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The Evaluation of Financial Management in South African Local Government: Budget Funding Compliance Measurement to Evaluate Best-Practice Financial Management Technical Assistance to South African Municipalities

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Abstract: A fundamental aim of South Africa's local government international financial management best-practice technical assistance program (MFMTAP) resides in financial management and budget technique quality improvement. Achieving credible and realistic municipal budgets and avoiding municipality financial failure is a second crucial element of the South African local government financial management reform program. This paper considers whether a municipal budget funding compliance technique recently developed by the South African National Treasury (NT) to measure municipal adherence to the budget funding requirements of the Municipal Finance Management Act (MFMA), including a focus on 'realistic' revenue budgeting, provides a potentially sound basis for understanding the reform program. In order to investigate this question, this paper employs a case study which suggests that NT and MFMA funding objectives are not being achieved in the budget process four years after the MFMTAP commenced, which could be attributable to either best practice technical assistance (BPTA) outcomes or the effects of BPTA termination. Following an analysis of various financial performance outcomes of a major South African metropolitan municipality, which constituted our case study entity, and was directly assisted by a BPTA advisor for approximately 3 years, both before and after receiving assistance, we conclude that BPTA performance can be assessed using the NT funding compliance technique. While our analysis raises several questions about the sustainability of the BPTA program for this aspect of the South African local government reform process, we add the caveat that firm conclusions cannot be drawn from a single case study municipality.

Keywords: Best-practice technical assistance; medium-term budgets; funding compliance; local government; South Africa.

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Introduction*

There is now widespread recognition that governance constitutes a crucial element in any development strategy. An important but oft-neglected aspect of effective governance resides in appropriate and transparent budgeting in the public sector (Huther *et al.* 1997). In the particular case of municipal government in developing countries, which is especially prone to local government failure (Buthelezi and Dollery 2004; Dollery and Wallis 2001), sound local public budgeting is an essential prerequisite to efficacious service provision. While the great comparative institutional advantage of local government undoubtedly resides in its superior knowledge of local conditions and local community needs, 'full realization of that promise requires strong fiscal administration so that citizen interests are reflected in local programs; so that policies are conducted in a fiscally sustainable way; and so that resources are not lost through inefficient, ineffective, wasteful, or corrupt operations' (Mikesell 2007, 15).

In response to the consensus that sound budgeting practice forms a critical foundation underlying municipal performance, in contemporary development strategies local budgets have evolved to include being a fiscal discipline tool, a key feature of MFMTAP. Other significant factors identified in the international development literature that are especially relevant to the South African municipal financial management environment encompass the following (Shah 2007):

- Revenue estimates should be as accurate as possible in order to avoid large financial deficits or surpluses, as well as making policy

* The municipal funding compliance technique described in this paper is one of the BPTA procedures being applied by the South African National Treasury (Local Government Budget Analysis (LGBA)) to evaluate MFMA funding compliance by municipalities. The financial management reform commitment of the South African National Treasury to improving municipal financial performance, is acknowledged. Brian Dollery also gratefully acknowledges the financial support provided by an Australian Research Council Discovery Grant DP 0770520.

makers aware of the fiscal impact of capital investments. As we shall see, South Africa has recognised the importance of this factor through budgeted revenue control in Section 18 of the Municipal Finance Management Act (MFMA).

- Shah (2007, 3) has observed that 'local governments in developing countries are facing increasing fiscal strain as cities and their infrastructure requirements expand and revenue growth lags behind'. This international trend is reflected fully in the massive growth in local service infrastructure in South Africa, particularly in electricity, water, sanitation and local roads, as the national government seeks to provide essential local services to the sprawling townships surrounding South African cities.
- In successful local development strategies 'fiscal discipline' represents a capstone in public finance management. Because it is intrinsically linked inherently to 'notions of affordability', it has come to imply 'maintaining budgeted and actual spending, revenue, and borrowing at levels that are financially sustainable and compatible with short and long-term economic objectives'. However, it must be stressed that the main 'value of fiscal discipline' derives not only in 'avoiding the negative external and internal impacts as in seeking the benefits of hard budget constraints for spending effectiveness and efficiency' (Shah 2007, 3).
- Shah (2007, 4) has noted that fiscal discipline is 'best supported by rules or by greater central government oversight and control over sub-national borrowing' and, at the local level, 'own-revenue capacity and efficient local revenue administration' represent the key pillars of local fiscal discipline. Moreover, those local authorities that employ contemporary budgetary techniques, such as 'medium-term budgeting, modern classification systems, improved internal controls and use of performance measures' are 'better placed' to preserve fiscal discipline. In the South African municipal context, these sentiments seem particularly apt.

- The proposition that the ‘ease or complexity of implementation’ plays a crucial role in local public financial management and must thus be carefully matched with administrative and technical capacity implies that ‘decision makers should select formats matching the skills and experience of budgeting and financial management staff’ (Shah 2007, 6). This principle has not been applied in the South African municipal milieu. By contrast, the BPTA has focused on developing ‘end-state’ formats to be progressively implemented as local capacity-building programs are rolled out.
- It should be emphasized that the South African MFMTAP is not dissimilar to analogous programs adopted elsewhere in southern Africa. While accepting this fact, Shah (2007, 6-7) is at pains to stress that ‘in sub-Saharan Africa’ where ‘budgeting is ‘evolving to meet new challenges’ the ‘best budgetary practices are dynamic’ and if ‘transposed to the development context in Sub-Saharan Africa, require continuous adaptation for success’ instead of ‘simple importation or imitation’.

Shah (2007, 10) concluded his analysis by setting out ‘five conditions’ under which a ‘separate’ and ‘well-developed’ capital budgeting process will benefit local government in developing countries; circumstances which accurately capture the contemporary South African local government environment. In the first place, where local government must accommodate local growth through local infrastructure investment, or alternatively, where local infrastructure investment is necessary to spur local growth. Secondly, where local government ‘faces large capital needs requiring the investment of substantial amounts of money’. Thirdly, where the fulfillment of local public infrastructure needs will improve the ‘most basic features of the community’. Fourth, where capital financing is based on long-term payment obligations, such as debt and capital leasing. Finally, where the ‘operating budget process is not well suited to planning and financing the local government’s capital needs’. These ‘five conditions’ all pertain in contemporary South African local government.

Against this background, this paper considers whether a municipal budget funding compliance technique recently developed by the South African National Treasury (NT) to measure municipal adherence to the budget funding requirements of the Municipal Finance Management Act (MFMA), including a focus on 'realistic' revenue budgeting, can potentially provide a basis for understanding MFMTAP achievements. In order to investigate this question, this paper employs a case study to assess whether the NT and MFMA funding objectives are being achieved in the budget process four years after the BPTA commenced.

The paper itself comprises four main parts. Section 2 describes the current South African municipal environment mainly to understand the circumstances in which the international best-practice reform program commenced, as well as the requirement for strict fiscal discipline encouraged by the BPTA program and the derivative need to determine whether the BPTA objectives are indeed being achieved. Section 3 considers the funding compliance procedure, describing both the procedure and the NT project that initiated the procedure. Section 4 examines the outcomes of our analysis, as it applied to the financial results of one large municipality (eThekwini Metropolitan) since its creation in 2000. The paper ends with some brief concluding remarks in section 5.

South African Municipal Government

Local authorities in South Africa are commonly referred to as 'municipalities'. In any analysis of the operation of these municipalities, it is important to appreciate the South African municipal government environment, its managerial and administrative capacity, together with the broad constitutional and legislative context in which local government finds itself. Brand (2007, 11) has provided an apt synoptic description of the current woes of South African local government:

> