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Financial Management Legislative Compliance by South African Local Government

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Abstract: South Africa's local government financial management best-practice technical assistance program (MFMTAP) aimed at financial management and budget technique quality improvement. Achieving credible, realistic municipal budgets and avoiding financial failure was another crucial reform program element. Earlier we explored whether a municipal budget funding compliance technique, recently developed by the South African National Treasury (NT) measuring municipal adherence to the Municipal Finance Management Act's (MFMA) budget funding requirements, provided a basis for understanding reform program performance by analysis of a sample municipality. That limited analysis suggested that the budget process was not achieving NT and MFMA funding compliance objectives over four years after MFMTAP commenced, possibly attributable to best practice technical assistance (BPTA) shortcomings or BPTA termination effects. We discuss analysis of funding compliance measures of a further four South African municipalities, two had a BPTA advisor and two received financial and indirect assistance; concluding that BPTA performance can be assessed using the funding compliance technique. We introduce Likert scales for quantitatively assessing the funding compliance trend, comparing scores between sample municipalities. 'Good tax' revenue theory evaluation is to understand constraints on municipal budgets achieving MFMA funding compliance. As analysis outcomes questions BPTA program effectiveness and sustainability for the 'budget funding' component of the reform process, we add the caveat that firm conclusions cannot be drawn from either the original single sample, or this larger sample, as it is not representative of the 283 municipality population. Analysis techniques and scale development provide a basis for further research, including its application to a representative sample and Likert scale factor correlation analysis.

Keywords: Best-practice technical assistance; medium-term budgets; funding compliance; good local tax theory, public finance reform, local government; South Africa.

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Introduction

We describe an extension of earlier analysis that sought to understand whether 'budget funding compliance measurement' could explain BPTA performance at South African municipalities. The earlier paper was limited to one important metropolitan municipality sample, was useful for understanding the funding compliance technique, but firm conclusions were not credible without a larger sample. From a larger sample we again conclude that the budget funding measurement technique is useful for assessing BPTA outcomes and suggest that analysis should be extended to a representative sample. But, we also propose other explanations for the apparent failure of this four municipality sample not to embed reforms and to comply with applicable legislation.

The earlier paper described:

1. The need for sound local public budgeting practice;
2. Local government (municipal) financial management challenges in developing countries and significant 'challenging' factors from recent international development literature;
3. A South African municipal environment overview, to portray the environment in which the international best practice program commenced, e.g. personnel shortages, under-performance, strict fiscal discipline needed, and the need to measure BPTA performance;
4. A detailed discussion of the specific MFMA funding compliance requirements;
5. Introducing NT's 'MFMA Funding Compliance measurement initiative and the testing procedure.

That material is not reproduced having been previously discussed extensively.

We provide an ancillary examination of some aspects of related theory, to summarise various needs for this type of research. We observe, associated with the funding compliance 'reasonableness' test of revenue levels, 'good local tax' theory; i.e. that:

- Local government South Africa has ‘at least one other broad-based local tax to support “adequate” levels of local public services’ (Bahl and Smoke 2003, 72),
- Local tax revenues are ‘elastic, automatically growing in proportion to the growth in expenditure needs’ (Bahl and Smoke 2003, 73). Property tax and service charge increases are associated with this factor.
- Local tax revenues are ‘politically acceptable’ (Bahl and Smoke 2003, 75). Collection rate trends are used as a proxy for this analysis.

Good local taxes should also be equitable, displaying various aspects of fairness, and should not export tax burden to other communities (Bahl and Smoke 2003), but these factors are beyond the scope of this quantitative analysis as here the key concern is sustainability rather than equity. Factors such as exporting tax burdens contribute to the overall fairness of a tax system, but ‘local’ politicians would likely see ‘exporting’ as a desirable objective.

A further four municipality sample of a MFMA funding compliance is analysed. Expectantly this analysis contributes to ‘a great need for applied research’ (Bahl and Smoke 2003, 278) in the municipal reform field. Indirectly, assistance for other information demands, including a fiscal condition measure for national government revenue sharing formulation (Bahl and Smoke 2003, 229) and evidence of ‘proper budgeting and sound financial management procedures’ (Bahl and Smoke 2003, 267) to improve the local debt market, could be use of the analysis. The next section deals with the selection basis of the municipality sample selection. Then a brief discussion of the analysis process followed by the outcomes description of each municipality is presented.

A Likert scale technique for quantitatively assessing the funding compliance measure trend of each municipality and comparing scores between municipalities is introduced, and we explain why the scale’s use was necessary. The paper ends with some brief concluding remarks. A summary table and charts of the analysis are included as annexures.

Theory and Definitions

We apply a limited definition of budget ‘credibility’. Others utilise broader criteria for evaluating public sector budget credibility including technical and governance perspectives. ‘Credibility’ is ‘more than ensuring that the numbers contained in the budget document are correct and based on realistic macroeconomic foundation’ (Folscher 2006, 5) and will include budget formulation rule and process predictability, macroeconomic frameworks, realistic revenue forecasts, transparent planning, solid budget classification and, importantly, implementation as planned (Folscher 2006). But we deliberately narrowly concentrate on NT’s funding compliance focus of the macroeconomic and ‘correct numbers’ technical aspects of ‘credibility’, which has implementation elements in terms of multi-year performance comparison and performance indicators, but certainly does not measure delivery of promised services.

The budget ‘sustainability’ discussed here is Sheehan’s (2005) definition ‘Fiscal strategy must be sustainable in the sense that it can be continued for the foreseeable future without any substantial change, and in particular without any sharp changes in tax rates or spending required to prevent a substantial deterioration in fiscal position’ (Sheehan 2005, 65), a central aim of NT’s funding compliance testing.

We were also mindful that ‘often reforms result in compliance, but not in any substantive behaviour change’ (Folscher 2006, 7), suggesting a limitation to the value of funding compliance, and concurrent evidence of genuine reform also warrants further investigation.

Finally, we also draw a conclusion relating to the theory related to the influence that political entrepreneurs (Dollery 2003), in particular those contributing to budgets that may not be sustainable or compliant. Municipal ‘political entrepreneurs’ seek to advance political careers to higher levels of governance by ‘capturing the attention of voters and party officials rather than allocatively efficient provision of public goods’ (Dollery 2003, 226), in this situation

potentially contributing to non-compliance with national ‘budget funding’ legislation.

Basis of Municipality Sample Selection

The subject of controlled tests and municipal sample selection to measure funding performance improvement was previously discussed (Dollery and Graves 2008, 13). We discussed some of the difficulties of isolating the causes of BPTA outcomes and concluded that a controlled test would be useful. But this was difficult in the real municipal environment because all municipalities had received some form of BPTA as financial assistance or guidance, although a limited number had been provided with a technical assistance advisor, some more than one; and some for only limited periods. The degree of variability in advisor ability, experience and acceptance was also an issue, and it was not uncommon for municipalities to resist receiving BPTA assistance.

Therefore, whilst credibility would be improved by a sample of municipalities that had not received any technical assistance, comparing their performance with those that had received an identical level of assistance including a BPTA advisor, such a sample was not available. The justification for the selection of the four sample municipalities for this further case study was therefore based on the following factors:

1. Identifying two municipalities publicly recognised for financial management achievements, but who had *not* received any BPTA ‘advisor’ assistance, and
2. Identifying two further municipalities that had received a BPTA advisor, but not a large metropolitan (‘metro’) municipality as our first paper examined a ‘metro’.

Analysis of the two ‘publicly recognised’ municipalities was to gain an understanding of the degree of financial management reform progress made by municipalities that had not had the benefit of a BPTA advisor. The use of the ‘publicly recognised’ sample, which could be argued would skew the analysis outcomes because the sample comprised already good performers, was

pragmatic in that lesser quality performers were unlikely to have the budget and financial statement information necessary to undertake the analysis. Lower capacity 'non-recognised' municipalities would likely not be producing financial information of sufficient quality or level of compliance. The two (2) municipal samples selected were Swartland Local Municipality (Western Cape Province) and Steve Tshwete Local Municipality (Mpumalanga Province).

The analysis of the 'non-metro' municipalities with BPTA advisor assistance was intended to understand whether municipalities with lesser management resources received and applied the BPTA compared to a 'metro'. However, the selection was also pragmatic, with the sample selected likely to have produced the budget and financial statement information necessary to undertake the analysis. The two (2) municipalities selected were Buffalo City Local Municipality (Eastern Cape Province) and Emakhazeni Local Municipality (Mpumalanga Province).

Analysis Procedure

The time series financial analysis of the sample was limited to commencing from the 2002/03 financial year as it is probable that reasonable financial information would be unavailable prior to that year. In a number of instances municipalities commenced the implementation of new accounting standard formats from the 2003/04 financial year, but provided restated comparative information in those statements for the 2002/03 financial year. Whilst there has been some prior piloting of BPTA the main MFMTAP BPTA commenced from January 2003. For these reasons the 2002/03 financial year was a reasonable baseline.

The financial analysis focused upon the comparison of key selected financial items obtained from municipal financial statements and budgets. One of the key financial management reforms is the conversion to 'Generally Recognised Accounting Practice' (GRAP – approved accounting standards) compliant financial statements prepared in accordance with 'specimen' format statements

issued by NT. The NT ‘capacity’ classification of a municipality determined the deadline financial year for conversion, although earlier conversion was encouraged. For the financial years prior to conversion it was common that the financial statements were prepared using formats issued by the Institute of Municipal Finance Officers (IMFO). Part of our analysis involved the translation of IMFO formats to NT prescribed formats, but a limitation is that complete information is not always available to make the conversion. Key differences of IMFO formats include using ‘internal loans’, effectively internally generated surplus funds and the phased ‘capital’ charging of capital expenditure over the loan period (internal and external loans). GAMAP/GRAP, closely aligned to accounting standards issued by the International Federation of Accountants (IFAC), do not allow internal loans and capital expenditure is allocated over the life of the asset by depreciation expense to a Statement of Financial Performance. Refer to **Annexure D** for the MFMA delays and exemptions description related to ‘GRAP’ implementation (section 122(3)), which explains how MFMA financial statement format reform was progressively implemented relative to municipal capacity.

Likert Scales

Background

Original analysis of NT’s funding compliance procedure revealed a challenge - how to assess whether a municipality’s ‘overall’ financial management performance had improved in terms of the reform objectives? The compliance procedure required NT analysts to individually examine each measure to assess MFMA ‘funding’ compliance. However, a common outcome was instances of improvement in some measures, deterioration in others, with the status quo maintained for the remainder. An individual assessment of each measure was useful for NT, or a Provincial Treasury (PT) in the case of the municipalities over which they had oversight (266), but would not provide anything other than an impression of whether a municipality had improved and a performance trend over the financial years analysed.

Others might suggest that comparative trend (of one municipality) and local government (with other municipalities) of financial performance analysis would be more reliable by applying established fiscal health tools rather than constructing a new tool. Tools such as the 'Ten-point Test of Fiscal Condition, the Financial Trend Monitoring System, and Fiscal Capacity Analysis' (Honadle *et al.* 2004, 139) have been found to have 'fairly modest data requirements' (Honadle *et al.* 2004, 139). These tools rely on local government data collections, such as the 'Government Finance Officers' Association (GFOA - USA) Financial Indicators Database' (Honadle *et al.* 2004, 140). However, whilst such data collections might be readily available in developed countries such as the USA such information is not available in South Africa. Also, the MFMA is very prescriptive legislation designed specifically for the South African local government environment. Local Government financial information is being assembled within NT's database, but it will be some time before the information is reliable and constructed consistently applying stable and accepted accounting standards. As noted elsewhere, 'It is essential to develop an adequate municipal information and monitoring system. Better information is needed about expenditure levels and needs, revenue levels and capacities, and fiscal performance' (Bahl and Smoke 2003, 277) equally applies to South Africa. Instead, the current position is based on the acceptance of related advice that 'If a local government wants to use some of the more sophisticated techniques for analysing financial data, it may need to start collecting certain data' (Honadle *et al.* 2004, 27), which is proceeding well at NT but currently of insufficient quality and detail over the time series analysed here.

This is not the first time that Likert scales are used as an evaluation technique of public sector reform; e.g. (Monavvarian 2003), however in that study scales were used to measure interviewee 'perceptions' of the success of the reforms.

Development

To meet the need for an overall assessment tool Likert scales were constructed to assess each of the seventeen (17) performance measures of the funding

compliance procedure. The 'Funding Measures' Likert scales are displayed at **Annexure E**.

A simple 5 point scale was selected for each measure and values of 2, 1, 0, -1 or -2 were assigned based on a summarised outcome. For example, the 'Cash and Cash Equivalent' position of a municipality could be 'Positive and improving' (2), 'Positive and stable' (1), 'Positive and declining' (0), 'Negative and stable' (-1) or 'Negative and declining' (-2). An assigned score is shown in brackets after the scale item example. After assigning scores for each measure the total scale item scores were summed for a total score. This was repeated for each financial year analysed. The total score was displayed by a line chart, for each sample municipality, with a trend line added to the chart. The trend line is intended to indicate overall progress. The charts for the sample analysed are included in **Annexure B**.

The scales require further development, but provide a preliminary basis for an overall performance assessment. Further quantitative assessment is required. Firstly, there will likely be a correlation between some of the measures used. Therefore, a positive score for one measure may be related to a positive score for another measure. Quantitative analysis should be applied to measure the degree of correlation and the effect of each measure on the total score. It may be possible to group some scales into factor scores as a more simplified approach. This approach could provide the basis of predicting municipal financial performance based on the trend information, which would be useful to national and provincial departments that have municipal oversight.

Another issue is the validity of summing the scores to obtain a total score. This approach was applied in applying K.W. Brown's (1993) 'Ten-Point Test of Fiscal Condition', which 'portrays the fiscal condition of a local government in a set of ten simple ratios' (Honadle *et al.* 2004, 140). In that test, developed in the USA, a score is assigned to each ratio included in the test depending on the relative relationship (quartile breakpoints) of a local government (municipality) compared to the GFOA database of all municipalities included. The score was

then summed for an overall score and the overall score ranked against other municipalities. Arguably, there is also a correlation between some of the tests; e.g. the ratio Total Revenues/Population would likely be correlated to Debt Service/Total Revenues. This matter must be explored further and to ascertain if other studies have considered the validity of a summated score in similar circumstances.

Municipality Sample Selection

This following further explains the basis of the sample selection in more detail.

The South African local government 'Vuna Awards' are coordinated each year to celebrate municipal service excellence. These awards 'reward municipalities that go beyond standards to give their communities excellent services and governance' (DPLG 2008). Importantly, one of the award categories is financial management. 'The Vuna awards are an initiative of the Department of Provincial and Local Government (DPLG), together with its partners in the coordination of development of and in local government, the South African Local Government Association (SALGA), Development Bank of Southern Africa (DBSA) and the National Productivity Institute (NPI).

'In the category of Local Municipalities, Swartland Local Municipality in the Western Cape scooped the award, followed by Steve Tshwete from Mpumalanga and Umngeni from KwaZulu-Natal' (DPLG 2008). Steve Tshwete Local Municipality had the benefit of a BPTA advisor for nearly 2 years from July 2003 until June 2005.

Swartland Municipality was not provided with a BPTA advisor. However, it was surmised that the funding compliance procedure should be applied to the financial results and budgets of Swartland, as their national 'Vuna' financial management award win suggested that there would be evidence of finance management reform progress.

Vuna awards are also awarded on a provincial basis. Emakhazeni Local Municipality was 'short-listed and got position three overall in Mpumalanga' (province) (Emakhazeni Local Municipality 2007). It was also predicted that application of the funding compliance procedure would find evidence of reform progress at Emakhazeni.

Buffalo City was a large municipality provided with a BPTA advisor, and Steve Tshwete was an award winner that also received advisor assistance. Therefore, this sample provided an opportunity of comparing the financial management reform performance of two significant (2) municipalities that had a BPTA advisor, with two (2) award winning municipalities that had 'not' had a BPTA advisor.

Table 1. The selected sample can be summarised as:

Municipality	No.	Category	Capacity *	Advisor **	Vuna award
Buffalo City	1	Local	High	Jan. 2003 - July 2005	2007 National
Steve Tshwete	2	Local	High	July 2003 - June 2005	2007 National Runner up
Swartland	3	Local	Medium	No	2007 National
Emakhazeni ***	4	Local	Low	No	2007 Provincial 3rd

Notes: * As defined by Government Gazette (National Treasury (No.1) 2004);

** MFMTAP record of advisors assigned (National Treasury (No.2) 2008);

*** Formerly and classified as the 'Highlands' Local Municipality (National Treasury (No.1) 2004).

Sample Municipality Analysis Outcomes

We previously argued that 'an important question is whether the funding compliance test can have an alternative application to provide an insight into the influence the international technical assistance program on South African municipal management capacity. It could be expected that, if successful, the various measurements that test the MFMA compliance could also explain underlying financial management performance change' (Dollery and Graves 2008, 22).

From the first municipal sample presented in our earlier paper, it was concluded there was 'sufficient performance differentiation to justify extending this line of analysis to other municipalities ... and that ... if the same results are evident in a larger sample, then this supports a finding that the measurements could be used with complementary evidence as analysis of BPTA performance outcomes' (Dollery and Graves 2008, 25). The sample analysis findings of this larger sample are now presented.

Sample number 1: BPTA advisor supported municipality:

Buffalo City Local Municipality

Buffalo City is a second tier 'Eastern Cape' municipality, an 'aspiring metro' classified by the NT as a 'high' capacity municipality for MFMA implementation (National Treasury (No.6) 2004, 11). 2006/07 annual revenue was approximately 1.745 billion Rand (US\$233 million at an exchange rate of 7.50 Rand to the \$US). **Annexure A1** provides the result of the funding compliance analysis of Buffalo City Local Municipality. The Likert scales scores and chart are presented as **Annexure B1**.

Unexpectedly, the score results show a marked difference comparing the audited financial results from 2003/04 to 2006/07 and the 2007/08 Medium Term Revenue and Expenditure Framework (3 year budget). However, there is an obvious cause of this, the Budgeted Cash Flow Statement. 2007/08 cash flow from ratepayers and consumers, the main revenue items, is estimated at less than the amount actually received in 2003/04. This is inconsistent with the revenue estimates, so either Buffalo City is expecting a substantial deterioration in debtor collection rates or has approved a poorly constructed budget. The cash flow prediction subsequently impacts on cash/investment balances and various related measures that contribute to poor scores. However, the predicted cause of the problem, which could be easily corrected, does not excuse that their MTREF does not comply with the legislated funding requirements, and suggests a lack of genuine capacity. The funding compliance measurement is proven to highlight the compliance issues, which presumably will assist this municipality to avoid this problem when it undertakes the compliance tests in

conjunction with the development of its budget (probably from 2008/09 or 2009/10) rather than this post-test.

Sample number 2: BPTA advisor supported municipality:

Steve Tshwete Local Municipality

Steve Tshwete local municipality is an 'Mpumalanga' municipality classified by NT as 'high' capacity for MFMA implementation (National Treasury (No.6) 2004, 16). 2006/07 annual revenue was approximately 506 million Rand (US\$67 million at an exchange rate of 7.50 Rand to the \$US). **Annexure A2** provides the result of the funding compliance analysis. The Likert scales scores and chart is presented as **Annexure B2**.

The analysis indicates that prior year financial outcomes display a higher degree of MFMA compliance than the 2007/08 MTREF, although the 'trend' line is straight. Whilst there was a reasonable level of MTREF format compliance the absence of a Budgeted Statement of Financial Position prevented the calculation of a number of measures. Steve Tshwete, as a high capacity municipality, should have achieved full format compliance in the previous year 2006/07 MTREF, so the absence of a key document in the 2007/08 MTREF is non-compliant with the MFMA and reform progress is questionable.

Sample number 3: 'Publicly recognised' municipality:

Swartland Local Municipality

Swartland is a relatively small 'Western Cape' municipality, with annual revenue of approximately 189 million Rand in 2006/07 (US\$25 million at an exchange rate of 7.50 Rand to the \$US), classified by the NT as a 'medium' capacity municipality for MFMA implementation (National Treasury (No.6) 2004, 9). To illustrate their comparative size Johannesburg 'Metro' had annual revenue 15.4 'billion' Rand in the same year or approximately US\$2 billion). However, Swartland is still a significant 'operation'. The average revenue budget for South African municipalities was 418 million Rand in 2007/08 (National Treasury (No.3) 2007, National Treasury (No.5), 2008). The average, excluding the six (6) metropolitan municipalities in 2007/08 was 171 million Rand (National

Treasury (No.3) 2007), and therefore although not a large municipality on this basis Swartland would be 'above the average' sized operation.

Annexure A3 provides the result of the funding compliance analysis of Swartland Local Municipality and **Annexure B3** presents the Likert scale scores and chart. GAMAP/GRAP formats were first introduced by Swartland in the 2004/05 annual financial statements, with the 2003/04 'comparatives' restated. IMFO format financial statements were available for the previous year and we restated these to align approximately to GAMAP/GRAP formats.

Financial statement quality overall was impressive with steady annual progression in the level of format compliance. The quality of the 2006/07 financial statements was high, closely adhering to MFMA format requirements. The level of detailed notes readily enabled the funding compliance procedure to be applied.

The funding compliance analysis specifically revealed:

- A steady improvement in the cash and investments position, from 2002/03.
- A significant improvement in cash and investments, less applications of funds, position from a large negative position in 2003/04, meaning there were insufficient funds to cash-back the reserves it was obliged or voluntarily accounted for, to a sizeable positive situation until 2006/07.
- A steadily improving operating surplus position, displaying property tax and service charge revenues adequate for a community 'paying its way' for the resources consumed.
- An impressive debt collection improvement, shown by annual average debtor collection rates exceeding 100 per cent and a reduction in long term debtor levels.
- Reasonable repairs and maintenance expenditure levels, although this conclusion is subject to a historical infrastructure asset condition assessment.

But, the quality of the budget information for the 2006/07 financial year and the 2007/08 MTREF was disappointingly poor compared to the quality of the financial statements. The budget format was to a large extent non-compliant with MFMA formats issued in 2005. Although, there were some tables of required information proving the municipality was aware of the requirements. The budget contained a mixture of English and Afrikaans wording, being non-compliant. Some information did not reconcile; e.g. capital expenditure did not agree with capital funding supporting tables. It was hard to believe that the same municipality, that had prepared such high quality financial statements for a number of years, had produced such a poor budget document.

It was discovered that Swartland was only lodging a high level summary return form to NT for its budget and financial reporting information in accordance with MFMA (Section 71) reporting requirements. This 'summary' return was introduced by NT to provide a temporary level of information compliance for municipalities that were failing to meet their full legal obligations, to allow NT to produce the consolidated quarterly local government returns that it was obliged to produce.

One suggestion is consulting assistance was used to produce the annual financial statements, but not the budget. An improvement in the quality of medium term municipal budgets and 'in-year' reporting are key MFMTAP reform program aims. Swartland was not achieving these aims. The lack of access to a BPTA advisor might be a factor. The analysis supported a conclusion that the funding compliance procedure could assist in understanding BPTA impact and reform progress.

Sample number 4: Publicly recognised municipality:

Emakhazeni local Municipality

Emakhazeni local municipality is a small 'Mpumalanga' municipality classified by NT as 'low' capacity for MFMA implementation (National Treasury (No.6) 2004, 16). 2006/07 annual revenue was approximately 70 million Rand (US\$9.3 million at an exchange rate of 7.50 Rand to the \$US). The funding compliance

output measurement for Emakhazeni is displayed as **Annexure A4**. Likert scales scores and chart are presented as **Annexure B4**. Emakhazeni, formerly known as 'Highlands' (National Treasury (No.6) 2004, 16) was exempt from many of the requirements of the MFMA including section 122(3) relating to financial statement format until 30 June 2008. **Annexure D** details the MFMA delays and exemptions that were granted by the Minister of Finance on 1 July 2004. However, the delay and exemption of implementation of selected parts of the section 17 and section 19 requirements (MTREF) expired after the preparation and approval of their 2006/07 annual budget. Therefore, even for a low capacity municipality full MFMA compliance was required for the 2007/08 MTREF, the medium term budget analysed.

Emakhazeni's 'annual financial statements' until 2006/07, the final year of 'actual' results analysed here, were all presented applying 'IMFO' formats, displaying minimal progress toward 'GRAP' compliance. This was MFMA 'delays' compliant, but better progress was expected from an award winning municipality. Regardless, our financial statements translation to the required format revealed suspect financial trends. The 2006/07 results refer to substantial debtors for grants spent but not received, presumably conditional capital transfers/grants. But if this amount is factored as revenue 'earned' the financial performance result is problematical, therefore displaying that these amounts have not been reported as revenue even though it is unclear how the amount could be shown as debtors in this case. More detail regarding the deficiencies is beyond the scope of this paper, but these problems could affect the Likert scale scores positively or negatively. Performance assessment credibility will be limited until the municipality produces a number of consecutive years of 'GRAP' financial statement history.

As the 'budget' format delays and exemptions had expired, prior to the preparation of the 2007/08 MTREF, the analysis reveals important compliance deficiencies. Critical to the funding compliance analysis is the presentation of 'budgeted' GRAP compliant statements for financial performance, financial position and cash flows. Yet only a partially compliant financial performance

budget is available. The information shortfall seriously limits the completion of the funding compliance requirements and the Likert scale scores applied.

Funding compliance improvement is evident in 2003/04, 2004/05 and 2005/06. A substantial deterioration occurred in the 2006/07 financial results, suggesting that solvency of the municipality is questionable. In that year it had borrowed funds for capital expenditure, had not spent the funds yet was in a poor liquidity situation. The 2007/08 MTREF is heavily non-compliant with MFMA requirements, making it very difficult to assess the budget credibility and subsequently apply Likert scoring. The trend line suggests overall deterioration in funding compliance since 2002/03. The findings are contrary to what was surmised that this award winning municipality would display continuing and improving MFMA compliance, instead financial management performance appears to be deteriorating; but again this still suggests the funding compliance procedure can be used to test BPTA progress.

Revenue and Good Local Tax Theory

These theories, as described earlier in the paper, are directly relevant to the funding compliance analysis. If the municipalities do not possess 'good taxes' in their repertoire they will be under pressure to maintain MFMA 'funding' compliance in a country under enormous pressure to expand and improve basic service delivery.

The sample municipalities are all 'local' category, so all levy a property rates 'tax'. They all deliver electricity, water and sanitation and refuse services, with the charges for these services able to cross-subsidise other municipal services depending on local policy.

The next factor to consider is whether local taxes are growing in proportion to expenditure needs. To measure this we use funding compliance measurement number five as a proxy, the percentage change in service charge revenue above the Reserve Bank inflation target. All of these municipalities would be

experiencing demand for increased services, and therefore it would be expected that this measure would be positive (greater than the Reserve bank target). The values are displayed in the following table (property rate and service charge revenue change greater than Reserve Bank inflation target):

Table 2. Property tax & service charge increases > Reserve bank inflation target

MUNICIPALITY	2003/04 Actual %	2004/05 Actual %	2005/06 Actual %	2006/07 Actual %	2007/08 Budget %	2008/09 Budget %	2009/10 Budget %
eThekweni 'metro'	5.1%	2.7%	(1.5%)	3.0%	2.8%	1.9%	1.1%
Buffalo City	2.3%	5.8%	(0.8%)	0.1%	0.8%	1.5%	(0.2%)
Steve Tshwete	N.A.	4.0%	(0.8%)	9.0%	(2.5%)	0.3%	(2.5%)
Swartland	10.4%	(0.3%)	5.6%	7.4%	N.A.	N.A.	N.A.
Emakhazeni	40.1%	15.5%	15.6%	12.1%	(2.4%)	(1.7%)	(1.7%)

The information from the table is not conclusive, especially as changes in accounting standards and formats limit data reliability, but negative values are suggestive of municipalities under political pressure to minimise tax and service charge increases. There is some suggestion of a correlation between this measure and funding compliance, with low increases and negative change putting pressure on revenue. However, comparing the tax/service charge increases to a 'municipal cost index', an index of the price increases of municipal inputs (remuneration, bulk electricity, bulk water, road materials etc), would be a better guide but beyond the scope of this paper.

Next is whether the local tax is politically acceptable. For this we use the revenue collection rate as a proxy, on the basis that a politically acceptable tax will exhibit high collection rates. We will also refer to the property rate/service charge increase table, as politically unacceptable taxes will likely experience budgetary 'containment' pressure.

Table 3. Collection rates

MUNICIPALITY	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
	Actual %	Actual %	Actual %	Actual %	Budget %	Budget %	Budget %
eThekwini 'metro'	91.0%	92.0%	90.0%	90.0%	95.0%	95.0%	93.0%
Buffalo City	131.6%	119.6%	127.6%	143.7%	88.6%	81.3%	81.8%
Steve Tshwete	140.9%	106.8%	94.7%	99.8%	80.1%	99.5%	99.6%
Swartland	97.7%	103.1%	111.6%	109.1%	No Cash Fl.	No Cash Fl.	No Cash Fl.
Emakhazeni	59.0%	118.8%	96.5%	56.3%	No Cash Fl.	No Cash Fl.	No Cash Fl.

Again, changes in accounting standards and formats limit the data reliability. Historical collection rates greater than 100 per cent resulted from including transfers from reserves as revenue, but 'GRAP' compliant financial statements and budgets exclude these transfers. Those municipalities that have implemented 'GRAP' are displaying collection rates below 100 per cent. There does not appear to be any correlation between tax/service charge increases and steadily improving collection rates at eThekwini. Buffalo City data is unreliable. There does not appear to be any correlation at Steve Tshwete and the data for Swartland is incomplete. There is a suggestion at Emakhazeni that a history of large tax/service charges increases are progressively impacting on collection rates. However, even though inconclusive there is a possibility that the MFMA funding compliance procedure can assess the impact of 'good tax' theory and its impact on municipal budget funding.

Concluding Remarks

Our conclusion of the sample funding compliance procedure analysis conducted is the evidence that the 2007-08 MTREF's:

Municipality	Conclusion
Buffalo City	Do not meet the basic requirements of MFMA section 18, and probably section 19, because expenditure budgets have been approved at a level that will be unlikely to be fully funded.

Steve Tshwete	Do not meet the basic requirements of MFMA section 18, and probably section 19, because expenditure budgets have been approved at a level that will be unlikely to be fully funded. Budgeted Cash Flow Statement corrections would likely indicate a different outcome.
Swartland	Does not meet the funding compliance test, trending negative. Very poor level of 2007/08 MTREF compliance for a medium capacity municipality.
Emakhazeni	2007/08 MTREF does not meet the funding compliance test, trending negative. Poor format compliance.

On this basis, as with the analysis of the metropolitan municipality sample presented in paper 1, there is sufficient justification for performance measurement differentiation to justify extending this line of analysis to an even larger sample of municipalities. Similar results in a larger sample would improve finding credibility that the measurements can be used with complementary evidence as analysis of BPTA performance outcomes, provided the analysis was supported by quantitative analysis of the relationship between the Likert scales used. Of course, we must ask the ‘so what’ question, with the answer being that this analysis could aid in the design and implementation of similar reform programs as a performance measure, or as an ongoing assessment of the municipal financial management reform in South Africa.

We must also heed the warnings of others. Honadle *et al.* (2004, 249) concluded that ‘relative quantitative analysis need always be strengthened by proper interpretation and feedback provided only through close interaction with local government officials ... direct inference from analytical methods alone can lead one to false conclusion of strong or weak fiscal condition’. The relative analysis undertaken for the sample is qualified as not having the benefit of local manager interpretation and feedback.

The municipal reform started in earnest in 2003, and the MFMA was ‘phased-in’ to suit the capacity of municipalities. As detailed in **Annexure D**, full compliance

to 'budget reform' (mainly MFMA section 17 and 19) of some elements even for 'low capacity' municipalities was required for the 2007/08 MTREF. Our interpretation would be disappointing to the Government, especially considering there would have been higher expectations from these municipalities. The literature describing 'policy shock' may explain one of the causes:

These developments raise substantial concerns about how much 'policy shock' the municipalities can absorb at one time, how quickly they can climb the required learning curve, and what the national government can afford in the short term and beyond (Bahl and Smoke 2003, 274).

The literature also warns about the requirements for capacity building:

Demanding too much at once especially if uncoordinated and/or unsupported by adequate capacity building, may prevent municipalities from adopting reforms successfully, damaging economic development and social well being (Bahl and Smoke 2003, 274).

Further, the apparent lack of reform progress may not be directly related to the funding compliance mechanism at all, but organisational resistance. Others have contended that as, 'long as the reformers are from within the bureaucracy, there is no hope to achieve desired results.' (Monavvarian 2003, 592).

An alternative explanation for the apparent non-compliance is the newly elected councils (March 2006), possibly included key political entrepreneurs (PEs) such as newly appointed mayors are putting pressure on funding compliance by a desire to accelerate basic services spending. Although 2006/07 was the first available budget after the election it is likely that 2007/08 was the first budget new councillors could genuinely influence. Variable correlation would be very difficult to prove, because electoral change doesn't necessarily cause an increase in PEs. But if a correlation existed between the funding compliance trend and the 5 year electoral cycle changes (percentage change in councillors at an election and a per cent change in mayoral committee members, who have the most influence) there might suggest some evidence.

It is too early to conclude from this small sample of four municipalities, five including the sample from paper 1, but early signs suggest reforms are not embedded regardless of providing a BPTA advisor or other assistance and the variable performance between the samples appears to be correlated with capacity. Bahl and Smokes (2003) warning about the pace of reform and capacity building requires further investigation, as does the influence of 'good tax' theory on the ability of municipalities to meet service demand and maintain 'funding' compliance with the MFMA.

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Annexure A1 – MFMA Funding Compliance Table (Buffalo City Local Municipality)

Description	MFMA section	Ref	2002/03		2003/04		2004/05		2005/06		2006/07		2007/08 Medium Term Revenue and Expenditure Framework		
			Audited Outcome		Audited Outcome		Audited Outcome		Audited Outcome		Budget Year 2007/08	Budget Year +1 2008/09	Budget Year +2 2009/10		
Funding measures															
Cash/cash equivalents at the year end - R'000	18(1)b	1	(68 685)	115 299	225 540	491 831	632 145	66 198	50 040	15 760					
Cash equivalents + investments less applications - R'000	18(1)b	2	206 096	197 534	202 306	307 410	380 204	9 971	(123 248)	(93 972)					
Cash at the year end: % of monthly employee/supplier payments	18(1)b	3	(1.0)	1.4	2.4	5.1	5.8	0.6	0.4	0.1					
Surplus/(Deficit) excluding depreciation offsets: R'000	18(1)	4	2 533	69 601	211 788	243 401	135 971	87 736	1.5%	34 925					
Service charge rev % change - macro CPX target exclusive	18(1)a.(2)	5	N.A.	2.3%	5.8%	(0.8%)	0.1%	0.8%	1.5%	(0.2%)					
Cash receipts % of Ratepayer & Other revenue	18(1)a.(2)	6	113.4%	131.6%	119.6%	127.6%	143.7%	88.6%	81.3%	81.8%					
Debt impairment expense as a % of total billable revenue	18(1)a.(2)	7	3.5%	4.6%	8.2%	5.1%	5.7%	2.7%	2.7%	3.6%					
Capital payments % of capital expenditure	18(1)c:19	8	100.0%	89.4%	100.0%	100.0%	100.0%	101.9%	127.6%	183.8%					
Borrowing receipts % of capital expenditure (excl grants)	18(1)c	9	33.7%	42.1%	72.6%	0.0%	85.8%	55.2%	50.7%	65.4%					
Grants % of Govt. legislated/gazetted allocations	18(1)a	10						93.5%	83.2%	79.3%					
Current consumer debtors % change - incr(decr)	18(1)a	11	N.A.	(5.6%)	3.9%	4.2%	0.0%	4.7%	10.0%	10.0%					
Long term receivables % change - incr(decr)	18(1)a	12	N.A.	(34.0%)	(64.8%)	(57.1%)	(59.2%)	123.5%	(2.2%)	(1.8%)					
R&M % of Property Plant & Equipment	20(1)(vi)	13	7.3%	6.9%	8.3%	7.1%	5.5%	5.1%	5.5%	5.8%					
Asset renewal % of capital budget	20(1)(vi)	14	Not recorded	Not recorded	Not recorded	Not recorded	Not recorded	Not recorded	Not recorded	Not recorded					

Notes

1. NA - the information for the calculation was unavailable because prior year data was unavailable, the municipality did not disclose the base information, or the funding compliance procedure did not require the measure for that financial year (i.e. Government transfer measurement is only required for the budget 'years').
2. Refer Annexure A5 for an explanation of the measurement references
3. R'000 - thousand South African Rand

Annexure A2 – MFMA Funding Compliance Table (Steve Tshwete Local Municipality)

Description	MFMA section	Ref	2003/04		2004/05		2005/06		2006/07		2007/08 Medium Term Revenue and Expenditure Framework		
			Audited Outcome		Audited Outcome		Audited Outcome		Audited Outcome		Budget Year 2007/08	Budget Year +1 2008/09	Budget Year +2 2009/10
Funding measures													
Cash/cash equivalents at the year end - R'000	18(1)b	1	25 715	62 648	65 633	68 251	20 112	23 495	27 666				
Cash equivalents + investments less applications - R'000	18(1)b	2	107 321	146 774	15 856	54 782							
Cash at the year end: % of monthly employee/supplier payments	18(1)b	3	1.5	3.3	2.9	2.9	0.8	0.8	0.9				
Surplus/(Deficit) excluding depreciation offsets: R'000	18(1)	4	27 833	70 239	110 113	174 489	39 250	35 293	28 369				
Service charge rev % change - macro CPIX target exclusive	18(1)a,(2)	5	N.A.	4.0%	(0.8%)	9.0%	(2.5%)	0.3%	(2.5%)				
Cash receipts % of Ratepayer & Other revenue	18(1)a,(2)	6	140.9%	106.8%	94.7%	99.8%	80.1%	99.5%	99.6%				
Debt impairment expense as a % of total billable revenue	18(1)a,(2)	7	0.8%	2.6%	1.3%	1.0%	1.0%	1.0%	0.9%				
Capital payments % of capital expenditure	18(1)c;19	8	100.0%	100.0%	93.8%	100.0%	74.8%	100.0%	100.0%				
Borrowing receipts % of capital expenditure (excl grants)	18(1)c	9	0.0%	69.2%	0.0%	0.0%	27.9%	22.2%	29.1%				
Grants % of Govt. legislated/gazetted allocations	18(1)a	10					147.7%	135.2%	129.4%				
Current consumer debtors % change - incr(decr)	18(1)a	11	0.0%	(5.2%)	64.5%	9.0%	(100.0%)						
Long term receivables % change - incr(decr)	18(1)a	12	0.0%	(12.7%)	(49.5%)	(75.1%)	(100.0%)						
R&M % of Property Plant & Equipment	20(1)(vi)	13	3.9%	3.8%	4.4%	4.0%							
Asset renewal % of capital budget	20(1)(vi)	14	Not recorded	Not recorded	Not recorded	Not recorded	Not recorded	Not recorded	Not recorded	Not recorded	Not recorded	Not recorded	

Notes

1. NA - the information for the calculation was unavailable because prior year data was unavailable, the municipality did not disclose the base information, or the funding compliance procedure did not require the measure for that financial year (i.e. Government transfer measurement is only required for the budget 'years').
2. Refer Annexure A5 for an explanation of the measurement references
3. R'000 - thousand South African Rand

Annexure A3 – MFMA Funding Compliance Table (Swartland Local Municipality)

Description	MFMA section	Ref	2002/03		2003/04		2004/05		2005/06		2006/07		2007/08 Medium Term Revenue and Expenditure Framework		
			Audited Outcome	%	Audited Outcome	%	Audited Outcome	%	Audited Outcome	%	Audited Outcome	%	Budget Year 2007/08	Budget Year +1 2008/09	Budget Year +2 2009/10
Funding measures															
Cash/cash equivalents at the year end - R'000	18(1)b	1	11 301		18 146		20 534		104 659		100 931				
Cash equivalents + investments less applications - R'000	18(1)b	2	2 206		(67 736)		67 167		251 563		250 056				
Cash at the year end: % of monthly employee/supplier payments	18(1)b	3	2.1		3.2		2.6		13.7		12.8				
Surplus/(Deficit) excluding depreciation offsets: R'000	18(1)	4	15 550		15 657		5 279		28 312		32 182		58 794		
Service charge rev % change - macro target exclusive	18(1)a.(2)	5	12.2%		10.4%		(0.3%)		5.6%		7.4%				
Cash receipts % of Ratepayer & Other revenue	18(1)a.(2)	6	106.3%		97.7%		103.1%		111.6%		109.1%				
Debt impairment expense as a % of total billable revenue	18(1)a.(2)	7	2.4%		1.9%		2.3%		2.7%		2.1%				
Capital payments % of capital expenditure	18(1)c;19	8	100.0%		100.0%		100.0%		100.0%		101.9%				
Borrowing receipts % of capital expenditure (excl grants)	18(1)c	9	0.0%		91.7%		0.0%		0.0%		0.9%				
Transfers % of Govt. legislated/gazetted allocations	18(1)a	10											100.0%	100.0%	100.0%
Current consumer debtors % change - incr(decr)	18(1)a	11	(16.8%)		16.2%		(3.8%)		16.5%		17.1%				
Long term receivables % change - incr(decr)	18(1)a	12	(2.1%)		(20.4%)		(19.5%)		(26.4%)		(27.0%)				
R&M % of Property Plant & Equipment	20(1)(vi)	13	8.9%		3.6%		3.7%		4.7%		3.6%				
Asset renewal % of capital budget	20(1)(vi)	14	Not Recorded		Not Recorded		Not Recorded		Not Recorded		Not Recorded		Not Recorded	Not Recorded	Not Recorded

Notes

1. NA - the information for the calculation was unavailable because prior year data was unavailable, the municipality did not disclose the base information, or the funding compliance procedure did not require the measure for that financial year (i.e. Government transfer measurement is only required for the budget 'years').
2. 2002/03 financial statements unavailable
3. Refer Annexure A5 for an explanation of the measurement references
4. R'000 - thousand South African Rand

Annexure A4 – MFMA Funding Compliance Table (Emakhazeni Local Municipality)

Description	MFMA section	Ref	2002/03		2003/04		2004/05		2005/06		2006/07		2007/08 Medium Term Revenue and Expenditure Framework		
			Audited Outcome	Audited Outcome	Audited Outcome	Audited Outcome	Audited Outcome	Audited Outcome	Budget Year 2007/08	Budget Year +1 2008/09	Budget Year +2 2009/10				
Funding measures															
Cash/cash equivalents at the year end - R'000	18(1)b	1	4 204	265	45	9 999	560	No Cash Fl.	No Cash Fl.	No Cash Fl.	No Cash Fl.	No Cash Fl.	No Cash Fl.	No Cash Fl.	No Cash Fl.
Cash equivalents + investments less application of funds - R'000	18(1)b	2	22 887	6 317	29 824	49 313	(670)	No Cash Fl.	No Cash Fl.	No Cash Fl.	No Cash Fl.	No Cash Fl.	No Cash Fl.	No Cash Fl.	No Cash Fl.
Cash at the year end: % of monthly employee/supplier payments	18(1)b	3	3.1	0.2	0.0	4.0	0.2	No Cash Fl.	No Cash Fl.	No Cash Fl.	No Cash Fl.	No Cash Fl.	No Cash Fl.	No Cash Fl.	No Cash Fl.
Surplus/(Deficit) excluding depreciation offsets: R'000	18(1)	4	(364)	5 739	546	1 577	17 201	1 588	1 656	1 727	(2.4%)	(1.7%)	(1.7%)	(1.7%)	(1.7%)
Service charge rev % change - macro target exclusive	18(1)a,(2)	5	N.A.	40.1%	15.5%	15.6%	12.1%	15.5%	15.6%	12.1%	15.5%	15.6%	12.1%	15.5%	15.6%
Cash receipts % of Ratepayer & Other revenue	18(1)a,(2)	6	100.0%	59.0%	118.8%	96.5%	56.3%	118.8%	96.5%	56.3%	118.8%	96.5%	56.3%	118.8%	96.5%
Debt impairment expense as a % of total billable revenue	18(1)a,(2)	7	0.0%	0.0%	20.2%	12.8%	14.2%	20.2%	12.8%	14.2%	20.2%	12.8%	14.2%	20.2%	12.8%
Capital payments % of capital expenditure	18(1)c;19	8	9174.7%	141.6%	5.6%	33.9%	52.3%	5.6%	33.9%	52.3%	5.6%	33.9%	52.3%	5.6%	33.9%
Borrowing receipts % of capital expenditure (excl grants)	18(1)c	9	64.3%	0.0%	0.0%	0.0%	(126.5%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Transfers % of Govt. legislated/gazetted allocations	18(1)a	10	N.A.	29.7%	30.9%	3.5%	37.3%	30.9%	3.5%	37.3%	30.9%	3.5%	37.3%	30.9%	3.5%
Current consumer debtors % change - incr(decr)	18(1)a	11	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Long term receivables % change - incr(decr)	18(1)a	12	N.A.	270.5%	333.3%	271.2%	71.3%	333.3%	271.2%	71.3%	333.3%	271.2%	71.3%	333.3%	271.2%
R&M % of Property Plant & Equipment	20(1)(vi)	13	50.2%	Not Recorded	Not Recorded	Not Recorded	Not Recorded	Not Recorded	Not Recorded	Not Recorded	Not Recorded	Not Recorded	Not Recorded	Not Recorded	Not Recorded
Asset renewal % of capital budget	20(1)(vi)	14	Not Recorded	Not Recorded	Not Recorded	Not Recorded	Not Recorded	Not Recorded	Not Recorded	Not Recorded	Not Recorded	Not Recorded	Not Recorded	Not Recorded	Not Recorded

Notes

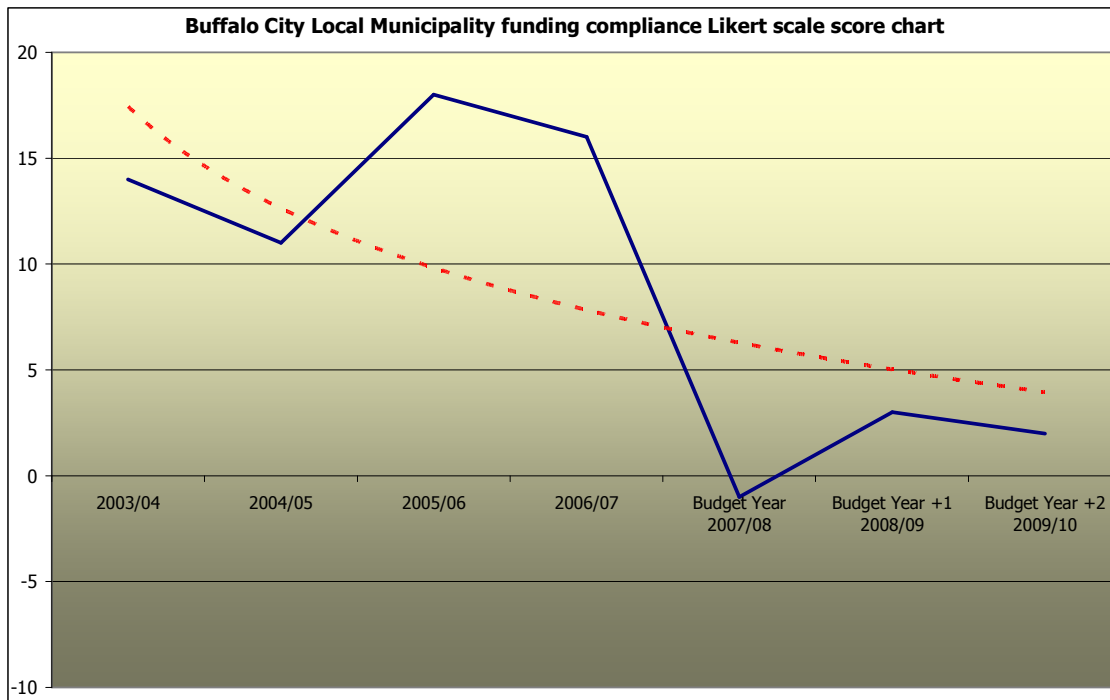
1. NA - the information for the calculation was unavailable because prior year data was unavailable, the municipality did not disclose the base information, or the funding compliance procedure did not require the measure for that financial year (i.e. Government transfer measurement is only required for the budget 'years').
2. Refer Annexure A5 for an explanation of the measurement references
3. R'000 - thousand South African Rand

ANNEXURE A5 – MFMA Funding Compliance Table References

1. *Positive cash balances indicative of minimum compliance - subject to 2*
2. *Deduct application of funds (defined) from cash balances*
3. *Indicative of sufficient liquidity to meet average monthly operating payments*
4. *Indicative of funded operational requirements*
5. *Indicative of adherence to macro-economic targets (prior to 2003/04 revenue not available for high capacity municipalities and later for other capacity classifications)*
6. *Realistic average cash collection forecasts as % of annual billed revenue*
7. *Realistic average increase in doubtful debt provision*
8. *Indicative of planned capital expenditure level & cash payment timing*
9. *Indicative of compliance with borrowing 'only' for the capital budget - should not exceed 100% unless refinancing*
10. *Substantiation of National/Province allocations included in budget*
11. *Indicative of realistic current arrear debtor collection targets (prior to 2003/04 revenue not available for high capacity municipalities and later for other capacity classifications)*
12. *Indicative of realistic long term arrear debtor collection targets (prior to 2003/04 revenue not available for high capacity municipalities and later for other capacity classifications)*
13. *Indicative of a credible allowance for repairs & maintenance of assets - functioning assets revenue protection*
14. *Indicative of a credible allowance for asset renewal (requires analysis of asset renewal projects as % of total capital projects - detailed capital plan) - functioning assets revenue protection*

