. The researcher applied the standard Chi-squared test, as well as the Yates test for independence between debt management and the other items in Section 3, respectively. Note that questions 3.15, 3.24, 3.25, 3.26 and 3.27 recorded the same response for all 20 participants, and could not be tested as above.

These tests on 2x2 tables of frequencies require at least five (some authors say 10) observations in each of the cells, and this requirement was not met with the researcher's example, which had only 20 observations in total. Hence the “Strongly agree” and “Agree” responses were grouped under code "2", and the “Strongly disagree” and “Disagree” responses were grouped under code "4". The standard Maximum Likelihood (ML) Chi-squared test was applied, as well as the more conservative Yates test, which is more reliable in tests of independence. The outcomes are summarised in Table 6.5.

Table 6.5: Chi-squared and Yates Tests (with asterisks indicating significance at p <.0.05)

Pair of Variables	**Maximum Likelihood Chi-squared Test: p-value**	**Significant**	**Yates' Chi-squared Test: p-value**	**Significant**
Questions 3.1 & 3.2	0.0014	*	0.0113	*
Questions 3.1 & 3.3	0.0148	*	0.0528	
Questions 3.1 & 3.4	0.0142	*	0.0113	*
Questions 3.1 & 3.5	0.0049	*	0.0441	*
Questions 3.1 & 3.6	0.0924		0.5805	
Questions 3.1 & 3.7	0.1804		0.4362	
Questions 3.1 & 3.8	0.0020	*	0.2614	
Questions 3.1 & 3.9	0.0925		0.2780	
Questions 3.1 & 3.10	0.0185	*	0.0976	
Questions 3.1 & 3.11	0.0386	*	0.0765	
Questions 3.1 & 3.12	0.0703		0.8274	
Questions 3.1 & 3.13	0.0624		0.2048	
Questions 3.1 & 3.14	0.0245	*	0.8969	
Questions 3.1 & 3.16	0.1042		0.3100	
Questions 3.1 & 3.17	0.1008		0.2598	
Questions 3.1 & 3.18	0.0441	*	0.5536	
Questions 3.1 & 3.19	0.0579		1.0000	
Questions 3.1 & 3.20	0.0180	*	0.4362	
Questions 3.1 & 3.21	0.3469		0.6770	
Questions 3.1 & 3.22	0.1056		0.5186	
Questions 3.1 & 3.23	0.4413		0.5536	
Questions 3.1 & 3.28	0.5512		0.1759	
Questions 3.1 & 3.29	0.0268	*	1.0000	
Questions 3.1 & 3.30	0.1226		0.0851	

The Chi-squared test can indicate significant dependence, yet the conservative Yates test (which takes a much more extreme stance before rejection) does not. However, if BOTH have a p-value less than 0.05, then there is sure to be a strong correlation between the two statements in Question 3.1 and each of the 24 items in Section 3, as marked with asterisks.

For questions 3.2, 3.3, 3.4 and 3.5, Chi-squared and Yates tests had p-values that were less than 0.05, and hence not independent of Question 3.1 respectively for alpha specified as 0.05. For questions 3.8, 3.10, 3.11, 3.14, 3.18, 3.20 and 3.29, the Chi-squared test indicated dependence, but the Yates test did not.

The sampled municipalities reflect (alpha = 0.05) that debt management (3.1) is not independent of cash flow (3.2), cash-back reserves (3.3), cash coverage (3.4) or debt problems (3.5) at municipalities in the Free State.

6.3.2.6 Interpretation of Section 1

The complexities in local government, the challenges experienced and high expectations of the public demand indicate that it is absolutely crucial that key personnel at municipalities have the necessary skills, experience and capacity to fulfil their responsibilities and exercise their functions and powers. The reforms in municipal financial and performance management have also resulted in a higher level of competency requirements for municipal managers and CFOs.

Instability in the administrative leadership can also threaten the financial health of a municipality. The municipal manager, as accounting officer, is responsible for overall accountability in the administration of the municipality, as determined in Section 60 of the MFMA (RSA, 2003). It is therefore critical to ensure that the posts of municipal manager and CFO are filled with qualified and competent officials. The following suppositions can be made:

- Age plays a crucial role in the appointment of CFOs and municipal managers. The participants who completed the questionnaire fell into the age group of 39 -59 years, which confirms the trend that besides other core competencies, experience is also used as a criterion in the filling of top management appointments at municipalities. Experienced leadership is the stand-out feature, but the delivery of positive outcomes from strategies can only happen if the municipal council is engaged and identifies with the oversight role and responsibility in the implementation of municipal strategy.

- Higher educational levels play a role in the appointment of CFOs and municipal managers. Only one respondent indicated a highest qualification of secondary education, with approximately 14 respondents holding degrees and diplomas. Municipal managers and CFO's face major challenges, not just financially but also in terms of building a brand for their municipalities, and in terms of engaging with, providing leadership to and working with an ever-growing network of partners, across sectors and geographies, both nationally and internationally. We can argue that qualifications should not be the only criteria and that other critical core competencies are fundamental to the posts of municipal managers and CFOs. In this regard the National Treasury has issued regulations and guidelines on the appointment of officials to these critical posts (National Treasury, 2009).

6.3.3 Section 3 of the Questionnaire

Section 3 of the questionnaire was designed to investigate the perceptions of municipal managers and CFOs regarding debt management.

Questions in this section elicited information based on four areas, namely:

a) Municipal Debt – (3.1 to 3.8);
b) Service Delivery – (3.9 to 3.16);
c) Financial Systems and Controls – (3.17 to 3.22); and
d) Municipal Policies – (3.23 to 3.30).

Table 6.6 is a statistical summary of the responses. Descriptive statistics, namely frequencies and percentages, are used to portray the data. The information is presented in tabular form, with the numbers representing "strongly agree," "agree", "don't know", "disagree" and "strongly disagree" respectively. The frequencies are presented both numerically and as percentages. To determine the areas in which the selected municipalities in the Free State Province may show either stronger or weaker performance, the frequencies and percentages have been clustered into four areas, namely debt management, service delivery, municipal policies, and financial systems and controls.

Table 6.6: Frequencies and Percentages of Debt Management

Item Description	Strongly Agree	%	Agree	%	Don't Know	%	Disagree	%	Strongly disagree	%
3. DEBT MANAGEMENT										
a) DEBT MANAGEMENT										
3.1 The municipality experienced debt problems in the last 3 years.	14	70	1	5	0	0	3	15	2	10
3.2 The debt problem impacted on cash flow at your municipality.	12	60	5	25	0	0	1	5	2	10
3.3 The debt problem is eroding the cash back reserves at your municipality.	11	55	5	25	0	0	1	5	3	15
3.4 At your municipality, the growing debt problem impacted on the cash coverage ratio of 2.5 months.	14	70	3	15	0	0	2	10	1	5
3.5 The debt problems impacted on going concern issues at your municipality.	9	45	3	15	2	10	5	25	1	5
3.6 Growing debt problems pose challenges to your municipality.	10	50	8	40	1	5	0	0	1	5
3.7 The municipality is utilizing conditional grants to fund the operational deficit.	4	20	5	25	0	0	5	25	6	30
3.8 The municipality had difficulty in paying its creditors within the last 3 months.	3	15	7	35	1	5	7	35	2	10
b) SERVICE DELIVERY										
3.9 The debt problems impacted on service delivery at your municipality.	5	25	12	60	0	0	3	15	0	0
3.10 The debt problem impacted on achieving service delivery in priority areas i.e electricity and water.	4	20	10	50	0	0	1	5	5	25
3.11 The growing debt problem impacted on achieving service delivery budget implementation targets.	2	10	13	65	0	0	5	25	0	0
3.12 Community protests increased because of service delivery backlogs in your municipality.	1	5	4	20	1	5	10	50	4	20
3.13 The debt problem is caused by a growing indigent base at your municipality.	2	10	12	60	2	10	2	10	2	10
3.14 The unemployment in the municipal jurisdiction contributes to the debt position at the municipality.	8	40	7	35	2	10	2	10	1	5
3.15 The culture of non payment contributes to the increase in the debtors book.	9	45	11	55	0	0	0	0	0	0
3.16 There are high poverty levels in the municipal jurisdiction.	11	55	5	25	1	5	3	15	0	0

Item Description	Strongly Agree	%	Agree	%	Don't Know	%	Disagree	%	Strongly disagree	%
3. DEBT MANAGEMENT (Continued) **c) FINANCIAL SYSTEMS & CONTROLS**										
3.17 The municipality has an adequate software solution for its revenue and debt management controls.	8	40	6	30	5	25	1	5	0	0
3.18 The municipality changed its financial system within the last year.	0	0	1	5	3	15	0	0	16	80
3.19 The municipality has adequate capacity to manage its IT system.	2	10	4	20	0	0	10	50	4	20
3.20 The municipality has effective indigent monitoring and control systems.	2	10	9	45	0	0	9	45	0	0
3.21 The municipality is able to effectively profile the customers in order to differentiate between those that can pay and those that cannot pay for services.	3	15	8	40	1	5	5	25	3	15
3.22 The municipality has an in house internal audit unit.	9	45	7	35	0	0	4	20	0	0
d) MUNICIPAL POLICIES										
3.23 The municipality implemented credit control and debt management policies.	5	25	14	70	0	0	1	5	0	0
3.24 The charges for rates and tariffs are affordable by customers in the last 3 years.	4	20	14	70	1	5	1	5	0	0
3.25 The municipality has the capacity to implement credit and debt control policies effectively.	2	10	7	35	0	0	11	55	0	0
3.26 The municipality implemented credit control and debt management policies.	4	20	8	40	0	0	8	40	0	0
3.27 The municipal council adopted a tariff policy on levying of fees for municipal services in compliance with Section 74 of the MSA.	8	40	12	60	0	0	0	0	0	0
3.28 The municipality promulgated credit control and debt bylaw in compliance with sections 75 and 96 of MSA.	5	25	5	25	2	10	4	20	4	20
3.29 The municipality implemented an effective Indigent Policy.	7	35	11	55	0	0	2	10	0	0
3.30 The municipality complied with Sections 24(2)c of the MFMA in relation to budget policies.	8	40	10	50	0	0	2	10	0	0

The following discussions emerge from Section 3 of the questionnaire, relating to debt management:

6.3.3.1 Question 1: The municipality has experienced debt problems in the last three years

There is a noticeable deterioration in the funding levels of local government budgets, including cash and cash liquidity. Since local government is largely self-financed, national government has limited discretion in terms of imposing expenditure reductions and enforcing performance efficiencies on local government. In this regard the purpose of this question was to determine the extent to which the debt management problem impacts on the sustainability of this vital service delivery arm of government.

6.3.3.2 Summary of Feedback on Question 1

Question 3.1, relating to how the sample municipalities have experienced debt problems in the last three years, reveals that 75 per cent of the respondents strongly agree or agree that their municipalities have experienced debt problems. The researcher is of the opinion that the 75 per cent who agree are probably the respondents who are not afraid to state the truth. This is affirmed by the increase in the debtor's book of R1.6 billion at Free State municipalities (see also paragraph 1.3 in Chapter 1 and paragraph 5.8.4 in Chapter 5).

The general response from participants was that because the local sphere does not have a comprehensive, uniform financial system, it contributes to some extent to the poor performance of municipalities with regard to inaccurate billing, weak credit control measures and inadequate customer service mechanisms.

Other participants indicated that consumers may be unable to pay as a result of unemployment and poverty. It is argued that the poverty of many households makes them unable rather than unwilling to pay, hence the need for free basic services to the poorer segments of the population and/or a lowering of the rates. This argument is supported by McDonald (2002b), amongst others.

Responses also indicate that the problem of non-payment could stem from the "culture of entitlement" and dependency. It is argued that many people believe that public services are a basic right and should not be paid for.

Participants also indicated that the problem of non-payment stems from "free-riding", in that nobody would voluntarily contribute to government unless under threat of punishment.

6.3.3.3 Interpretation of Responses to Question 1

These observations are affirmed in paragraph 6.3.2.5, i.e. many municipalities in the Free State are confronted by the inability to collect consumer debts and are experiencing debt problems. The researcher is in agreement that to an extent, the problem of debt and its impact on municipalities can be related to a "culture of entitlement" and dependency (refer to Figure 5.2 in Chapter 5, showing R4.5 billion outstanding from households in the debtors' books of Free State municipalities).

In terms of item 3.15, all respondents concurred that the culture of non-payment had contributed to the increase in the debtors' book. Furthermore, a survey conducted by Burger (2001:13) revealed that many people are in a position to pay, but opt for non-compliance.

In Chapter 2, paragraph 2.4.2 provides detailed reasons why municipalities are experiencing debt problems. The researcher found that municipalities have not implemented effective credit control and debt collection policies, which should detail credit control and debt collection procedures and mechanisms. The policy may differentiate between different categories of users, ratepayers or debtors, as long as the differentiation does not amount to unfair discrimination. In addition, the policy must provide for indigent debtors in a manner consistent with the municipality's tariff policy and any national indigent policy.

It may be that municipalities are not projecting realistic targets in terms of estimates of income, with provision for bad debts, and therefore have experienced revenue challenges. Municipalities should use generally acceptable accounting practices and collection ratios to help them to accurately estimate the amount of income they will receive from service charges.

The rate of interest charged on arrears, extensions of time for the payment of accounts and other matters relating to late payments should be covered by municipal policy. The policy must also detail the termination or restriction of services when payments are in arrears. Matters related to theft, damages and unauthorised consumption of services should also be covered in the policy.

In addition, municipalities are pressured to maintain at least the very minimum in a positive cash position. If the municipality does not reflect a positive cash position, it is the first indicator of financial distress. In light of this, it is imperative that municipal councils adopt by-laws to give effect to municipal credit control and debt collection policies, and that they have the capacity to implement and enforce such policies. Section 118(3) of the MSA (RSA, 2000a) allows for the customer to be charged an amount due for municipal service fees, surcharges on fees, property rates and other municipal taxes, levies and duties.

The scholarly view is that negative cash balances are indicative of more deeply rooted financial difficulties prevalent in the municipality, which may impact on the provision of essential municipal services. However, the argument for a uniform financial system as a contributing factor in addressing the debt problem is not entirely supported by scholars, given that a large proportion of the 278 municipalities in South Africa are billing and collecting effectively.

6.3.3.4 Questions 2 and 3: The debt problem has impacted on cash flow at the municipality, and the debt problem is eroding the cash reserves at the municipality

The purpose of these questions was to determine liquidity and whether the municipalities' cash reserves have diminished and if they are experiencing financial difficulty in paying operational costs, more specifically creditors.

6.3.3.5 Summary of Feedback on Questions 2 and 3

With regard to Question 3.2 regarding the impact of debt on the cash flow of a municipality, 60 per cent of respondents strongly agree and 25 per cent agree that their municipalities are experiencing debt problems, i.e. 85 per cent of the respondents agree that the debt problem has impacted on the cash flow at their municipality.

With regard to Question 3.3, namely "Debt problems are eroding the cash reserves at the municipality", 55 per cent of the respondents strongly agree and 25 per cent (5 respondents) agree that their municipality is experiencing cash problems; five per cent (one respondent) disagrees and 15 per cent (three respondents) strongly disagree. This means that 80 per cent of respondents agree that debt problems are eroding the cash reserves at their municipality.

Responses from participants indicate that their current debtors and the payment trends of consumers could potentially paralyse the cash flow position of their municipalities and hinder their ability to fulfil their constitutionally mandated responsibilities. Chapter 3, Section 3.7 provides official information on the impact of the growing consumer debt and the ability to maintain a positive cash balance.

6.3.3.6 Interpretation of Responses to Questions 2 and 3

The objective of a cash flow statement is to provide information on the historical changes in cash and cash equivalents of a municipality, as well as details of the cash inflows and outflows of the entity during the period, from operating, investing and financing activities. Information on a municipality's cash flows is useful in assisting users to predict the municipality's future cash flow requirements (amount, timing and certainty), enabling the municipality to generate cash flows in the future to finance changes in the scope and nature of its activities.

Cash comprises cash on hand and demand deposits. Cash equivalents are cash for the short term – highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. An example is a money market instrument such as a call account or a demand deposit. A municipality maintains cash reserves to enable it to conduct its day-to-day operations and to protect itself from unplanned events and other emergencies. Cash flows are inflows and outflows of cash and cash equivalents. Generally speaking these cash reserves are maintained in the form of deposits held with a bank or otherwise in the form of cash, such as petty cash, held by the entity.

Municipalities must present a reconciliation between the opening and closing balances of cash and cash equivalents (as reflected in the statements of financial position) and in the cash flow statements. This difference is referred to as a net increase/(decrease) in cash and cash equivalents and is further explained as amounts either generated from or utilised in operating, investing and financing activities.

The opinion of the researcher is that poor billing and collection is not specific to smaller, less-resourced municipalities, but improvements in billing and collection activities have the potential to bring about immediate improvements to the revenue base of municipalities. Instead, as households, businesses and government confirm, incorrect billing issues continue to negatively affect the integrity of local authorities. Poor performance in terms of paying customers being categorised as defaulters can in certain instances exacerbate an unwillingness to pay. Achieving and maintaining accurate and efficient billing and collection processes depends on a number of factors, including accurate customer databases, effective and regular metering of service consumption, adequate staff capacity, and convenient facilities for customer payments.

In addressing the billing and collection challenge, municipalities must determine the root cause of poor performance, improve their collections and maintain positive cash balances. In instances where municipalities do not have the financial and human capital resources to upgrade and employ more sophisticated administrative and billing systems, consideration should be given to either outsourcing the function or establishing an internal municipal service district to facilitate improved performance. Consumer debtors as a per cent of own revenue provides a useful, easily calculated indicator of the state of a municipality's debtor management capacity. In terms of good practice, municipalities with debtors greater than the average 30 per cent of own revenue are at serious financial risk, especially if there is an ongoing deteriorating trend. The respondents of 85 and 75 percentages indicate that municipalities are in a vulnerable position and this may influence the breakdown of service delivery. This was affirmed by the ML Chi-squared test of dependence. The researcher is of the opinion that effective credit control and debt collection are key to the sustained financial viability of municipalities (refer to Section 2.7 of Chapter 2).

6.3.3.7 Question 4: The growing debt problem has impacted on the cash coverage ratio of 2.5 months

A municipality also needs to have enough cash on hand to meet its monthly payments as and when they are due. In this regard, calculating the level of cash coverage in a municipality is important, should the municipality be faced with circumstances that threaten its revenue base. It is generally accepted that a prudent level of cash coverage is 2.5 months of average operational expenditure. The purpose of this question was to identify the number of municipalities with sufficient cash reserves to meet their monthly obligations.

6.3.3.8 Summary of Feedback on Question 4

With regard to Question 3.4, i.e. whether the growing debt problem has impacted on the cash flow coverage ratio of 2.5 per cent, 85 per cent of respondents agree, 70 per cent strongly agree and 5 per cent strongly disagree. These findings are supported by the fact that the economy is shrinking, thus fuelling unemployment and poverty rates. This places added pressure on municipalities to exercise fiscal discipline by judiciously spending their funds on budgeted programmes and projects. The responses to this statement are supported by item 3.3, i.e. debt problems are eroding the cash reserves at the municipality, with which 80 per cent of respondents agree.

The majority of vulnerable people will be exposed to harsher realities of poverty and unemployment, which would inevitably contribute to a growth in debt and pose a challenge to municipalities. The growth in municipal debt is further substantiated by the fact that national grant transfers to local government, through the annual Division of Revenue Act, have continued to grow significantly as a means to protect the sustainability of some municipalities.

6.3.3.9 Interpretation of Responses to Question 4

A prudent budgeting approach would help to generate the internal capacity to fund capital infrastructure from the municipalities' own revenue sources. The following events could push those municipalities with an already low level of cash coverage into a negative cash position:

a) The economic recession and rising rates and tariffs impacting on the affordability of household budgets;
b) The need to finance the cash-flow difference between paying for the increased cost of bulk electricity and water and the collection of revenues from customers; and
c) Ratepayer/consumer boycotts.

Cash is the lifeblood of any municipality and is a vital element in its success and continuity. A municipality's cash flow is one of the best indicators of financial health. Revenue and debt collection is one critical element that ensures a healthy financial status for a municipality.

Effective financial management can help municipalities to transform their local areas into better places in which live and work. Most councillors and members of the community know which municipal services they would like to have in their area.

One of the responsibilities of a municipal council is to approve and regularly monitor the budget of the municipality, which also provides money to implement the projects in the IDP. This work should be done in consultation and cooperation with the ward committees. The community should be involved as much as possible in deciding on the spending priorities for the area in which they live. Ward councillors and ward committees should report to ward meetings about the broad budget plans and consult the residents about programmes and projects that will affect them.

The view scholars is that without funds to implement the policies, councillors will not be able to make a difference or serve their communities well. Effective financial management ensures that there are funds available to implement council policies. This is a huge responsibility, as municipalities are responsible for managing large amounts of money and delivering services that affect people's daily lives. Councillors, committee members and officials all have a duty to ensure that these monies are managed carefully, transparently and honestly.

Good financial management is the key to local delivery, and ward committee members should understand municipal finances and budgets so that they can engage councillors in broader debates on spending and development priorities.

It appears that municipalities are beginning to demonstrate an understanding of the importance of budgeting for operating surpluses to mitigate cash and liquidity challenges; however, progress in this regard is still not satisfactory.

It is suggested that municipalities develop their cash coverage to at least 2.5 months of average operational expenditure to avoid an increase in short-term borrowing. This will enable municipalities to maintain a positive cash position and avoid a vulnerable cash position. This relationship became apparent in the ML Chi-squared test.

6.3.3.10 Question 5: Debt problems have impacted on the municipality as a going concern

The purpose of this question was to determine whether the municipalities are forecasting positive cash positions for any of the years of the medium-term budget.

6.3.3.11 Summary of Feedback on Question 5

With regard to Question 3.5, in terms of debt problems having impacted on the municipality as a going concern, only 60 per cent of respondents strongly agree or agree, while 30 per cent disagree.

According to the respondents, a municipality that has already invested in assets to address service delivery backlogs would be required to maintain and improve such service levels, and therefore the percentage of spending allocated to new assets may not be significantly higher.

On the other hand, a municipality where the infrastructure and level of services provided is low and the associated expenditure is also low, the percentage of investment in new assets compared to total expenditure would be significantly higher and would not promote economic activity, thus impacting negatively on revenue growth and collections.

6.3.3.12 Interpretation of Responses to Question 5

The scholar view is that insufficient monies are being spent on repairs and maintenance, to the extent that this could impair useful assets in providing vital municipal service delivery.

Cash flow is the movement of money into and out of the municipality's bank account, as money is received from ratepayers or paid out to staff and service providers. When more money flows into the bank account than has to be paid out, the municipality has a surplus of money and can proceed with development projects that have been planned in the budget. This places the municipality in a balanced position.

Conversely, when more money has to be paid out than the amount that flows in, the municipality could be heading for major financial problems or be at risk of going "bankrupt". To avoid such a situation, the municipality can borrow money from the bank (overdraft), or from another sphere of government (loan or grant), or increase the property rates and service charges (tariffs) that people must pay for local services. None of these options is very good for a municipality's reputation and credit viability as a going concern.

Even though ward committees and community organisations are not involved in the municipality's cash flow management affairs, they need to know how important it is to avoid a negative cash flow or a budget deficit (when the municipality owes more money than it has in the bank, and has to suspend projects it cannot afford). The scholars views are that cash flow management should be a regular item on the agenda of municipal council meetings, and relevant reports on this should be presented at council or ward committee meetings. There should be debates and engagement on how well the money flow is being planned, monitored and followed up by those responsible, namely the municipal manager, CFO and executive committee or mayoral committee.

An increasing expenditure trend may be indicative of high asset-usage levels, which can prematurely require advanced levels of repairs and maintenance. Also, should an increasing expenditure trend suddenly drop to lower levels without an increase in the fixed asset value, this may be indicative of challenges in spending patterns. This may also indicate that the municipality is experiencing cash flow problems and is therefore unable to spend at appropriate levels on its repairs to existing assets or purchasing of new assets, in turn impacting negatively on service delivery and the municipality as a going concern.

6.3.3.13 Question 6: The growing debt problem is posing a challenge to the municipality

The purpose of this question was to ascertain the effectiveness of the collection and credit control procedures, as well as the extent to which the municipality has provided for doubtful debts.

6.3.3.14 Summary of Feedback on Question 6

With regard to Question 3.6 in terms of the growing debt problem posing a challenge to the municipality, half of the 20 respondents strongly agree and eight agree. However, the responses to Question 6 appear to be line with the responses to questions 3.1 to 3.5.

Participants indicated that the cash flow position is a problem and they are reliant on grant transfers for the payment of operational costs. Hence, they indicated that the revenue function is, to an extent, not given priority.

6.3.3.15 Interpretation of Responses to Question 6

An overwhelming 90 per cent of the respondents agree that debt is becoming a significant challenge at municipalities. Municipalities that continually assess their collection ratio will give an indication of the performance against a number of areas, for example:

- Quality of credit control – ensuring that what is billed is collected (refer to Section 2.7 of Chapter 2); and
- Quality of revenue management – the ability to set affordable tariffs and to bill correctly.

Municipal revenue collection requires urgent attention, and therefore corrective measures must be implemented. A municipality with outstanding debtors should aim at achieving a collection rate of more than 100 per cent. In this regard, the participants commented that municipalities must appoint competent employees and adequately staff the revenue function. Cash is important for the existence of any organisation. Paragraphs 2.7.4 and 2.8.5 of Chapter 2, as well as paragraph 4.2 of Chapter 4, reflect the research on the importance of quality and the setting of accurate and cost-reflective tariffs to improve confidence in collections.

6.3.3.16 Question 7: The municipality is utilising conditional grants to fund operations

The purpose of this question was to determine the vulnerable cash position of municipalities and their reliance on grants to fund operations.

6.3.3.17 Summary of Feedback on Question 7

With regard to Question 3.7, i.e. the municipality is utilising conditional grants to fund operations, nearly half the respondents agree.

The respondents' feedback on this question does not match the responses to questions 3.1 to 3.6. However, the participants indicated that they make use of short-term loans or overdrafts from financial institutions.

6.3.3.18 Interpretation of Responses to Question 7

Due to their limited income base, many municipalities in rural areas are unable to fund capital projects from their own revenues, making them totally dependent on grant funding for the construction of new facilities (community halls, sports fields, etc.) and new services infrastructure (roads, water, sewerage, storm water, etc.).

Municipalities need to answer the question of whether they are prepared to adjust their operating budgets upwards, to allow for such maintenance. With insufficient funding available for an increasing asset base, maintenance backlogs will eventually reach a level where assets will need to be replaced long before they have reached the end of their intended lifespan. This would have cash consequences and municipalities would be forced to utilise grants for their operations.

It is critical that municipalities have a balanced funding mix, which will allow them to tap into affordable, long-term borrowings. Loans could then be targeted to addressing service delivery needs, providing the municipal jurisdiction with investment centres, and growing their revenue base.

6.3.3.19 Question 8: The municipality has had difficulty in paying its creditors during the last three months

The purpose of this question was to ascertain the extent of the municipalities' dependence on national and provincial grants.

6.3.3.20 Summary of Feedback on Question 8

With regard to Question 3.8, i.e. the growing debt problem is posing a challenge to the municipality, half the respondents agree.

Participants indicated that they hold back payments and have made payment arrangements with creditors. These steps are a contravention of Section 65 of the MFMA (RSA, 2003).

6.3.3.21 Interpretation of Responses to Question 8

A period of longer than 30 days taken to settle creditors is normally an indication that the municipality may be experiencing cash flow problems. In certain instances this may be as a result of disputes, processing of payments or other reasons. If the norm of 2.5 months is exceeded, this indicates that the municipality may not be adequately managing its working capital or that effective controls are not in place to ensure prompt payments.

Scholar's postulates that such municipalities would find themselves in a vulnerable cash flow position and would to a large extent not be able to service their bulk service providers and statutory payments. The municipality would not be in compliance with its financial obligations and would place itself at risk. This observation is mirrored in Table 6.5.

This concludes the discussion of Section 3 of the questionnaire, designed to investigate the perceptions of municipal managers and CFOs regarding debt management. The next set of eight questions, as addressed below, pertains to service delivery.

6.3.3.22 Interpretation of Responses to Service Delivery Questions 3.9 to 3.16

With regard to Question 3.9, i.e. debt problems have impacted on service delivery, an overwhelming 19 of the 20 respondents agree that this is indeed the position. This finding is supported by the added pressure on municipalities to exercise fiscal discipline by spending their funds on budgeted service delivery programmes. Fourie *et al.* (2011:238) supports that all municipalities in South Africa are faced by one of the most critical risks, namely their inability to collect revenue due to them for services rendered to the communities they serve. In addition, the majority of vulnerable people become more exposed to harsher realities of poverty and unemployment, which will in turn result in the growth of municipal debt. The latter then poses a challenge to the achievement of MDG targets.

Questions 3.13, 3.14 and 3.16 aggregate to 81.5 per cent respondents agreeing that unemployment is fuelling poverty and indigent reliance for municipalities. Burger (2001:13) supports that affordability is also of major concern when it comes to payment of service bills, and with his finding of 57 per cent of his sample earning less than R1000 per month in household income, it is not difficult to imagine the scale of the problem. Household debt keeps growing despite attempts to reduce consumption by encouraging people to cook less often and to make use of paraffin, candlelight and energy-efficient stoves, and by attempting to curb the illegal use of electricity Burger (2001:13).

The study now look at the third section of Section 3, namely financial systems and controls.

6.3.3.23 Interpretation of Responses to Questions 3.17 to 3.22

Section 64 of the MFMA (RSA, 2003) guides municipalities to ensure that the fees levied are cost reflective and collected and accounted for based on the systems of internal controls. With regard to Question 3.17, 70 per cent of the respondents agree that municipalities have acquired a financial solution to revenue and debt. Conversely, for Question 3.19, 70 per cent of respondents agree that municipalities lack the capacity to manage their financial systems. This can be attributed to poor collections, poor management of indigents, and poor implementation of municipal policies on debt management.

As indicated in paragraph 4.3.2 of Chapter 4, as well as USAID (2010:15), effective financial control systems are critical to an efficient billing process. Factors needed for an effective financial control system include the following:

- Financial staff must have access to certain functionalities on the software system, such as passwords;
- A password or biometric protection system is required; and
- Supervisors should be given the authority to open and close accounts and/or change the account status.

The financial controls recommended by USAID (2010) should also be applied at South African municipalities.

In addition to the above, the National Treasury (2011c:41) supports that the municipal billing process requires a number of processes to be completed, including the finalisation of each billing run, and the capturing of all receipts, meter readings, electronic fund transfers (EFTs) from financial institutions, and journals and credit notes. Further information technology processes include the compilation of pre-billing reports, variance reports and backup bills, the production of audit reports, the verification of reports, and the preparation of files for bill printing and rollover to the next period (USAID, 2010:16).

Section 3 of the questionnaire investigated the perceptions of municipal managers and CFOs regarding debt management and how this pertains to service delivery and financial systems and controls. The same process applies to municipal policies.

6.3.3.24 Interpretation of Responses to Questions 3.23 to 3.30

Sections 96 and 97 of the MSA (RSA, 2000a) provide for the debt collection responsibility of municipalities, as well as municipalities' ability to adopt, maintain and implement a credit control and debt collection policy. In terms of Section 96(a) of the MSA (RSA, 2000a) a municipality must collect all monies due to it, subject to the provisions contained elsewhere in the Act and any other applicable legislation. Furthermore, Section 96(b) of the MSA (RSA, 2000a) provides that a municipality must adopt, maintain and implement a credit control and debt collection policy, which is consistent with its rates and tariff policies and which complies with the provisions of the MSA (RSA, 2000a).

Section 97(2) of the MSA (RSA, 2000a) provides that a municipality's credit control and debt collection policy may differentiate between various categories of ratepayers, users of services, debtors, taxes, services, service standards and other matters, as long as the differentiation does not amount to unfair discrimination. In this regard, municipalities must comply with national government legislation, as well as their own adopted by-laws. With regard to questions 3.23 and 3.27, 74 per cent of respondents agree that their municipalities have implemented the necessary credit and debt control policies. This is contrary to the responses to Question 3.28, with only 50 per cent of the respondents agreeing that such policies had been promulgated in compliance with

Section 75 of the MSA (RSA, 2000a). This could be another obstacle for municipalities in terms of collecting revenue from consumers for the services provided.

6.3.4 Interpretation of Responses to Section 4

Section 4 of the questionnaire was designed to investigate the perceptions of municipal managers and CFOs regarding meeting procedures and reporting. Questions in this section elicited information based on four different areas.

Table 6.7: Findings on Meeting Procedures and Report Writing

Item Description	Very Competent	Competent	Not competent enough	Yes	No	Find it problematic
4. Meeting Procedures and Report Writing.						
4.1 How competent are you in chairing meetings effectively.	**10**	**8**	**2**			
4.2 Do you require training in meeting procedures.				**14**	**6**	
4.3 How competent are you in writing a report.	**9**	**9**				**2**
4.4 Do you require training in report writing.				**5**	**15**	

Table 6.7 above shows that 18 of the 20 respondents claim to be competent in meeting procedures and report writing. This could be supported by the fact that 19 of the 20 municipal managers and CFOs have a university qualification. Only two of the 20 respondents indicated that they find this aspect problematic.

Five respondents requested further training. It should be noted that, given the fiscal and administrative responsibilities of municipal managers and CFOs, reporting and writing are not core functions of these top-level officials and are usually performed by their secretaries or personal assistants.

However, the scholar engaged the respondents in this regard, because they are accountable for this assignment and as such should take this responsibility seriously.

6.3.5 Interpretation of Responses to Section 5

Section 5 of the questionnaire was designed to investigate the perceptions of municipal managers and CFOs regarding financial management and budgeting. The respondents answered 11 questions in this regard, as portrayed in Table 6.8.

Table 6.8: Frequencies Pertaining to Financial Management and Budgeting

Item Description	Very Familiar	Familiar	Very Important	Important
5. Financial Management and Budgeting.				
5.1 How familiar are you with the Municipal Finance Management Act, 56 of 2003 (MFMA) and its requirements.	**13**	**7**		
5.11 How familiar are you with the Preferential Procurement Policy Framework Act, 5 of 2000, its regulations and its requirement.	**13**	**7**		
5.2 How important do you regard your role in the implementation of the MFMA.			**18**	**2**
5.9 How important do you regard the role of the AGSA in municipal financial management.			**18**	**2**

Table 6.8 is a summary of the responses to the four questions above. Descriptive statistics, namely frequencies, are displayed. The observed frequencies among the four questions in this section revealed that most responses were similar to 20 observations. For questions 5.1 and 5.11, all 20 respondents stated that they are familiar with the legislation. Similarly, in terms of recognising the importance of fiscal legislation, all were able to identify their revenue streams and 18 were able to respond to accountability. It seems that municipal managers and CFOs are knowledgeable about fiscal legislation within the local government sphere. It is imperative that municipal managers and CFOs also apply this knowledge in the workplace.

Table 6.8: Frequencies Pertaining to Financial Management and Budgeting (Continued)

Item Description	Equitable Share	All sources	Treasury	Municipality	The people	Very effective	Effective	Not so effective	Yes	No
5. Financial Management and Budgeting.										
5.3 What are the revenue sources of your municipality.	**2**	**18**								
5.4 In your opinion, to whom does the money the municipality receives as revenue belong.			**2**	**1**	**17**					
5.5 How effectively can you analyse and interpret the financial statements of your municipality.						**9**	**9**	**2**		
5.10 Do you require training in financial management and budgeting.									**14**	**6**

MFMA Circular No. 51 (National Treasury, 2010b) requires that municipalities prepare balanced budgets. The scholar supports the notion that municipalities must make reasonable estimates of income and match these to anticipated expenditure. With regard to questions 5.3, 5.4, 5.5 and 5.10, all participants have an exceptionally good understanding of financial management and budgeting, as well as the interpretation of financial statements. Given the current pace of change in the local sphere, it is reasonable that 14 of the 20 respondents requested further and more up-to-date training (Question 5.10).

Sections 18(1) and (2) of the MFMA (RSA, 2003) require that the municipal budget may only be funded from the following sources:

- Realistic anticipated revenues to be collected;
- Cash-backed accumulated funds from previous surpluses not earmarked for other purposes; and
- Borrowed funds, but only for the capital budget referred to in Section 17(2) of the MFMA (RSA, 2003).

The FFC (2010:157) further suggests that South Africa should follow a sustainable pro-poor growth pattern. Unless municipalities exercise fiscal discipline by spending their funds on budgeted programmes and projects, the majority of vulnerable people will be exposed to harsher realities of poverty and unemployment, and the municipalities' revenue basis will diminish.

Table 6.8: Frequencies Pertaining to Financial Management and Budgeting (Continued)

Item Description	Very good	Good	Not so good	Qualified	Unqualified	Disclaimer	The survey serves a good purpose	The questionaire address relevant issues
5. Financial Management and Budgeting.								
5.6 How well can you monitor the implementation of the budget through financial reports and thereby evaluate the financial performance of the municipality.	5	13	2					
5.7 What was the most positive audit opinion that your municipality received recently from the Auditor General South Africa (AGSA).				10	1	9		
5.8 What is the best opinion the AGSA could express.							15	5

Of concern is the responses received specifically in respect of audit opinions, thus contributing towards the poor audit outcomes of municipalities in the Free State Province. With regard to budgets and supply chain management, the responses were positive; however, the implementation and application thereof remains a challenge, given the deficit in the cash position and management of the budget.

6.3.6 Interpretation of Responses to Section 6

Section 6 of the questionnaire was designed to obtain the opinions of respondents. The questions in this section elicited information based on six different items.

With regard to the statement "The survey serves a good purpose", 75 per cent of respondents agree. The researcher received a positive response from the majority of respondents.

The most important factors from the empirical study that should be included in the model are cash management, revenue management, customer relations, credit management, indigent management and community consultation.

6.4 SUMMARY

This chapter outlined the research methodology followed in the study and also discussed the analysis and interpretation of the data, giving empirically derived observations in each case. The demographic profile of the respondents was firstly examined, and the local government municipal managers and CFOs were provided with an explanation as to the nature of the study and the purpose of the research.

Respondents were asked to complete the questionnaire at their respective municipalities and to return them to the researcher by fax or e-mail. As the forms were returned, the regions from which they came were marked off for record purposes. The anonymity of the employees was assured as far as possible, since the researcher had access to the respondents' confidential data.

In Section 3, Cronbach's alpha calculations were done for the four individual groups, with the 20 answers per question in each respective section rendering the calculations informative.

Municipalities are the custodians of public funds, whether raised from their own revenues or received through intergovernmental grants. They are tasked with using these resources to respond to the needs of their communities in terms of infrastructure, local services such as water, electricity and refuse removal, and the enabling and guiding of the spatial development of their localities. Although municipalities are entitled to a share of the national fiscus, this share is mostly used to sustain municipal administrations, rather than to fund service delivery projects. The main sources of revenue for municipalities are user charges and funds generated by the sale of water and electricity. In most cases, the local authority enters into a contract to supply goods and services and then bills the beneficiary based on the conditions of the contract.

This does not mean that municipalities are always delivering effectively and that consumers are always at fault in terms of non-payment. The provision of basic services such as electricity, water and sanitation, refuse and waste removal is critical for the people living in the areas serviced by municipalities. If consumers cannot afford to pay for services, they simply have no means of doing so – contrary to what has been argued by some other researchers. It appears that the central problem of non-payment stems from deepening poverty amongst non-payers, making this a problem of "an inability to pay" rather than a problem of "a culture of non-payment" (refer to paragraph 5.9 of Chapter 5).

In light of this study, it is crucial for essential services to be made more affordable to poor households, if the promise of service access for all is to be kept. Also, there is a need for major debt relief to service arrears due the unconstitutional practices in terms of household evictions, water and electricity cut-offs, etc., since these practices are simply not sustainable either socially, morally or economically.

If the problem of non-payment persists, the government will be faced with a situation where all major public utilities are likely to incur significant and possibly unsustainable losses due to non-payment. This could lead government to support these utilities by subsidising them and accepting lower returns. Consumers should bear in mind that if the current trend of non-payment for services continues, a collapse in service delivery will become inevitable.

Chapter 7 provides a summary of the study and outlines the key findings, with particular conclusions being drawn and recommendations made regarding municipal debt.

CHAPTER SEVEN : CONCLUSIONS AND RECOMENDATIONS

7.1 INTRODUCTION

The Constitution (RSA, 1996) commits government to take reasonable measures, within its available resources, to ensure that all South Africans have access to adequate housing, health care, education, food, water and social security.

Local government is at the heart of development as it attempts to translate these national priorities into achievable goals for all citizens. Currently the National Development Plan (NDP), supported by the New Growth Path, highlights the importance of social and economic reforms. The Minister of Finance, in his 2013 budget speech (Gordhan, 2013), indicated that a new local government equitable share formula is proposed, providing a subsidy for free basic services designed to reach 59 per cent of households. It is imperative for government in mobilising municipalities that their viable and future sustainability is guaranteed for citizens. The translation of national imperatives into grassroots successes needs to be supported by legislation. Municipalities need good legislation to make sure communities are well planned, responsibly administered and accountable to their citizens.