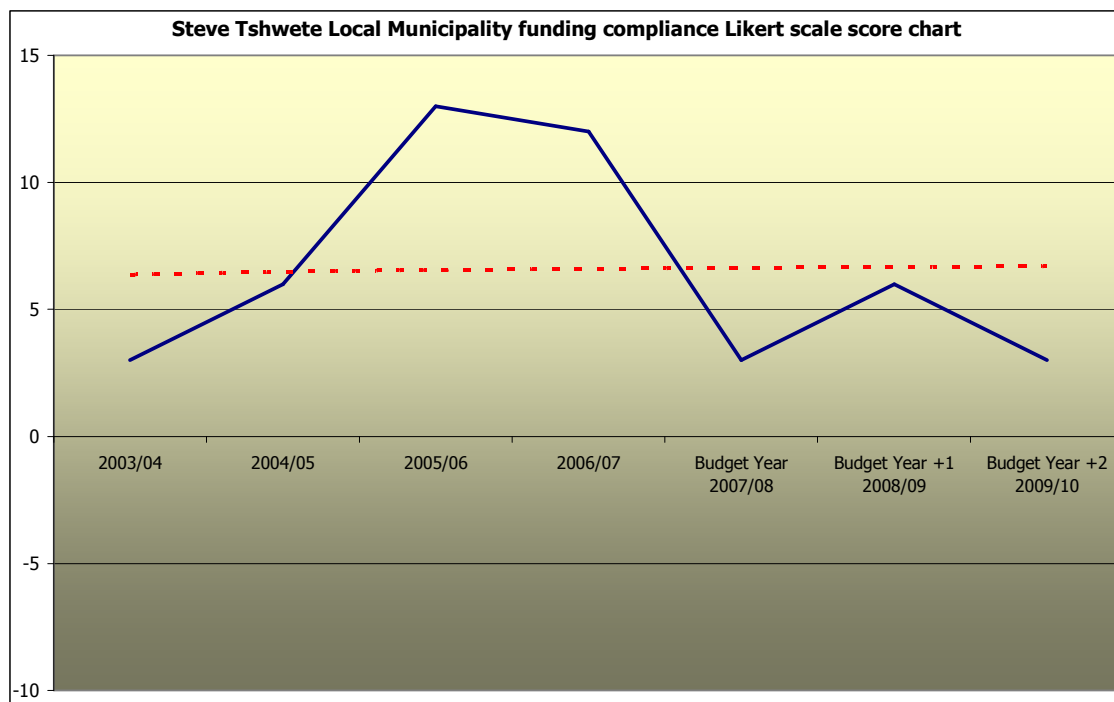
Annexure B1 – Likert Scales Scores (Buffalo city)

Financial Year:	Measure #	2003/04	2004/05	2005/06	2006/07	Budget Year	Budget Year +1	Budget Year +2
		Audited Outcome	Audited Outcome	Audited Outcome	Audited Outcome	2007/08	2008/09	2009/10
Funding measures title								
	1	2	2	2	2	0	0	0
Cash/cash equivalents at the year end	2	1	1	2	2	0	-2	-1
Cash equivalents + investments less applications	3	-1	1	2	2	-1	-1	-1
Cash at the year end:% of monthly employee/supplier payments	4	2	2	2	0	0	0	0
Surplus/(Deficit) excluding depreciation offsets	5	0	-2	-2	2	2	1	0
Service charge revenue % change - macro CPIX target exclusive	6	2	1	2	2	-2	-2	-2
Cash receipts % of Ratepayer & Other revenue	7	0	0	2	1	2	1	1
Debt impairment expense as a % of total billable revenue	8	1	-2	-2	-2	0	2	2
Capital payments % of capital expenditure	9	1	-2	2	-2	0	0	0
Borrowing receipts % of capital expenditure (excl grants)	10					0	0	0
Transfers/Grants % of Govt. legislated/gazetted allocations	11a	-1	0	-1	0	-2	-2	-2
Current consumer debtors % change - incr(decr)	11b	-1	2	2	2	-2	1	1
Long term receivables % change - incr(decr)	12	1	2	1	1	0	2	1
Repairs & Maintenance % of Property Plant & Equipment	13							
Asset renewal % of capital budget	14	2	2	1	1	1	1	1
Financial Performance Budget result (surplus/deficit)	15	2	1	2	2	1	1	1
Financial Position Budget	16	2	2	2	2	1	1	1
Cash flow budget	17	1	1	1	1	-1	0	0
Other key performance measures		14	11	18	16	-1	3	2



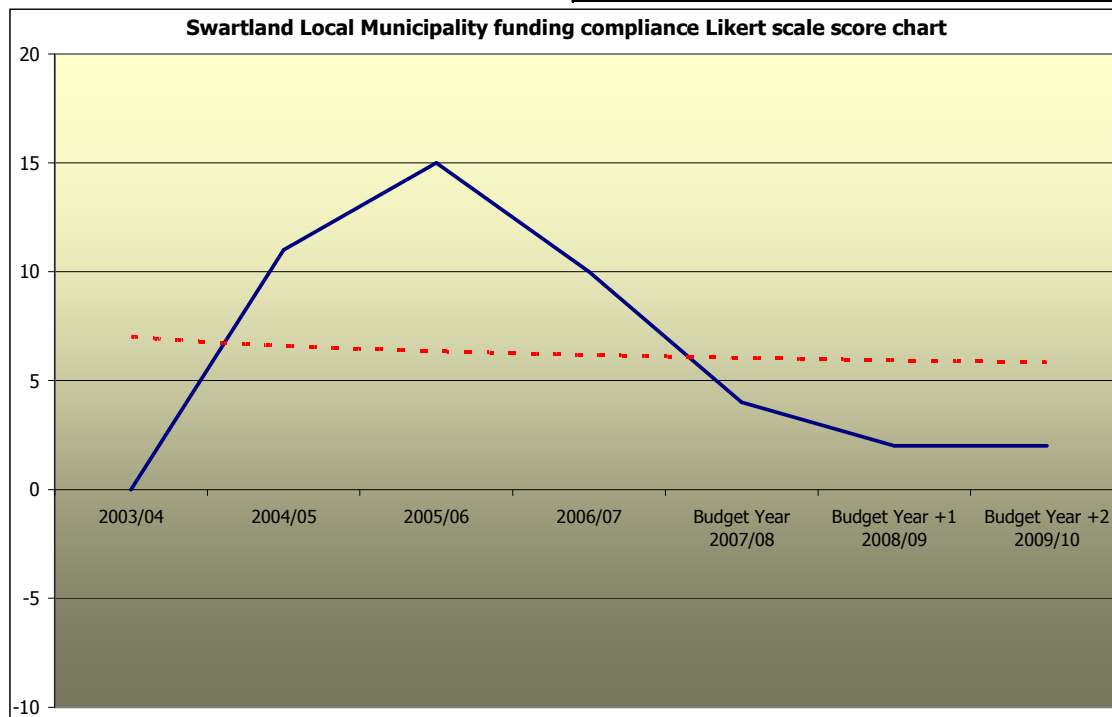
Annexure B2 – Likert Scales Scores (Steve Tshwete)

Financial Year:	Measure #	2003/04	2004/05	2005/06	2006/07	Budget Year	Budget Year +1	Budget Year +2
		Audited Outcome	Audited Outcome	Audited Outcome	Audited Outcome	2007/08	2008/09	2009/10
Funding measures title								
Cash/cash equivalents at the year end	1	0	2	1	1	0	1	1
Cash equivalents + investments less applications	2	0	2	0	2			
Cash at the year end:% of monthly employee/supplier payments	3	0	1	1	1	-1	-1	-1
Surplus/(Deficit) excluding depreciation offsets	4	1	2	2	2	0	0	0
Service charge revenue % change - macro CPIX target exclusive	5	1	-1	-2	-1	-2	0	-2
Cash receipts % of Ratepayer & Other revenue	6	1	0	2	2	-2	2	1
Debt impairment expense as a % of total billable revenue	7	1	0	2	1	1	1	1
Capital payments % of capital expenditure	8	-2	-2	1	-2	1	-2	-2
Borrowing receipts % of capital expenditure (excl grants)	9	2	-2	2	2	1	2	1
Transfers/Grants % of Govt. legislated/gazetted allocations	10							
Current consumer debtors % change - incr(decr)	11a			-2	-2	2		
Long term receivables % change - incr(decr)	11b			2	2	2		
Repairs & Maintenance % of Property Plant & Equipment	12	-1	-1	-1	-1	-1		
Asset renewal % of capital budget	13							
Financial Performance Budget result (surplus/deficit)	14	1	1	2	2	2	1	2
Financial Position Budget	15		2	2	2			
Cash flow budget	16	0	2	0	0	-1	1	1
Other key performance measures	17		0	1	1	1	1	1
		3	6	13	12	3	6	3