The following sections of Chapter 4 of the MSA (RSA, 2000a) focus on community participation:

- Section 16: Development of culture of community participation
- Section 17: Mechanisms, processes and procedures for community participation
- Section 18: Communication of information concerning community participation
- Section 19: Public notice of meetings of municipal councils
- Section 20: Admission of public to meetings

Section 16(1) of the MSA (RSA, 2000a) comprehensively addresses participation by the community in local decision-making. Cognisance is given to those who cannot read or write, women, people with disabilities and other disadvantaged groups. Although South Africa has highly progressive legislation with regard to community participation, daily media reports are centred on violent strikes and protest action by communities to communicate their dissatisfaction with service tariffs and service delivery by local government.

This chapter is the final chapter in the study. It succeeds the analyses and interpretations that were concluded in Chapter 6. The findings are used and linked with the literature reviewed to make some recommendations as part of the objectives of the study. Recommendations about further research areas related to this study are also identified and proposed. It is important to acknowledge the limitations of the study, because this enables the reader to become conscious of the shortcomings of the study, which adds to the credibility of the findings. In Chapter 7 particular conclusions are drawn and recommendations are made regarding municipal debt and the debt position.

7.2 RESEARCH OBJECTIVES

As indicated earlier, an attempt was made to reflect on the extent to which the research objectives have been realised in Chapter 1. The main aim of the study was to develop an integrated debt management model for municipalities in the Free State Province. The study attempted to investigate the implications of effective debt management for service delivery within selected municipalities in the Free State Province. Emerging from the above, the aims of the study had the following co-objectives:

- To investigate, through the extensive literature, legislative frameworks and policy guidelines, the requirements, and principles of municipal financial management, municipal revenue, debt management and the local and international municipal funding models;
- To determine, through an evaluation of the municipal financial reports from 2009 to 2012, as well as through structured interviews in the selected municipalities, the current debt management challenges and the impact on effective service delivery of municipalities in the Free State Province;

- To conduct a comparative analysis between Free State municipal debt with municipalities in other provinces;
- To test dependence of debt management to service delivery, municipal policies, financial systems and controls;
- To make specific recommendations based on research findings in view of improving effective debt management in municipalities; and
- To develop an an integrated debt management model for the Free State Province municipalities based on the literature analysis and empirical study.

7.2.1 Objective 1: To investigate, through the extensive literature, legislative frameworks and policy guidelines, the requirements, and principles of municipal financial management, municipal revenue, debt management, and local and international municipal funding models

In Chapter 2 of the study, an extensive theoretical review of related literature was conducted, using both national and international sources. The literature review involved the use of primary sources such as government reports, legislative frameworks and government databases. The literature review also involved secondary sources such as journal articles, books, conference papers, dissertations, theses, internet sources and data from the Local Government Database (National Treasury, 2013a). The literature review enabled the researcher to identify shortcomings in the literature concerning debt management in municipalities.

7.2.2 Objective 2: To determine, through an evaluation of the municipal financial reports from 2009 to 2012, as well as through structured interviews in the selected municipalities, the current debt management challenges and the impact on effective service delivery of municipalities in the Free State Province

Chapter 3 of the study explored in detail the financial requirements of the MFMA (RSA, 2003) and the National Treasury (2005a) in preparation of municipal annual budgets. In addition the municipal budget cycle was discussed. The detailed functions of councillors with regard to the annual budget were also discussed. The chapter discussed the linkage between budgets, service delivery and municipal debt, plus the underperformance of actual collections against billed revenue in the operating budget, attributed to, amongst other things, the affordability of municipal services. To further satisfy this objective the researcher detailed, in Chapter 4, the debtor management cycle, the debtor control system, an evaluation of municipal debt over three years, and the socio-economic impact on debt and the impact on municipalities achieving the MDG goals. The chapter also provided debt challenges at municipalities and international remedies and treatment of municipal debt. In Chapter 6, more specifically section 6.3.1, the study calculated the perceptions of debt management impact on service delivery, based on the responses to the eight questions in the service delivery group of the questionnaire (Cronbach's alpha at 0.92).

7.2.3 Objective 3: To conduct a comparative analysis between Free State municipal debt with municipalities in other provinces

In Chapter 5, Table 5.2, the study showed the total outstanding debt owed to the municipalities for each of the nine provinces over the period 2009 to 2012. Gauteng Province had the highest debt owed to municipalities at R35 billion, followed by KwaZulu-Natal Province at R9.9 billion. The total amount owed to municipalities in Free State grew from R3.2 billion in 2009 to R6.4 billion in 2012. Figure 5.3 in Chapter 5 showed that Free State municipalities are owed R6.4 billion compared to the total debt owed to municipalities in South Africa at R77.6 billion, indicating municipalities are struggling to collect revenue for services.

7.2.4 Objective 4: To test the dependence of debt management to service delivery, municipal policies, financial systems and controls

Based on all data obtained from the completed research questionnaires that were distributed to municipal managers and chief financial officers in the selected municipalities in the Free State Province, Chapter 6, Table 6.1, presented a statement of findings and an analysis of data received from the interviews at selected municipalities, which illustrated the tests for relationships between the 29 respective items in section 3 of the questionnaire to question 3.1, "The municipality has experienced debt problems in the last three years". The sampled municipalities reflect (alpha = 0.05) that debt management (3.1) is not independent of cash flow (3.2), cash back reserves (3.3), cash coverage (3.4) and debt problems (3.5) at municipalities in the Free State.

7.2.5 Objective 5: To make specific recommendations based on research findings in view of improving effective debt management in municipalities

These are discussed in Section 7.4.

7.2.6 Objective 6: To develop an integrated debt management model for the Free State Province municipalities based on the literature analysis and empirical study

The integrated debt management model are discussed in Section 7.5.

7.3 REVIEW OF THE CHAPTERS

The purpose of the study was to develop an integrated debt management model for municipalities in the Free State Province. The study attempted to investigate the implications of effective debt management for service delivery within selected municipalities in the Free State Province. The thesis on this study was divided into seven chapters. Chapter 1 introduced the study by discussing the background to the study, outlining the problem statement, research methodology, research question, research design, ethical considerations, as well as operational definitions used in the study. In the second chapter an extensive review was given of literature related to the subject of governance in the financial administration of municipalities. The chapter provided the legislative framework for local government financial administration as well as the statutory roles, responsibilities and duties of officials and structures, followed by a discussion about revenue management and administration of debtors and funding models for municipalities. The third chapter provided an overview of local government financial management and the challenge of debt management. Aspects discussed in this chapter included the policy framework of financial management and the requirements of the MFMA (RSA, 2003) in preparation of the annual local budget, the budget cycle and the composition of the budget. In addition, the chapter detailed the roles and responsibilities of both the political and administrative functionaries at a municipality in terms of the budget. The fourth chapter outlined the debtor management cycle, the debtor control system, an evaluation of municipal debt over three years in the Free State Province, the socio-economic impact on debt and the impact on municipalities in achieving the MDG goals. The chapter concluded by providing the debt challenges at municipalities and the international remedies for and treatment of municipal debt. Chapter 5 provided a comparative study, using secondary data from the National Treasury database, on the debt position of Free State municipalities compared to the municipalities in the other eight provinces. In the sixth chapter, the research methodology that was employed in the study was discussed, including the analysis and interpretation of the data. Chapter 7 concluded the study by discussing the conclusions drawn from the study, suggesting some recommendations and highlighting the limitations of the study, as well as the implications for further research.

7.4 RECOMMENDATIONS FROM LITERATURE REVIEW

According to Fourie *et al.* (2011:238) all municipalities in South Africa are faced by one of the most critical risks, namely their inability to collect revenue due to them for services rendered to the communities they serve.

The Constitution (RSA, 1996) empowers municipalities, in terms of Section 229, to levy the charges, and Section 64(a) of the MFMA (RSA, 2003) requires municipalities to have effective systems to bill and collect revenue. Sections 96 and 97 of the MSA (RSA, 2000a) provide for the debt collection responsibility of municipalities, as well as their ability to adopt, maintain and implement a credit control and debt collection policy. Section 64 of the MFMA (RSA, 2003) requires municipal managers to have effective revenue collection systems and effective credit and debt control policies. Section 60 of the MFMA (RSA, 2003) places responsibility on the municipal manager as the accounting officer to ensure that a municipality has and implements a credit control and debt collection policy.

Municipal councils as custodians of municipal policies should establish structures that will enable community participation. Local government should be transparent; this means that it has to make its information available to the community, by making income and expenditure statements to the community as prescribed by Section 75 of the MFMA (RSA, 2003). If information is not available to communities, the participation of and engagement with communities will not be effective. The MFMA (RSA, 2003) requires the municipal manager and chief financial officer of a municipality to exercise the functions and powers assigned to them in terms of Section 64 of the Act.

In light of the above, Van der Waldt *et al.* (2007:199) mention that the accounting officer of a municipality is responsible for the management of the revenue of its municipality. Van der Waldt *et al.* (2007:199) further hold that the accounting officer must take all reasonable steps to ensure that:

- The municipality has effective revenue collection systems consistent with the municipality's credit control and collection policy;
- The revenue due to the municipality is calculated on a monthly basis;
- The accounts for municipal tax and charges for municipal services are prepared every month, or less often if the monthly accounts are uneconomical;
- All money received is promptly deposited into the municipality's bank account;
- The municipality maintains its management, accounting and information systems that recognise revenue, account for debtors, and account for receipts of revenue;
- The municipality maintains its systems of internal control over debtors and revenue;
- The municipality charges interest on arrears except in cases where the municipal council has granted exemptions in accordance with its budget-related policies; and
- All revenue received by the municipality, including revenue received by any collection agents on its behalf, is reconciled on a weekly basis.

Van der Waldt *et al.* (2007:198-199) state that municipal councils must adopt by-laws to give effect to the credit control and debt collection policy, as well as to ensure that it is implemented and enforced. Fourie *et al.* (2011:239) further hold that Section 97 of the MSA determines that a municipality's credit control and debt collection policy must be consistent with a municipality's rates and tariff policies and must provide for the following:

- The credit control procedures and mechanisms;
- The debt collection procedures and mechanisms;
- To make provision for indigent debtors, consistent with its rates and tariff policies, including any national policy on indigents;
- To set realistic targets consistent with generally recognised accounting practices and collection ratios, including estimates of income set out in the budget, less any acceptable provision for bad debts;
- To make provision for interest on arrears;
- To make provision for extension of time for the payment of accounts;
- To terminate services or restrict the provision of services when payments are in arrears;
- To make provision for matters related to unauthorised consumption of services, as well as theft and damages; and
- To make provision for any other matters that may be prescribed.

De Villiers and Michel (2006:8) indicate that residents cannot tolerate poor services for their money. People inevitably have different perspectives on what is important to them and it depends heavily on their income, social status, time perspective and level of development. Effective service delivery is enhanced by technical competence, friendliness, speed, correctness and overall effectiveness in forming a total positive image or perspective by the user (De Villiers & Michel, 2006:8).

Of the total outstanding debt owed to the municipalities for each of the nine provinces, Gauteng had the highest debt owed at R35 billion, followed by KwaZulu-Natal at R9.9 billion. The total amount outstanding to municipalities in the Free State grew from R3.2 billion in 2009 to R6.4 billion in 2012. This represented an increase of 98.3 per cent from 2009 to 2012 compared to a 54 per cent increase in the national total over the same period. Similarly, the increase in the outstanding debt for KwaZulu-Natal from 2011 to 2012 at 38 per cent was significantly higher than the national total (20 per cent) at 18 per cent. This indicate that municipalities are in a debt position and are barely sustaining their operational costs, relying on nationally raised resources for their basic services and capital infrastructure projects, legislated each year in the annual Division of Revenue Act.

The recent community boycotts and protestations on service delivery in 2012 were another indication that the pace of service delivery was lagging. In addition, the MDGs can only be achieved if there is demonstrated commitment by both parties. If these are not addressed the implications will be that the Free State Province will not be able to attain the MDGs. These results can be extrapolated for all 278 municipalities in the country.

The problem of non-payment also stems from the "culture of entitlement" and dependency, which further regresses the municipalities' debt position and declines their cash position. It is argued that many people believe that public services are a basic right and should not be paid for. Many people are too dependent on government; they think that they are entitled to get the services free of charge (Fjeldstad, 2004:8).

In a survey conducted by the researchers, it was found that in urban municipalities many households and individuals who can pay for the services opt for a "free ride" because the basic behavioural assumption is that people are "free riders".

South Africa is faced with high rates of unemployment and poverty, which reduce the ability of households to pay for the services delivered by their local authorities. The poverty rate is increasing year-on-year, suggesting that the situation is deteriorating. This makes it even more likely that households will be unable to afford to pay for services. In addition, the high levels of dissatisfaction with customer services seem to strengthen the inclination to sacrifice payments. Chapter 5 of the thesis indicated that unemployment rates rose for all the Free State municipal districts and for the province between the years 2000 and 2002, stabilising in the following two years (2003 – 2004) and steadily declined for the next four years (2005 – 2008), with the exception of the Lejweleputswa District, which saw volatile unemployment rates between 2002 and 2005 and a gradual decline until 2008. The Lejweleputswa and Thabo Mofutsanyana district municipalities have both over this twelve-year period consistently exhibited unemployment rates well above the provincial rate, with Lejweleputswa's unemployment rate being the highest throughout the period, followed by the Thabo Mofutsanyane District. This could be the contributing factor in growth in the debtor's book and indigent base at municipalities in the Free State.

According to Section 96 of the MSA (RSA, 2000a), municipalities' customer care and debt management practices should be stipulated in their credit control and debt collection policies, revised annually, and supported by the relevant by-law.

Municipalities must compile and maintain the 'municipal code', which comprises all the by-laws, and the public must be able to request copies of the municipal code information at a reasonable fee.

- The municipality should document the procedures that it follows to give effect to the policies and by-laws that it has adopted.
- The introduction of consolidated billing would facilitate the debt collection process.
- When customers only pay their municipal accounts in part, their payment is allocated in a specific order, and the electricity service is usually used as leverage to collect the balance of the amount due.
- It is imperative that municipalities ensure accurate billing information before pursuing credit control measures such as disconnection of electricity.
- Amounts due for municipal services, property rates and other property taxes are a charge upon the property, and municipalities should use this provision to ensure the collection of outstanding debt and the timely registration of property owners.
- Where there is outstanding debt on property that is older than the two-year minimum period, the municipality must endorse the revenue clearance certificate to confirm that there is debt older than two years and that the new owner will inherit the debt.

- It is useful for officials working in revenue management, particularly those involved with the legal process, credit control and clearances, to familiarise themselves with all judgments that may have an impact on the municipality's credit control and debt collection activities.

7.5 RECOMMENDATIONS FROM EMPIRICAL STUDY

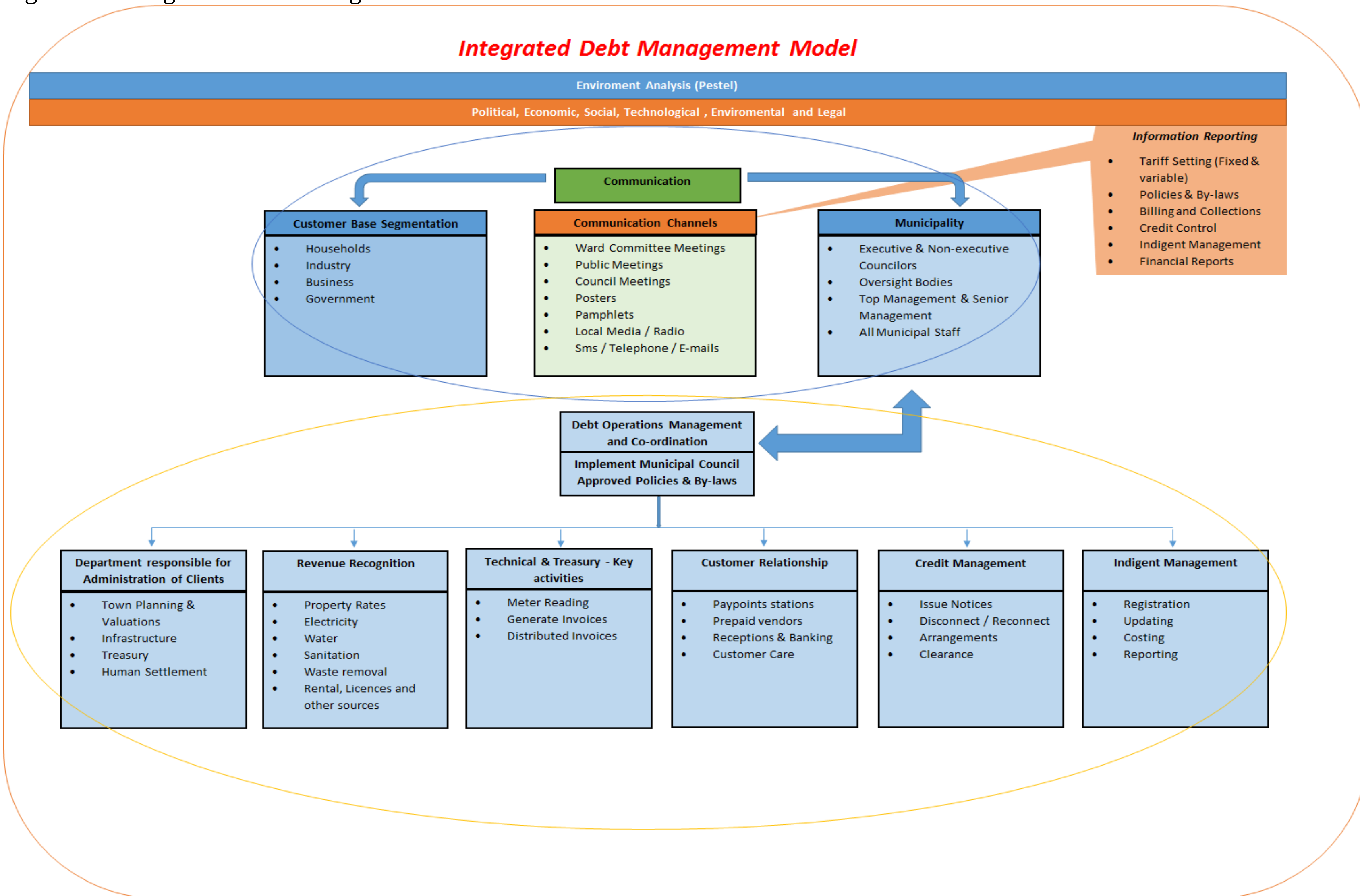
The municipalities are still utilising conditional grants to fund the operational expenditure indicating that municipalities are not adequately collecting own revenue and this is having had adverse effect on service delivery.

In addition, the inefficiencies on financial disciplines, policy management and internal controls also compromise own collections. The researcher concluded that there is a strong relationship between debt management, service delivery, municipal policies, financial systems and controls, refer to Section 6.3.1.

7.6 INTEGRATED DEBT MANAGEMENT MODEL

The main aim of the study was to develop an integrated debt management model for municipalities in the Free State Province. The integrated debt management model was developed based on the literature study and empirical findings. The integrated debt management model focuses on maximising revenue collection. A holistic approach for municipalities' sustainability is crucial in ensuring that all the critical elements are simultaneously addressed. The model may seem simple to implement; however, cognizance should be taken of the diverse political nature and social-economic status of the municipal customer base. The model is presented and discussed below.

Figure 7.1: Integrated Debt Management Model



Source: Researcher's own interpretation

- ### Communication

A comprehensive communication strategy was fundamental to building a relationship between the municipality and its clients or the community it serves. It is only through communication that customers' and municipalities' expectations can be clearly articulated and understood by all the partners. Municipal office-bearers, officials and communities should build and foster a cordial relationship and be equally accountable and responsible for the efficiency of services and the collection of revenue in the municipal jurisdiction.

Both players in the municipal space need to understand that communication is a two-way process and involves community participation, which is enshrined in the Constitution (RSA, 1996) and MSA (RSA, 2000a). The communication process should facilitate alignment between municipal expansion targets and community expectations on service delivery. Furthermore, it is only through continuous communication that the relationship between the municipality and its customer can be enhanced and that service delivery, investment, employment opportunities and sustainability of municipalities can be advanced. The model provides communication modes that can be used by both the municipality and the community during progressive participation engagements.

- ### Tariff setting

The municipality and consumers must set realistic tariffs by:

– Understanding the demand (number and type of consumers, levels of service to which they have access, and the current levels of consumption of services)

Determined what the real cost for providing a service, including:

– Direct costs (employee-related costs, bulk purchases, repairs and maintenance, contracted services, other costs, etc.)
– Overheads (costs of running the municipality as a whole)

- Capital financing costs (external interest, depreciation, provisions to capital reserves)
- Adequate budget for all expenditure required (if budgets are inadequate, costs will be under-provided for and tariff revenues will not be sufficient)
- Cost classification (i.e. variable costs versus fixed costs).

The second step once the demand was understood and the costs of providing the service are determined, is to calculate the tariff to fully recover costs (primary baseline tariff). The primary baseline tariff is calculated as the total cost divided by the number of baseline units. Two types of baseline units for water and electricity are the number of consumers served and the unit of consumption (kl of water or kWh of electricity). For water and electricity, the baseline tariff has a fixed and variable component. The fixed component is the fixed costs divided by the number of consumers, and the variable component is the variable costs divided by the total consumption of services (including any consumption that is given away free of charge), resulting in a baseline tariff that is the same for all consumers and which covers all costs. Tariffs should also be monitored and reviewed annually and should not only be inflation adjusted.

- **Policies and by-laws**

Municipalities must adhere to Sections 95(d) and (e) of the MSA (RSA, 2000a) and take reasonable steps to ensure that the consumption of services by individual users is measured through accurate and verifiable metering systems, and ensuring that persons liable for payments receive regular and accurate accounts that indicate the basis for calculating the amounts due. In addition municipalities are also required to have policies and by-laws in terms of Sections 74, 96 and 98 of the MSA (RSA, 2000a) respectively.

- **Billing**

Accurate billing for services was a critical element of the municipal debt model. Due to poor billing and revenue collection, municipalities are becoming increasingly dependent on intergovernmental funding to balance their budget. The model recommends the following for effective billing of consumers:

- The customer's property information must be accurate and the municipality must have signed an agreement with the customer for services to be provided to their residence.
- The municipal tariffs must be reflective of their policies, and by-laws must be also in place.
- Property tariffs must be cost reflective using variables such as land usage, debtor type (business or residence etc.), land zoning, and service type. The valuation roll should link to the customer base of a municipality.
- The inclusion of accurate ward information per property.
- Adherence to the municipality's steps in the process of opening and closing accounts.

Other important factors for effective billing are technology (billing system) and effective control. Technological not only contributes to effective billing but also promotes financial integrity. Successful billing is therefore mostly a function of the accuracy of the data input into the system. Systems and controls need to supplement the financial software to ensure complete and accurate billing.

- **Credit control**

Revenue collection was based on the integrity of the two components of metered service and billing. This critical element includes the collection of revenue, customer management, debt and credit management, and indigent registration and management. Effective credit control is a service delivery imperative, as municipalities can only pay for bulk purchases, maintain infrastructure and fund new infrastructure if their own revenue and credit control activities function effectively. Effective credit control and debt collection are key to the sustained financial viability of municipalities. Credit control and debt collection policies have value only if implemented effectively. The effectiveness of implementation depends on the ability of a municipality, which includes competent and experienced officials tasked with implementation and enforcement, appropriate systems and procedures, and political will and support. Section 96 of the MSA (RSA, 2000a) requires all municipalities to collect all outstanding debts. The MFMA (RSA, 2003), in Sections 62(1), 64(1), and 96(b), regulates the collection and management of municipal revenue.

The most crucial aspect of a credit control and debt collection process is that it must be planned thoroughly, controlled well and followed diligently. It is important that all officials within the municipal treasury department are aware of their roles and of their place in the overall plan.

Step 1:

The details of the consumers in arrears must be extracted daily from the financial system and imported into the credit management system.

Step 2:

All transactions pertaining to these accounts must be transferred from the billing system to the credit control system on a daily basis. This is done to ensure that the arrangements can be monitored and that paid-up accounts are removed.

Step 3:

Financial systems must be updated with data feedback such as information on municipal costs, arrangements, indigents, summonses and accounts handed over to attorneys.

Step 4:

The municipality are advised to take the following actions, to be included in the council-approved policies:

- Electricity cuts;
- Pre-paid meter blocks;
- Water restrictions;
- Summonses; and
- Judgments.

On-site inspection should be conducted to determine whether the services have been illegally reconnected. If illegal reconnection or tampering is detected, the consumer must be subjected to a much stricter disconnection/restriction process, which may involve either a by-law process or a specialised debt collection process. If reconnection persists for electricity, the circuit breaker should be removed and a harsher sentence should be imposed in that the municipal council can approve that the supply line is permanently removed.

- **Indigent management**

Due to the level of unemployment and poverty within municipal areas, there are households that are unable to pay for basic services, and are referred to as 'indigents'. A municipality is required to adopt an indigent policy to ensure that indigents have access to services. Municipalities should use their own discretion in compiling the criteria to identify indigents, as there are varying conditions amongst municipalities. However, the following criteria can be applied by a municipality as a boundary within which the municipality's own indigent definition can be developed:

- South African citizenship (applicants must have valid identification documents, and if not an SA citizen, the applicant should provide proof of refugee status).
- Applicant must reside in a dwelling (services are provide to a household), and applicants residing in informal settlements should be eligible to qualify.
- Applicant must provide proof that they cannot afford to pay for the services, by submitting a UIF card, bank statements and proof of income.
- The combined monthly household income of the applicant should not be higher than the amount specified in the municipal indigent policy. In terms of the Framework for a Municipal Indigent Policy (DPLG, 2005a) the limit should be the state pension x 2 (R1200 x 2 = R2 400) per household. This threshold must be reviewed annually.
- Child-headed households should be regarded as indigents.
- Beneficiaries of state grants should be viewed as potential indigents, but their eligibility must be tested or verified.

Schedule 2, Section 10 of the MSA (RSA, 2000a) states that a staff member of a municipality may not be in arrears to the municipality for rates and service charges for a period longer than three months, and a municipality may deduct any outstanding amounts from a staff member's salary after this period. The municipality must uphold this conduct of officials and ensure that stop orders are implemented.

Section 102 of the MSA (RSA, 2000a) allows for the consolidation of separate accounts of persons liable for payments to the municipality, and municipalities can therefore credit a payment by such a person against any account of that person and implement any of the debt collection and credit control measures provided for in relation to any arrears on any of the accounts of such a person.

In light of the above, municipalities may cut off electricity if the account holder is in arrears with water or property rates. In cases where electricity is provided directly by Eskom to consumers, the municipality should include a clause in the agreement with Eskom that should an account holder be in arrears with water or property rates, Eskom will cut off the service to the consumer.

- **Debt operation management and co-ordination**

The operation management and coordination component of the model provides a framework to guide key activities and actions. Its success will depend on all role players taking responsibility for the model. To synthesis the model further, the researcher recommends that all departments within the municipality, as well as monitoring and oversight departments at national and provincial level, should be equally responsible for debt management and revenue collection at a municipal level.

Municipal trading and investment are key inputs in reshaping the municipal jurisdiction and political landscape. Most municipalities are in an urbanisation trajectory with a large youthful population, which presents an opportunity for municipalities to boost economic growth, increase employment and reduce poverty. The demand for municipal commodities places added pressure on municipalities to improve debt management and collection to redress historical infrastructure weaknesses and urbanisation service demands.