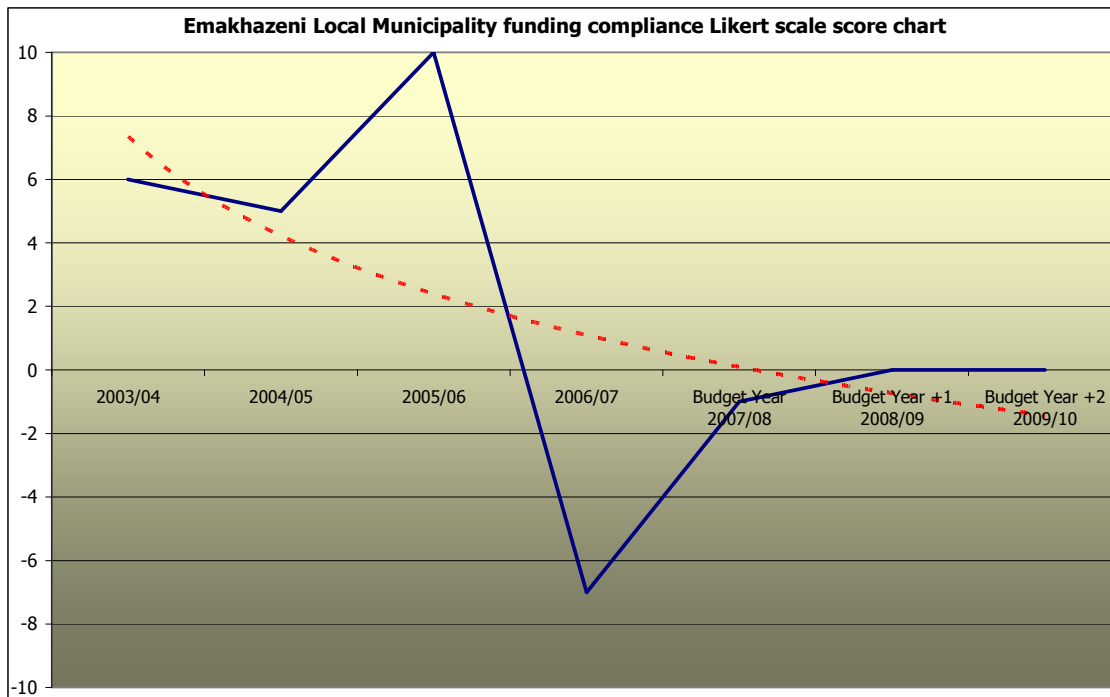
Annexure B3 – Likert Scales Scores (Swartland)

Financial Year:	Measure #	2003/04 Audited Outcome	2004/05 Audited Outcome	2005/06 Audited Outcome	2006/07 Audited Outcome	Budget Year 2007/08	Budget Year +1 2008/09	Budget Year +2 2009/10
Funding measures title								
Cash/cash equivalents at the year end	1	2	1	2	1			
Cash equivalents + investments less applications	2	-2	2	2	1			
Cash at the year end:% of monthly employee/supplier payments	3	1	1	2	2			
Surplus/(Deficit) excluding depreciation offsets	4	1	0	2	2	2		
Service charge revenue % change - macro CPIX target exclusive	5	-2	-2	-2	-2			
Cash receipts % of Ratepayer & Other revenue	6	0	2	2	1			
Debt impairment expense as a % of total billable revenue	7	0	2	2	0			
Capital payments % of capital expenditure	8	-2	-2	-2	0			
Borrowing receipts % of capital expenditure (excl grants)	9	-2	2	2	2			
Transfers/Grants % of Govt. legislated/gazetted allocations	10					2	2	2
Current consumer debtors % change - incr(decr)	11a	-2	1	-2	-2			
Long term receivables % change - incr(decr)	11b	2	2	2	2			
Repairs & Maintenance % of Property Plant & Equipment	12	-2	-1	-1	-1			
Asset renewal % of capital budget	13					-2	-2	-2
Financial Performance Budget result (surplus/deficit)	14	1	0	2	2	2	2	2
Financial Position Budget	15	2	1	1	1			
Cash flow budget	16	2	1	2	1			
Other key performance measures	17	1	1	1	0			
		0	11	15	10	4	2	2



Annexure B4 – Likert Scales Scores (Emakhazeni)

Financial Year:	Measure #	2003/04	2004/05	2005/06	2006/07	Budget Year	Budget Year +1	Budget Year +2
		Audited Outcome	Audited Outcome	Audited Outcome	Audited Outcome	2007/08	2008/09	2009/10
Funding measures title								
	1	0	1	2	0			
	2	0	2	2	-2			
	3	-1	-1	2	-1			
	4	2	0	2	2	0	1	1
	5	-2	-2	-2	-2	-2	-2	-2
	6	-2	2	2	-2			
	7	1	-2	-2	-2	-2	-2	-2
	8	2	-1	-1	-1			
	9	2	2	2	2	2	2	2
	10					0	0	0
	11a	-2	-2	0	-2			
	11b							
	12	2	2	0	0			
	13							
	14	2	1	2	2	1	1	1
	15	0	0	0	0			
	16	1	1	2	1			
	17	1	2	-1	-2			
		6	5	10	-7	-1	0	0



Annexure C – Selected funding compliance measure descriptions

‘14. Financial Performance Budget result (surplus/deficit): the purpose of this measure is to assess the overall budget. A ‘balanced’ budget (revenue = expenditure) may indicate funding compliance, taking into consideration some key aspects of the budget after closer examination (depreciation, asset contributions, capital grants), and evidence of a community paying its way for the resources it plans to consume during the budget period. A deficit may be indicative of property taxes/rates, services tariffs or other fees and charges being too low to cover consumption by the community in the budget period (community may not be ‘paying its way’ and may be deferring obligations to future generations). A deficit greater than the level of non-cash items such as depreciation may indicate a severe funding shortfall and non-compliance with the MFMA. This may require further review and should be considered in the context of the responses to factors 4 ‘surplus/deficit excluding depreciation offsets’ and 16 ‘cash flow budget’. A surplus is not necessarily indicative of additional funds available to spend, as items such as conditional capital transfers/grants may have an influence and the surplus should be examined with care. A surplus may be required to be at a level to produce sufficient internally generated funds to support a sustainable capital budget. Analysis of the trend of previous years’ surplus/deficits is also very relevant, as an improving or deteriorating trend may motivate further or different action.

Care should be taken to motivate and review contributions to provision items initiated for the first time to comply with GRAP/GAMAP; e.g. landfill rehabilitation. Some items may affect the surplus/deficit, but not have an immediate effect on MFMA funding compliance cash position. These items and assumptions should be described in budget documentation. If the Financial Performance Budget result is in ‘balance’ (revenue equals expenditure) depending on the circumstances of the municipality it may also be evidence of non-compliance. If a ‘balanced’ result is being supported by a large amount of capital transfers/grants and other asset contributions it is reasonable to conclude that the levels of tax and service revenue are insufficient to be sustainable.

15. Financial Position Budget: the purpose of this measure is to also assess the overall budget. Special attention should be given to key items such as Inventory, Current Debtors, Non-current debtors (these 3 items broadly grouped as part of ‘working capital’), Borrowing and Community Wealth. Recognition also needs to be given to community growth and its impact on the financial resources of the municipality. If a community is experiencing substantial growth it will likely be causing expanded municipal operations, with increased billing, creditor payments and inventory (refer to individual items for specific discussion). This may require an increased investment in inventory (another working capital item); requiring a cash payment that is not directly reflected in the Financial Performance Budget until the inventory is booked to operational expenses. Efficiency improvements such as ‘Just-in-time’ may

reduce the investment in inventory with a beneficial cash flow impact relative to previous financial years. Debtor collection and creditor payment timing may cause a cash flow shortfall; i.e. if average debtor collection is 45 days and creditor payment and remuneration is 30 days then growth will cause an increased need for cash to cover the gap between payment and collection. Borrowing levels need to be sustainable in that the municipality must be able to prove that it will generate sufficient funds to meet the repayment obligations. An accumulated surplus may indicate that past revenues exceeded expenditure, but unless the surplus is cash-backed it is not available to fund the next medium term budget (refer factor 2 'cash plus investments less application of funds').

16. Cash Flow Budget: the purpose of this measure is to also assess the overall budget. The Financial Performance Budget on an accrual basis contains a number of non-cash items and excludes some cash items, so the Cash Flow Budget is crucial to analyse. Positive cash position and cash flows are required to meet obligations as and when they are due. A steadily improving cash flow balance, relative to the growth of the municipality is a good sign of financial health. Declining cash balances may be evidence of financial difficulties. Care needs to be taken that too much focus is not put on the year end balances of cash alone. This could be the most unfavourable cash position time of the financial year, even of the well-managed municipality, as it could be a sign that the all expenditure programs have been finalised prior to the end of the year. An examination of average monthly balances will overcome this deficiency. Large cash balances may be a sign of mismanagement or disguising mid-year performance problems. Large cash balances could mean that the capital expenditure program was rushed at year end and contractors/suppliers have not been paid, or the program has not been completed and an adjustment budget will be required. Poor revenue collection performance for some months during the year may create temporary cash shortfalls.

17. Other key performance measures: this measure requires an overall review of the performance indicators presented in Table A8 to ascertain if funding related measures are deteriorating, which may be indicative of a funding issue. Crucial performance measures (current debtors' collection rate, the non-current debtors' collection rate, the capital expenditure rate, borrowing level, own-funds devoted to the capital program and the rate of new and renewal/rehabilitated asset acquisition; also electricity and water losses if these apply) should be analysed to ascertain if they are deteriorating. A deteriorating trend could be evidence of a budget that is not credible and sustainable. Trends of these measures can be as crucial as the absolute amount. Deteriorating measurements require investigation and possibly cause a review of the budget' (National.Treasury.(No.5) 2008, 12)

Annexure D – MFMA ‘Budget’ Delays and Exemptions

The Minister of Finance granted a number of delays and exemptions of various sections of the MFMA in Government Gazette (National.Treasury.(No.6) 2004). The delays and exemptions related to ‘budget content’ and ‘annual financial statement’ requirements, categorised by municipal capacity to implement the reforms, were:

Medium Capacity Municipalities

‘The implementation of the following provisions of the Act are **delayed** for medium capacity municipalities until 30 June **2005**:

Section 17(1)(c) and (d)(ii) and (3)(b);

Section 19;

Section 122(2)

The implementation of section 122(3) of the Act is delayed for medium capacity municipalities until **30 June 2007**’ (National.Treasury.(No.6) 2004, 6).

The text of these delayed sections/sub-sections:

‘Contents of annual budgets and supporting documents

17. (1) An annual budget of a municipality must be a schedule in the prescribed format—

(c) setting out indicative revenue per revenue source and projected expenditure by vote for the two financial years following the budget year

(d) setting out— (ii) actual revenue and expenditure by vote for the financial year preceding the current year’ (Treasury 2007, 34)

‘(3) When an annual budget is tabled in terms of section 16(2), it must be accompanied by the following documents:

(b) measurable performance objectives for revenue from each source and for each vote in the budget, taking into account the municipality’s integrated development plan’ (Treasury 2007, 35).