Technology continues to revolutionise, and municipalities must use debt management systems to further enhance their billing, collection strategies and processes. National and provincial monitoring and oversight departments must support municipalities with an innovative edge through investment in research and development in order to create more dexterous municipalities in South Africa.

This will ensure greater collaboration and outline achievable and relevant targets, which are quarterly performance measured to attain the desired outcome. In any democracy the link between the legislature and the executive is critical in ensuring that the executive is held to account, that policies are subject to rigorous debate, and that questions are asked when things go wrong. The non-executive councillors should maintain oversight over the executive. The municipal council must provide forums for rigorous debate and champion the concerns of citizens. This will promote a strengthening of relationships of trust and understanding between the municipalities and the communities they serve.

Figure 7.1 provides a coherent and holistic approach by identifying key departments and activities within the municipal organisation that will be responsible for debt management. For the model to be actioned, it is of utmost importance that the key municipal departmental heads and the executive have the necessary experience, expertise, ethic and sense of professional common purpose and a commitment to municipal debt management and revenue collection.

Municipalities contain a mix of high levels of wealth and also high levels of poverty and service-delivery backlogs. For municipalities to produce much of their economic wealth, they need to enhance their economic status. In addition, it is paramount for municipal political and administrative arms to protect the interests of the poor.

The researcher has commenced with piloting the integrated debt management model at Matjhabeng Municipality in the Free State Province, given there current defiencies in the revenue and debt management processes.

7.7 OTHER RECOMMENDATIONS FOR DEBT MANAGEMENT

The study has provided an analysis of the various issues relating to the non-payment of municipal services and debt in the Free State. It has demonstrated that the phenomenon of non-payment is not a "culture of non-payment" but one of non-affordability. Municipalities are faced with problems relating to resources, for example human, financial, knowledge and skills. These have impacted negatively on their ability to collect debt from consumers.

All municipal officials, together with the oversight departments, namely the Department of Cooperative Governance and Traditional Affairs and the National and Provincial Treasuries, must ensure that they are committed to the following recommendations in order to change the municipal or local government arena.

7.7.1 Possible Solutions to Non-payment

The steps identified to help improve the debt collection process include making an adequate and realistic provision for potential bad debts in the accounting records and financial statements; a review of standards; a national campaign that encourages payment; improved administration procedures; providing incentives in the form of tangible service delivery; greater emphasis on financial sustainability in planning processes; better use of technology; adoption of policy procedures; systems that are fair but which do not detract from the need to take legal and other actions, and linking bills to owners and not tenants. These must be done annually during the municipal budget preparation process that commences in August of each year, as required by Section 21 of the MFMA (RSA, 2003).

7.7.2 Non-payment of Debt

The steps identified to help improve the non-payment situation include service cut-offs that will force those affluent households that can afford to pay but opt to "free-ride" to pay their bills. Service cut-offs have become a major mechanism of payment enforcement in South Africa, but illegal connections have made the system ineffective. There should be follow-ups after a disconnection in an area or there should be a plan to make it impossible for any illegal connections to occur, such as removing the entire meter. Permanent cut-offs of basic services have been identified: shutting off services through the removal of cables and pipes; increasing reconnection fees, which are usually so severe that they effectively limit who can afford to reconnect; requiring residents to pay off outstanding payments before being able to reconnect; and self-disconnecting by prepaid meter (Ruiters, 2002:52-53).

7.7.3 Tariffs

Tariffs are a pricing system whereby the per-unit price of a service increases when more of the service is consumed, thus charging higher per-unit costs for a service for those who consume more in order to subsidise the costs of supply services to the poor. The rationale behind block tariffs is twofold: Firstly, they act as a cross-subsidisation mechanism by charging more for higher levels of consumption, and these revenues are then used to pay for the initial cheap or free blocks of consumption for poor households. Secondly, if done properly, block tariffs can curb over-consumption of environmentally sensitive resources such as water and electricity by acting as a price disincentive at higher levels of consumption.

According to the National Treasury (MFMA Circular 70, municipalities are advised to structure their 2014/15 electricity tariffs based on the approved 7.39 per cent NERSA guideline tariff increase and provide for an 8.06 per cent increase in the cost of bulk purchases for the tabled 2014/15 budgets and MTREF. Municipalities are urged to examine the cost structure of their electricity undertakings and apply to NERSA for electricity tariff increases that are cost reflective and ensure continued financial sustainability.

The National Treasury (2013c) supports the use of the following formula, proposed by NERSA, for calculating municipal electricity tariff increases:

$$MG = (B \times BPI) + (S \times SI) + (R \times RI) + (C \times CCI) + (OC \times OCI)$$

Where:

MG = % Municipal guideline increase

B = % Bulk purchases

BPI = % Bulk purchase increase

S = % Salaries

SI = % Salary increase

R = % Repairs

RI = % Repairs increase

C = % Capital charges

CCI = % Capital charges increase

OC = % Other costs

OCI = % Other costs increase

The formula for calculating the guideline:

MG = (B x BPI) + (S x SI) + (R x RI) + (C x CCI) + (OC x OCI)

= (70 x 8.06) + (10 x 6.5) + (6 x 5.5) + (4 x 5.5) + (10 x 5.5)

= 6.48 + 0.64 + 0.32 + 0.22 + 0.54

= 7.39%

Municipalities must familiarise themselves with the municipal tariff guidelines on electricity price increases, which include inclining block tariffs from NERSA (available at the following link: www.nersa.org.za).

Where a municipality's evaluation of its cost structure results in a lower or higher tariff increase to that proposed by NERSA, the municipality must structure its tariffs accordingly and ensure that it provides the necessary motivation and information in its tariff application to NERSA.

It is also important that any proposed IBT is fully aligned to the principles set out in the South African Electricity Supply Industry: Electricity Pricing Policy, including the principle that electricity tariffs must be cost reflective and that any cross-subsidies should be explicit. A municipality must structure its IBT tariff according to its own specific circumstances and ensure that it provides the necessary motivation and information to NERSA in its tariff application. In this regard, municipalities need to pay careful attention to determining an appropriate level of cross-subsidisation between the different IBT blocks given the profile of its customer base, and also have regard for the price elasticity of the demand for electricity.

Municipalities must review the level and structure of their water and sanitation tariffs carefully with a view to ensuring that:

- Water and sanitation tariffs are on aggregate fully cost-reflective – inclusive of bulk costs of water;
- The cost of maintenance and renewal of purification/treatment plants and network infrastructure, and the cost of new infrastructure, are taken into account;
- Water and sanitation tariffs are structured to protect basic levels of service; and
- Water and sanitation tariffs are designed to encourage efficient and sustainable consumption.

To mitigate the need for water tariff increases, municipalities must put in place an appropriate strategy to limit water losses to acceptable levels. In this regard municipalities must ensure that water used in their own operations is charged to the relevant service, and not simply attributed to water losses.

Municipalities must also calculate and report non-revenue water in accordance with the International Water Association standards, as required by the Department of Water Affairs (DWA), and should contact the DWA for assistance in this regard.

The tariffs for solid waste management must take into account that it is good practice to maintain a cash-backed reserve to cover the future costs of rehabilitating landfill sites. Municipalities are encouraged to explore alternative methodologies to manage solid waste, including recycling and incineration in plants that use the heat energy to generate electricity.

7.7.4 Free Services

Although a potentially important way of ensuring access for poor households, the current government priority looks unlikely to resolve the underlying crisis of cost recovery.

Part of the challenge here is the quality of the free services being offered. On the electricity side, 50 free kilowatt hours per household per month would provide some financial relief, but it is less than ten per cent of the average electricity consumption of low-income households in South Africa and barely enough to run a lightbulb and few small appliances. It would be difficult for municipalities to sustain this service given the major backlogs in the provision of this electricity in rural areas.

For water services, the 6000 free litres per household per month also offer little financial respite due to the fact that most poor households need much more than this amount of water, partly because of the large number of people per household. The 6000 litre figure is based on an average household size of eight people and works out to about 25 litres per person per day, half of the World Health Organisation's recommended minimum of 50 litres per person per day for basic needs and a healthy existence. However, municipalities must develop policies and controls to effectively manage indigents and impose severe sanctions on "free-riders".

Due to the economic downturn, the majority of rural households cannot afford to pay for these services no matter how hard they try, and some would have to give up other essential goods and services to be able the pay for services. The recommendation is that government should review the fiscal allocation for rural municipalities, while urban municipalities should self-financed.

7.7.5 Infrastructure

One solution for non-payment can be found in economic growth and job creation. Infrastructure is an important catalyst for economic growth and job creation; thus infrastructure development is essential. An improvement in the provision and maintenance of infrastructure reduces the degree of uncertainty and risk faced by existing and prospective investors. Any decrease in uncertainty is an incentive for investment. Should infrastructure not be maintained because of non-payment of services, municipalities are faced with the possibility of increased costs. Municipalities must ensure that adequate provisions are made in their annual budgets for renewal, repair, replacement and expansion of essential service delivery infrastructure.

7.7.6 Campaigns and Awareness Programmes

Awareness campaigns must be launched to inform people of the problems facing municipalities. Such campaigns must be used by municipalities as a way to reverse the culture of non-payment. Thus, if the people's mindset is put right regarding payments through such campaigns, non-payment will regress and become less of a problem for the South African government, since people could be encouraged and motivated to pay.

Unless the consumer debt trend is reversed as a matter of urgency, municipalities will not be able to make inroads into eliminating backlogs in development and service delivery. What is needed is a national coordinated approach to prevent further consumer debt escalation; otherwise, according to Yorke (2003:119), the future for municipalities will remain bleak.

7.7.7 Revenue Value Chain

The municipal revenue value chain reflects the interdependence of activities in the municipal revenue collection process. Every customer should have their own water and electricity account; customers should not inherit an existing water and electricity account from a previous owner or tenant of a property. When opening an account for the supply of water and electricity, the consumer must furnish the following basic information to be included in the contract:

- Copy of a valid South African identity document;
- Details of next of kin;
- Banking details;

- Contact details, including name, employer, employee number (Persal number in the case of government employees), telephone and cellphone numbers, physical and postal addresses, and e-mail address;
- Deposit amount (cash, cheque or internet banking);
- Copy of offer to purchase or deeds document;
- Meter number/s and latest readings; and
- Completed application form for the supply of water and electricity.

The value of the above information is heightened when consumers are assessed relative to equivalents for income groups, the median or some national norm/benchmark. Monitoring of trends represents what can be termed a more ex-post approach. McPhail (1993:969) suggests incorporating assessments of affordability and willingness to pay at the planning stage of a public good such as water or electricity, especially if the intention is to recover costs. The information can provide insight into potential service usage patterns and, therefore, the tariff to be charged in order to maximise cost recovery. In addition, government officials must lead by example in the payment of their consumer bills.

All problems identified and reported by meter readers, such as broken meters, leaking meters and inaccessible meters, must be reported to the technical department for follow-up. Reports of faulty meters must be reviewed on a monthly basis for follow-up and rectification. A monthly report must be printed on all debtor accounts where the meter has been changed, with confirmation of whether all the relevant information has been recorded correctly on the debtor's account.

Effective credit control is imperative as a disciplined process aimed at securing payment from consumers for services rendered by the municipality.

The Free State should take advantage of the large number of young people in the province for future economic benefit by providing them with better education and training. Making young people active in the economies of municipalities may contribute to a possible increase in the municipal revenue base in order to turn around the municipalities' debt burden.

The setting of affordable tariffs for the services provided is one of the most critical success factors in relation to revenue enhancement.

It is indicated that accurate billing is important in order to restore consumer confidence in the amount charged for services. Therefore, the selected municipalities need to have correct details of the customer's particulars regarding residential address and names. The other important aspect for the selected municipalities to consider is to determine if the tariff charges to particular customers are correct regarding the business tariff and the household tariff. Correct billing ensures satisfied customers.

Municipalities are reminded that the MSA (RSA, 2000a) states that municipalities must compile and maintain the 'municipal code', which comprises all the by-laws, and that the public must be able to request copies of the municipal code information at a reasonable fee. In compliance with the MSA (RSA, 2000a) the accounting officer at a municipality should consider the following:

- The municipality should document the procedures that it follows to give effect to the policies and by-laws that it has adopted.
- Consolidated billing facilitates the debt collection process.
- When customers only pay their municipal accounts in part, their payment is allocated in a specific order, and the electricity service is usually used as leverage to collect the balance of the amount due.
- It is imperative that municipalities ensure accurate billing information before pursuing credit control measures such as disconnection of electricity.
- Section 118(3) of the MSA (RSA, 2000a) stipulates that an amount due for municipal services, property rates and other property taxes is a charge upon the property, and municipalities should use this provision to ensure that they collect outstanding debt and register owners.
- Where there is outstanding debt on property that is older than the two-year minimum period, the municipality must endorse the revenue clearance certificate to confirm that there is debt older than two years and that the new owner will inherit the debt in terms of Section 118(3) of the MSA (RSA, 2000a).

Municipalities must effectively manage all functions that impact on them protecting and growing their revenue base. The implementation of internal controls along the revenue value chain will aid in effective data handovers, in utilising system data validation mechanisms and in ensuring that service level standards are fundamental to the integrity of billing data. Municipalities tend to neglect these basics and opt for costly 'data cleansing' exercises; however it is the protection of data integrity at the source that will yield longer-term benefits.

The following are fundamental in maximising the potential of existing revenue sources:

- The billing system must correctly reflect all billing data and customer data required to issue an accurate invoice on time to the relevant customer.
- All properties within the municipality's area of jurisdiction must be correctly valued, whether in the General Valuation Roll or Supplementary Valuation Rolls; and the billing system must be updated with any change in property ownership. This is necessary to grow and protect the municipality's property rates base.
- There should be effective business processes to ensure that new property developments and improvements to existing properties are valued as required and that billing records are updated accordingly; this requires good working relations between the municipality's town planning, valuations and revenue management functions.
- Correct categorisation of properties in terms of the Municipal Property Rates Policy; this impacts usage and property rates tariffs applied to the properties.
- Property usage must be correctly recorded so that the relevant property rates tariff is applied to the property; changes to property usage must also be communicated to the revenue function so that the billing system is updated.
- Water and electricity meter numbers must be recorded correctly and linked to the corresponding property on the billing system.
- Water and electricity meters must be adequately maintained to minimise losses due to leakages or incorrectly measured consumption.
- Water and electricity meters must be read with regularity and accuracy so that the correct consumption information is recorded on the billing system; meter reading estimates must

be minimised or at least undertaken in accordance with the municipality's Credit Control Policy prescriptions.

- Refuse and sanitation service charges must be included in the billing records.
- Billing records must be routinely reconciled to the source of the billing data and customer data.
- Billing queries must be resolved within reasonable timeframes.
- Municipal Revenue and Debt Units must be adequately staffed with competently skilled individuals who understand the job requirements and how to deliver on them.

7.7.8 Property Rates

In order to ensure that the property ratepayers are affordably charged, the MPRA (RSA, 2004a) empowers the minister of the department of CoGTA to determine the ratios to be followed when levying the charges for property rates among the residential and non-residential categories of properties. The determination of different ranges of property rates ratios ensures that the existence of public institutions referred to as 'public benefit organisations', such as schools and welfare and humanitarian organisations, is not jeopardised.

All municipalities are required to conduct a valuation of all properties in their respective areas and to keep a complete and accurate valuation roll indicating the market value of all the properties (RSA, 2004a:41). The valuation roll forms the basis of determining the charges of property rates to be paid based on the market value of the property. The information relating to each debtor is captured and maintained in a debtors' master file, or sub-ledger, on the municipality's database, and is used for billing purposes (Fourie *et al.*, 2007:170).

The municipality's budget finalisation process must include the passing of a resolution for the levying of property rates per category of property; this resolution must be promulgated in the provincial gazette upon ratification of the budget decisions.

7.7.9 Electricity Services

Quality supply of electricity services in a sustainable manner is an enormous responsibility that needs a well-capacitated and resourced municipality. Gower (2010:6) identifies three factors in the supply of electricity, referred to as non-technical losses, namely: database errors, faulty electrical installations and illegal connections, and meter tampering. It is recommended that the over-averaging of meters, in cases where the accurate meter reading data is unavailable, is also not a good practice since it actually projects inaccurate sales figures until the proper exercise of meter reading can be completed.

7.7.10 Water and Sanitation Services

Water is a scarce resource, especially in South Africa. Municipalities must ensure FBS provision to indigents only. The municipality must invest in infrastructure for water distribution to reduce bursts, leakages and thefts.

Fourie *et al.* (2007:169) state that sewage services include waterborne sewage disposal, vacuum or conservancy tanks, and bucket removals. The costs of these services can be calculated independently, e.g. the case of a waterborne system whereby the tariff is based on water consumption per residence or building.

7.7.11 Legacy Matters – Writing Off of Debt

Where the municipality identifies customers whose debts appear to be irrecoverable even after the entire credit control and debt collection process has been followed in terms of trying to obtain payment, then such accounts should be regarded as irrecoverable. Once a debt has been identified as irrecoverable, it must be grouped with other such debts in view of tabling a report to council, no later than April each year, to implement the writing off of such irrecoverable debts.

Broadly, the municipality will strive to issue debt that is supported by specific revenue sources and to avoid the pledging of rates and general revenues unless a substantial proportion of the population will benefit from the asset being financed.

Where the municipality has identified customers whose debts appear to be irrecoverable even after the entire credit control and debt collection process have been followed in terms of trying to obtain payments due by customers, then such accounts should be regarded as irrecoverable, unless:

- Legal recourse has been exhausted and the municipality is still unable to secure payment of the outstanding debt; or
- The success of future legal action by the municipality to recoup the outstanding debt is compromised due to actions or inactions by the municipality; or
- The cost of instituting legal action for the recovery of the outstanding debt would be higher than the value of the outstanding debt; or
- The debtor in question cannot be traced and a tracing agency has rendered a non-traceable report on the debtor in question; or
- The amount outstanding is the residue after payment of a dividend in the rand from an insolvent estate; or a deceased estate is insolvent and has no liquid assets to cover the outstanding amount; or
- Due to a lack of evidence, it is not possible to prove the debt outstanding; or
- The outstanding amount is due to an irreconcilable administrative error by the municipality.

Any cases that fall outside the above-mentioned criteria should be submitted to the Chief Financial Officer for further consideration for approval.

7.7.12 Updating of Indigent Register

An indigent policy should be adopted to promote social and economic development and to provide services to the poorest of the poor (indigent households). The aim is to set clear guidelines on how the council will assist indigent households, and the roles of the different departments. This policy furthermore sets broad principles for the adoption of a by-law for the implementation and enforcement of a tariff policy:

- To determine which households qualify as indigent households according to specified criteria;
- To set clear guidelines on the level of services that will be supplied to indigent households;
- To determine the role of the department of the Chief Financial Officer and the department of the Strategy and Development Manager respectively; and
- To set guidelines for the cross-subsidisation and funding of indigent households.

7.8 LIMITATIONS OF THE STUDY

This study provided a number of useful insights into the impact of debt on municipalities in terms of sustaining service delivery. However, despite every effort to ensure that the study is without flaw, there are several constraints to be highlighted so they can be addressed in future. Firstly, the findings of the study are restricted to respondents based in one particular geographical location, namely the Free State Province. Therefore, caution should be exercised regarding the generalisation of the findings to other provinces in the country and beyond (Babbie & Mouton, 2007:169). Secondly, the use of a random selected sampling technique may have increased the weakness of the study. Lastly, it was not possible for the researcher to control how the respondents completed the questionnaire, and moreover the respondents had to remain anonymous to ensure their protection from harm or coercion.

7.9 IMPLICATIONS FOR FURTHER RESEARCH

This study is not without implications for further research. Firstly, the findings of the study may be refined by conducting studies along similar categories of municipalities. The scope of the study could be expanded to include other municipalities within other provinces in South Africa. For this particular study, data was collected from the top managers at the relevant municipalities.

This study was conducted by using qualitative data from the questionnaire; it would be interesting to conduct a similar study using a triangulation method, integrating both quantitative and qualitative methods. In the questionnaire, this approach could ensure a trade-off between the strengths and the shortcomings of the two methods, thereby boosting the validity of the results (Bogdan & Knopp Biklen, 2006:11).

Further studies could be conducted to establish the impact of the Integrated Debt Management Model on debt management of municipalities in the Free State Province. Studies can also be conducted to establish the efficiency of the budget and treasury offices at municipalities and the structure of the organograms for different categories of municipalities in order to establish human capital gaps and the impact thereof on municipal services.

7.10 SUMMARY

The aim of the study was to develop an integrated debt management model to assist municipalities in the Free State Province to improve their debt management – nationally raised revenues, less debt repayment liabilities, as divided amongst the three spheres of government based on their expenditure responsibilities and the other revenue sources available to them. Thus, provincial governments, which have far fewer revenue sources than local governments, receive a commensurately larger portion of their resources from national transfers. In practice, the vertical division of revenue is an outcome of government's deliberations on policy and associated expenditure priorities. This reflects government's balanced approach to meeting policy priorities in the medium term, considering the responsibilities, expenditure pressures, capacity and performance of each sphere of government.

Municipalities are the custodians of public funds, whether raised from their own revenues or received through intergovernmental grants. They are tasked with using these resources to respond to the needs of their communities for infrastructure, local services such as water, electricity and refuse removal, and the enabling and guiding of the spatial development of their localities. Although municipalities are entitled to a share of the national fiscus, this share is mostly used to sustain municipal administrations, rather than to fund service delivery projects.

The main sources of revenue for municipalities are user charges and funds generated by the sale of water and electricity. In most cases, the local authority enters into a contract to supply goods and services and then bills the beneficiary based on the conditions of the contract.

This does not mean that municipalities are always delivering effectively and that consumers are always at fault in terms of non-payment. The provision of basic services such as electricity, water and sanitation, refuse and waste removal, is a critical service requirement of people living in areas serviced by the municipalities. A key feature of a developmental state is to ensure that all citizens, especially the poor and other vulnerable groups, have access to basic services. The Constitution (RSA, 1996) places the responsibility on government to ensure that such services are progressively expanded to all. Municipalities will only be in a position to provide these services if they have sufficient revenue.

If the ability to pay is more important than the willingness to pay, then no amount of moralising or threatening would alleviate the payment crisis within municipalities. One cannot squeeze blood from a stone! If people cannot afford to pay, it is simply impossible for them to do so, and not because there is necessarily a culture of non-payment, as other researchers have argued. It appears that the central problem of non-payment stems from deepening poverty amongst non-payers, making it primarily a problem of an inability to pay rather than a problem of a culture of non-payment.

In the light of this study, it is crucial for essential services to be made more affordable to poor households if the promise of services access for all is to be met. Also, there is a need for major debt relief for service arrears due the unconstitutional practices of household evictions, water and electricity cutoffs which are simply not sustainable either socially, morally or economically.

If the problem of non-payment persists, the government will be faced with a situation in which all major public utilities are likely to incur large and possibly unsustainable losses due to non-payment. This could lead government to support these utilities by subsidizing and accepting lower returns. People should bear in mind that if the current trend of non-payment for services continues in the future, a collapse in service delivery will become inevitable.

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APPENDICES

Annexure A

Enquiries: Reggie Chetty

Tel: 083-3891651

E-mail: Chetty.Regie@treasury.fs.gov.za

4 March 2013

To: The Municipal Manager and Chief Financial Officer

Dear Sir/Madam

RESEARCH PROJECT FOR THE DEGREE DTECH IN PUBLIC MANAGEMENT

I am currently a registered student (Student No.: 212501240) at the Central University of Technology, Free State (CUT) for the DTech Degree in Public Management. In view of completing my studies, I plan to submit a thesis titled: *"**Development of a debt management model for municipalities in the Free State Province**"*.

As part of my research, I am required to interview selected municipalities by means of a questionnaire. I therefore kindly request your participation and contribution, as the Municipal Manager and the Chief Financial Officer, by completing the attached questionnaire, which should take no longer than 15 minutes of your time. This research study will not be possible without your participation – hence your cooperation in this regard would be highly appreciated. All information collected during the course of this study will be utilised solely for research purposes.

I further commit myself to the following:

- Your contribution will be treated with the utmost confidentiality;
- Your participation in the survey is on a completely voluntary basis;
- No harm will result from any contribution made;
- Your municipality is welcome to request an electronic copy of the final thesis upon completion; and
- The information gathered from your responses to the questionnaire shall be held in safekeeping.

Should you have any queries concerning this study, please do not hesitate to contact me at the number provided below. I look forward to your response, and please allow me to express my sincerest gratitude in anticipation of your cooperation.

Yours faithfully

Reggy Chetty
(Work): 051-4054192   (Cell): 083 3891651
Chetty.Regie@treasury.fs.gov.za

Annexure B

Municipal Questionnaire

Municipal Manager and Chief Financial Officer

M.Chetty

Purpose

The purpose of the questionnaire is to examine the effectiveness of municipal debt management at your municipality and its implications for the cash flow position.

Your responses must be accurate and related to the current situation at your municipality, so as to enable the researcher to diagnose the gaps/problems in the selected sample and thus provide suitable solutions.

Instructions to Selected Municipalities/Municipal Officials

Step 1: Use a black pen and mark your response clearly with an X in the columns using the rating scale provided.

Step 2: Use the likert rating scale below to rate each item in the column provided, in terms of the current position at your municipality.