‘Capital projects

19. (1) A municipality may spend money on a capital project only if—

(a) the money for the project, excluding the cost of feasibility studies conducted by or on behalf of the municipality, has been appropriated in the capital budget referred to in section 17(2);

(b) the project, including the total cost, has been approved by the council;

(c) section 33 has been complied with, to the extent that that section may be applicable to the project; and

(d) the sources of funding have been considered, are available and have not been committed for other purposes.

(2) Before approving a capital project in terms of subsection (1)(b), the council of a municipality must consider—

(a) the projected cost covering all financial years until the project is operational; and

(b) the future operational costs and revenue on the project, including municipal tax and tariff implications.

(3) A municipal council may in terms of subsection (1)(b) approve capital projects below a prescribed value either individually or as part of a consolidated capital programme' (Treasury 2007, 38).

'Preparation of financial statements

122. (3) Both annual financial statements and consolidated annual financial statements must be prepared in accordance with **generally recognised accounting practice** prescribed in terms of section 91(1)(b) of the Public Finance Management Act'. (Treasury 2007, 120).

'After 30 June **2005** medium capacity municipalities are exempted from or in respect of sections 17(1)(c) and (d)(ii), 17(3)(B), 19 and ... in so far as those sections are applicable to their annual budgets for the 2005/06 budget year' (National.Treasury (No.6) 2004, 6).

(emphasis added)

Low Capacity Municipalities

'The implementation of the following provisions of the Act are **delayed** for medium capacity municipalities until 30 June **2006**:

Section 17(1)(c) and (d)(ii) and (3)(b);

Section 19' (National.Treasury (No.6), 2004, p7).

'After 30 June **2006** low capacity municipalities are exempted from or in respect of sections 17(1)(c) and (d)(ii), 17(3)(B), 19 and ... in so far as those sections are applicable to their annual budgets for the **2006/07** budget year' (National.Treasury (No.6) 2004, 7).

The implementation of section 122(3) of the Act is delayed for medium capacity municipalities until **30 June 2008**' (National.Treasury (No.6) 2004, 8).

Refer to 'Medium Capacity' delays and exemptions section above for the wording of the relevant MFMA sections.

(emphasis added)

Annexure E – Likert Scales Description

Funding measures title	Measure #	Scale				
Cash/cash equivalents at the year end	1	Positive improving	Positive stable	Positive decline	Negative stable	Negative decline
		2	1	0	-1	-2
		A positive cash balance, either improving or stable is evidence of s18 MFMA compliance. A positive, but declining balance (compared to previous year) could indicate a trend away from compliance, and negative balances would indicate non-compliance.				
Cash equivalents + investments less applications	2	Positive improving	Positive stable	Positive decline	Negative stable	Negative decline
		2	1	0	-1	-2
		A positive cash & investments, balance less committed applications of those funds, either improving or stable is evidence of s18 MFMA compliance. A positive, but declining balance (compared to previous year) could indicate a trend away from compliance, and negative balances would indicate non-compliance.				
Cash at the year end:% of monthly employee/supplier payments	3	Ratio > 4	Ratio > 2	Ratio = 1	Ratio < 1	Ratio < -1
		2	1	0	-1	-2
		A ratio of 4 indicates an ability to meet monthly fixed payment commitments for 4 months without cash inflows (i.e. in the case of a disaster that prevented billing); a ratio of 2 refers to 2 months, a ratio of 1 is for 1 month. A ratio of less than 0 or less than -1 would indicate different degrees of risk in a situation that would require a municipality to rely on short term borrowing.				
Surplus/(Deficit) excluding depreciation offsets	4	Positive improving	Positive stable	Positive decline	Negative stable	Negative decline
		2	1	0	-1	-2
		A positive and improving surplus indicates that revenue is more than sufficient to meet the economic benefits provided to the community, a 'stable' surplus indicates that revenue is sufficient to meet the economic benefits provided to the community, a declining surplus indicates that there may not be sufficient revenue to cover the cost of economic benefits provided in the future, and deficit results (stable or declining) indicate insufficient revenue is being generated.				
Service charge revenue % change – macro CPIX target exclusive	5	% result < 1%	% result < 2%	% result = 0	% result > 0%	% result 'negative' or > 2%
		2	1	0	-1	-2
		The variation to the macro CPIX target is being used as a proxy for real growth in revenues, although in periods where inflation exceed the target rate this may be an inappropriate proxy. Negative % results indicate that revenues are declining in real terms. Positive % increases can indicate (unless proven to be real growth and consumption) price increases greater than National Government macro policy.				
Cash receipts % of Ratepayer & Other revenue	6	> 95% & improving	> 95% stable	> 95% decline	> 90% stable	Other lower collection rate %
		2	1	0	-1	-2
		The % measure is the imputed collection rate by comparing cash collections to revenue billed. In the South African context a rate greater than 95% would generally be accepted as 'good', rates less than 90% would not be uncommon, but indicate a risk of expenditure greater than will be supported by cash collection.				
Debt impairment expense as a % of total billable revenue	7	< 10% & improving	< 10% & stable	< 10% & declining	> 10% and stable	Other higher %
		2	1	0	-1	-2
		There is a correlation between debt impairment (provision for doubtful debts change) and the collection rate, but over medium term averages. Individual financial years can display the result of the sum of the collection rate and debt impairment % exceeding 100% as indicative of collection of 'arrear' debt. A sum of <100% would indicate that the provision was previously over-provided possibly because collection				
Capital payments % of capital expenditure	8	Capital payments % > 110%	Capital payments % > 105%	Capital payments % > 100%	Capital payments % < 100%	Capital payments % = 100%
		2	1	0	1	-2
		It would generally be extremely rare that the capital cash outflows are exactly equal to capital expenditure (100%), simply because of payment timing. However, it is apparent that many municipalities the amounts are equal, indicating that they have not considered timing issues. More serious is that they have not considered the impact on cash management, which can be significant. This situation would mean their treasuries are managing cash by the 'seat of the pants' on a daily basis without any recognition of the medium term budget. Capital payments greater than expenditure in an financial year could indicate the capital program is slowing, with a lower level of risk. Variations from 100% at least partially7 indicate that the municipality recognises and possibly manages cash timing issues. Capital payments less than expenditure could indicate that the capital program is growing, with a greater level of risk on cash management activities.				
Borrowing receipts % of capital expenditure (excl grants)	9	< 50% stable	< 50% deteriorating	< 60% = 0	> 60% stable	> 60% deteriorating
		2	1	0	-1	-2
		A generally accepted norm is that borrowing should be limited to 50% of 'own-funded' capital expenditure. Analysis of one metropolitan municipality suggested that this was the approximate % that could be sustained in the long term (loans repaid without extraordinary price increases for services).				
Transfers/Grants % of Govt. legislated/gazetted allocations	10	= 100% exactly	< 100%	< 95%	> 100%	>105%
		2	1	0	-1	-2
		Allocations to municipalities are included in legislation (National Government - Division of Revenue Act) or gazetted by Provincial Governments. If the % = 100% this indicates that the municipality has exactly included all allocations in its medium term budget, or spent the allocations provided. Other %s indicate either allocations have not been fully budgeted, or budgets higher than allocations and over-expenditure has				
Current consumer debtors % change incr(decr)	11a	Negative < 5%	Negative % (0-5%)	< 5% improving	< 5% stable	> 5%
		2	1	0	-1	-2
		A 'negative; % indicates that debtors balances are reducing, either by improved collection or write-offs. Increasing balances indicate deteriorating collection. This factor relates to only current debtors (billed within the last 12 months).				
Long term receivables % change - incr(decr)	11b	Negative < 5%	Negative % (0-5%)	< 5% improving	< 5% stable	> 5%
		2	1	0	-1	-2
		A 'negative; % indicates that debtors balances are reducing, either by improved collection or write-offs. Increasing balances indicate deteriorating collection. This factor relates to only non-current debtors (billed before the last 12 months).				
Repairs & Maintenance % of Property Plant & Equipment	12	> 5% & improving	> 5% & stable	> 5% & declining	< 5% and stable	Other lower %
		2	1	0	-1	-2
		A reasonable norm appears to be around the range of 6% to 8%. National Treasury has recommended 7 to 15% for infrastructure such as water and sanitation assets (NT(4), 2008). Higher levels of expenditure could be caused by maintenance backlogs and threatening revenue protection. Similarly low levels of expenditure could be causing maintenance backlogs, also a risk to future revenue.				
Asset renewal % of capital budget	13	> 50% & improving	> 50% & stable	> 50% & declining	< 50% & stable	Other lower %
		2	1	0	-1	-2
		A norm has not been established. A 2005 National Treasury circular requested that municipalities include this information in their budgets, but few appear to do so. It is assumed that higher levels of expenditure could be caused by backlogs and threatening revenue protection. Similarly low levels of expenditure could be causing backlogs, also a risk to future revenue.				
Financial Performance Budget result (surplus/deficit) (refer measure 14 Annexure C for a description of the measurement)	14	Surplus & improving	Surplus & stable	Balance	Deficit & stable	Deficit & deteriorating
		2	1	0	-1	-2
		Overall assessment of magnitude and direction of the overall financial performance result (surplus/deficit)				
Financial Position Budget (refer measure 15 Annexure C for a description of the measurement)	15	Substantial improvement	Minor improvement	Stable	Minor deterioration	Substantial deterioration
		2	1	0	-1	-2
		Overall assessment of the financial position				
Cash flow budget (refer measure 16 Annexure C for a description of the measurement)	16	Positive & improving	Positive & stable	Neutral cash movement	Negative & stable	Negative & deteriorating
		2	1	0	-1	-2
		Overall assessment of the cash flow budget				
Other key performance measures (refer measure 17 Annexure C for a description of the measurement)	17	Substantial improvement	Minor improvement	Stable	Minor deterioration	Substantial deterioration
		2	1	0	-1	-2
		Overall assessment of key performance measures				