Rating Scale

1=Strongly Agree 2=Agree 3=Don't Know 4=Disagree 5=Strongly Disagree

1	2	3	4	5

1. BIOGRAPHICAL INFORMATION

OPTIONAL: NAME AND ID NO.:

Surname: Initials

ID No.:

1.1 Population Group

1	African	2	Asian	3	Coloured	4	White

1.2 Gender

1	Male	2	Female

1.3 Disabled

1	Male	2	Female

1.4 Language most commonly used

1	Afrikaans	2	English	3	Sesotho	4	Setswana
5	IsiXhosa	6	IsiZulu	7	Other		

1.5 Age Group

1	18 - 29	2	30 - 39	3	40 - 49	4	50 - 59
5	60 - 69	6	70 - 79	7	Older		

1.6 Highest level of education completed (indicate only one of the following)

1.6.1 Basic Education

1	Primary
2	Secondary

1.6.2 Higher Education (University/University of Technology/College)

3	Degree
4	Diploma
5	Certificate

1.6.3 Postgraduate Qualification

6	Honours or equivalent
7	Masters/MBA
8	Doctorate

BIOGRAPHICAL INFORMATION

2.1 Municipal council at which you are currently employed.

1	Mangaung Metropolitan Municipality
2	Xhariep District Municipality
3	Lejweleputswa District Municipality
4	Thabo Mofutsanyana District Municipality
5	Fezile Dabi District Municipality
6	Letsemeng Local Municipality
7	Kopanong Local Municipality
8	Mohokare Local Municipality
9	Naledi Local Municipality
10	Masilonyana Local Municipality
11	Tokologo Local Municipality
12	Tswelopele Local Municipality
13	Matjhabeng Local Municipality
14	Nala Local Municipality
15	Setsoto Local Municipality
16	Dihlabeng Local Municipality
17	Nketoana Local Municipality
18	Maluti a Phofung Local Municipality
19	Phumelela Local Municipality
20	Mantsopa Local Municipality
21	Moqhaka Local Municipality
22	Ngwathe Local Municipality
23	Metsimaholo Local Municipality
24	Mafube Local Municipality

3. DEBT MANAGEMENT

1=Strongly Agree 2=Agree 3=Don't Know 4=Disagree 5=Strongly Disagree

a)	Debt Management					
3.1	Your municipality has experienced debt problems in the last 3 years.	1	2	3	4	5
3.2	Debt problems have impacted on cash flow at your municipality.	1	2	3	4	5
3.3	Debt problems are eroding the cash-back reserves at your municipality.	1	2	3	4	5
3.4	At your municipality, growing debt problems have impacted on the cash coverage ratio of 2.5 months.	1	2	3	4	5
3.5	Debt problems have had an impact on ongoing concern issues at your municipality.	1	2	3	4	5
3.6	Growing debt problems have been posing a challenge at your municipality.	1	2	3	4	5
3.7	Your municipality is utilising conditional grants to fund the operational deficit.	1	2	3	4	5
3.8	Your municipality has had difficulty in paying its creditors within the last 3 months.	1	2	3	4	5
b)	Service Delivery					
3.9	Debt problems have impacted on service delivery at your municipality.	1	2	3	4	5
3.10	Debt problems have impacted on the achievement of service delivery priority areas, i.e. electricity and water.	1	2	3	4	5
3.11	Growing debt problems have impacted on the achievement of service delivery budget implementation targets.	1	2	3	4	5
3.12	Community protests have increased because of service delivery backlogs in your municipality.	1	2	3	4	5
3.13	Debt problems are caused by a growing indigent base at your municipality.	1	2	3	4	5
3.14	Unemployment in the municipal jurisdiction contributes to the debt position at your municipality.	1	2	3	4	5
3.15	The culture of non-payment contributes to the increase in the debtor's book.	1	2	3	4	5
3.16	There are high poverty levels in your municipal jurisdiction.	1	2	3	4	5

c) Financial Systems and Controls

1=Strongly Agree 2=Agree 3=Don't Know 4=Disagree 5=Strongly Disagree

3.17	The municipality has an adequate software solution for its revenue and debt management controls.	1	2	3	4	5
3.18	The municipality has changed its financial system within the last year.	1	2	3	4	5
3.19	The municipality has adequate capacity to manage its IT system,	1	2	3	4	5
3.20	The municipality has effective indigent monitoring and control systems.	1	2	3	4	5
3.21	The municipality is able to effectively profile the customers in order to differentiate between those that can pay and those that cannot pay for services.	1	2	3	4	5
3.22	The municipality has an in-house internal audit unit.	1	2	3	4	5

d) Municipal Policies

3.23	The municipality has implemented credit control and debt management policies.	1	2	3	4	5
3.24	The charges for rates and tariffs have been affordable by customers over the last 3 years.	1	2	3	4	5
3.25	The municipality has the capacity to implement credit and debt control policies effectively.	1	2	3	4	5
3.26	The municipality has implemented credit control and debt management policies.	1	2	3	4	5
3.27	The municipal council has adopted a tariff policy on the levying of fees for municipal services in compliance with Section 74 of the MSA.	1	2	3	4	5
3.28	The municipality has promulgated credit control and debt bylaws in compliance with Sections 75 and 96 of the MSA.	1	2	3	4	5
3.29	The municipality has implemented an effective Indigent policy.	1	2	3	4	5
3.30	The municipality complies with Section 24(2)c of the MFMA in relation to budget policies.	1	2	3	4	5

MEETING PROCEDURES AND REPORT WRITING

4.1 How competent are you in chairing meetings effectively?

1	Very Competent	2	Competent	3	Not competent enough

4.2 Do you require training in meeting procedures?

1	Yes	2	No

4.3 How competent are you in writing a report?

1	Very Competent	2	Competent	3	Find it problematic

4.4 Do you require training in report writing?

1	Yes	2	No

5. FINANCIAL MANAGEMENT AND BUDGETING

5.1 How familiar are you with the Municipal Finance Management Act, 56 of 2003 (MFMA) and its requirements?

1	Very familiar	2	Familiar	3	Not so	4	Not familiar at all

5.2 How important do you regard your role in the implementation of the MFMA?

1	Very important	2	Important	3	Not so important	4	It's not my responsibility

5.3 What are the revenue sources of your municipality?

1	Property Rates	2	Service Charges / Tariffs	3	Fines	4	Equitable share from National Government
						5	All of the said sources

5.4 In your opinion, to whom does the money received by the municipality as revenue belong?

1	Government	2	Treasury	3	Municipality	4	The People

How effectively can you analyse and interpret the financial statements of your municipality?

1	Very effectively	2	Effectively	3	Not so effectively	4	It is not my function

5.5 How well can you monitor the implementation of the budget through financial reports and thereby evaluate the financial performance of the municipality?

1	Very Good	2	Good	3	Not so good	4	It is not my function

5.6 What was the most positive audit opinion that your municipality received recently from the Auditor General South Africa (AGSA)?

1	Qualified	2	Unqualified	3	Disclaimer	4	I'm not sure

5.7 What is the best opinion the AGSA could express?

1	Unqualified	2	Qualified	3	Disclaimer	4	I'm not sure

5.8 How important do you regard the role of the AGSA in municipal financial management?

1	Very Important	2	Important	3	Not important	4	They do not have a role to play

5.9 Do you require training in financial management and budgeting?

1	Yes	2	No

5.10 How familiar are you with the Preferential Procurement Policy Framework Act, 5 of 2000, its regulations and its requirements?

1	Very familiar	2	Familiar	3	Not so familiar	4	Not familiar at all

6. COMMENTS

Which one of the following options would best summarise your opinion of the survey?

1	The survey serves a good purpose
2	The questionnaire addresses relevant issues
3	The questionnaire is too long
4	The survey is unnecessary
5	The survey is long overdue
6	The questionnaire addresses irrelevant issues

Annexure C

Cases	Municipality name	Q 3.1	Q 3.2	Q 3.3	Q 3.4	Q 3.5	Q 3.6	Q 3.7	Q 3.8	Q 3.9	Q 3.10	Q 3.11	Q 3.12	Q 3.13	Q 3.14	Q 3.15	Q 3.16	Q 3.17	Q 3.1 8	Q 3.19	Q 3.20	Q 3.21	Q 3.22	Q 3.23	Q 3.24	Q 3.25	Q 3.26	Q 3.27	Q 3.28	Q 3.29	Q 3.30
CFO 1	Mohokare	1	1	1	1	1	1	2	2	2	2	2	2	2	1	1	1	2	5	4	2	3	4	2	2	4	4	1	1	1	1
CFO 2	Kopanong	1	1	1	1	1	1	1	2	1	1	2	3	2	1	1	1	1	5	4	2	2	1	2	1	4	2	1	1	1	1
CFO 3	Masilonyana	1	1	1	1	2	1	4	4	1	1	2	5	1	1	1	1	4	4	5	4	4	1	1	4	2	2	2	4	4	2
CFO 4	Tokologo	1	2	2	2	4	2	1	5	2	2	4	4	2	2	2	1	1	5	4	4	5	4	2	2	2	2	2	3	2	2
CFO 5	Dihlabeng	1	1	5	1	2	1	2	1	1	2	2	5	2	2	2	2	2	5	5	4	2	2	2	2	2	2	1	1	1	1
CFO 6	Letsemeng	4	4	4	4	4	2	4	4	4	4	4	4	4	4	2	4	4	5	1	1	1	1	1	1	1	1	1	4	1	1
CFO 7	Mantsopa	1	1	1	1	1	1	5	2	2	2	2	4	2	1	1	1	2	5	2	2	2	1	2	2	4	4	1	5	2	1
CFO 8	Ngwathe	5	5	5	5	5	5	1	4	2	2	2	2	2	2	1	1	5	4	5	4	4	2	2	3	4	4	2	2	2	2
CFO 9	Metsimaholo	4	2	1	1	3	2	4	4	2	4	2	4	3	3	2	2	1	5	4	2	5	2	2	2	4	4	2	5	2	4
CFO 10	Matjhabeng	1	1	1	1	1	1	5	2	2	3	2	4	2	2	2	3	2	5	4	4	2	2	2	2	4	2	2	2	2	2
MM 1	Mohokare	1	1	1	1	1	1	2	1	1	1	1	1	2	2	2	2	4	5	4	4	4	4	2	2	4	4	2	2	4	2
MM 2	Kopanong	1	1	2	1	1	2	2	4	2	2	2	4	2	2	2	1	2	5	5	2	2	2	2	2	2	2	2	2	2	2
MM 3	Masilonyana	1	1	2	1	4	2	5	2	2	2	2	4	2	1	2	1	1	2	4	4	2	1	1	2	4	1	1	1	1	1
MM 4	Tokologo	1	2	2	2	4	2	1	5	2	2	4	4	2	1	1	1	1	5	4	4	4	4	2	2	2	2	2	3	2	2
MM 5	Dihlabeng	2	2	2	1	2	3	5	3	4	4	4	5	5	4	2	4	1	5	2	2	1	1	2	2	2	2	2	1	1	1
MM 6	Letsemeng	5	5	5	4	4	2	5	4	4	4	4	5	5	5	2	4	4	5	1	1	1	1	1	1	1	1	1	4	1	1
MM 7	Mantsopa	1	1	1	1	1	1	5	2	2	2	2	4	2	1	1	1	2	5	2	2	2	1	2	2	4	4	1	5	2	2
MM 8	Ngwathe	1	1	1	1	1	1	2	2	2	2	2	2	4	2	1	2	4	4	4	4	4	2	4	2	4	4	2	4	2	2
MM 9	Metsimaholo	4	2	1	1	3	2	4	4	2	4	2	4	3	3	2	2	1	5	4	2	5	2	2	2	4	4	2	5	2	4
MM 10	Matjhabeng	1	1	1	2	1	1	4	1	1	1	1	2	1	1	1	1	1	5	2	2	2	1	1	1	2	1	2	2	1	1

Item Description	Acronymns	Srongly Agree	%	Agree	%	Don't Know	%	Disagree	%	Strongly disagree	%
3. Debt Management											
a) Debt Management											
3.1 The municipality experienced debt problems in the last 3 years	DP	14	70	1	5	0	0	3	15	2	10
3.2 The debt problem impacted on cash flow at your municipality	CFP	12	60	5	25	0	0	1	5	2	10
3.3 The debt problem is eroding the cash back reserves at your municipality.	CR	11	55	5	25	0	0	1	5	3	15
3.4 At your municipality, the growing debt problem impacted on the cash coverage ratio of 2.5 months.	CCR	14	70	3	15	0	0	2	10	1	5
3.5 The debt problems impacted on going concern issues at your municipality.	GC	9	45	3	15	2	10	5	25	1	5
3.6 Growing debt problems posed challenges to your municipality.	DPC	10	50	8	40	1	5	0	0	1	5
3.7 The municipality is utilizing conditional grants to fund the operational deficit.	CG	4	20	5	25	0	0	5	25	6	30
3.8 The municipality had difficulty in paying its creditors within the last 3 months.	PC	3	15	7	35	1	5	7	35	2	10
b) Service Delivery											
3.9 The debt problems impacted on service delivery at your municipality.	DPS	5	25	12	60	0	0	3	15	0	0
3.10 The debt problem impacted on achieving service delivery priority areas i.e electricity and water.	DPIS	4	20	10	50	0	0	1	5	5	25
3.11 The growing debt problem impacted on achieving service delivery budget implementation targets.	DPSDBIP	2	10	13	65	0	0	5	25	0	0
3.12 Community protests increased because of service delivery backlogs in your municipality.	CP	1	5	4	20	1	5	10	50	4	20
3.13 The debt problem is caused by growing indigent base at your municipality.	DPIBG	2	10	12	60	2	10	2	10	2	10
3.14 The unemployment in the municipal jurisdiction contribute to the debt position at the municipality.	UIDP	8	40	7	35	2	10	2	10	1	5
3.15 The culture of non payment contribute to the increase in the debtors book.	CNPDB	9	45	11	55	0	0	0	0	0	0
3.16 There is high poverty levels in the municipal jurisdiction.	HP	11	55	5	25	1	5	3	15	0	0
c) Financial Systems & Controls											
3.17 The municipality have an adequate software solution for its revenue and debt management controls.	SS	8	40	6	30	5	25	1	5	0	0
3.18 The municipality changed its financial system within the last year.	CFS	0	0	1	5	3	15	0	0	16	80
3.19 The municipality have adequate capacity to manage its IT system	ACIT	2	10	4	20	0	0	10	50	4	20
3.20 The municipality have effective indigent monitoring and control systems.	EIDM	2	10	9	45	0	0	9	45	0	0
3.21 The municipality is able to effectively profile the customers in order to differentiate between those that can pay and those	ECP	3	15	8	40	1	5	5	25	3	15
3.22 The municipality have an in house internal audit unit.	IA	9	45	7	35	0	0	4	20	0	0
d) Municipal Policies											
3.23 The municipality implemented credit control and debt management policies.	CCDM	5	25	14	70	0	0	1	5	0	0
3.24 The charges for rates and tariffs are affordable by customers in the last 3 years.	ART	4	20	14	70	1	5	1	5	0	0
3.25 The municipality have capacity to implement credit and debt control policies effectively.	CCCDM	2	10	6	30	0	0	12	60	0	0
3.26 The municipality implemented credito control and debt management policies	ICCDM	4	20	8	40	0	0	8	40	0	0
3.27 The municipal council adopted a tariff policy on levying of fees for municipal services in compliance with Section 74 of the	CAP	8	40	12	60	0	0	0	0	0	0
3.28 The municipality promulgated credit control and debt bylaw in compliance with sections 75 and 96 of MSA.	PB	5	25	5	25	2	10	4	20	4	20
3.29 The municipality implemented an effective Indigent Policy.	EIP	7	35	11	55	0	0	2	10	0	0
3.30 The municipality complied with Sections 24(2)c of the MFMA in relation to budget policies.	CM	9	45	9	45	0	0	2	10	0	0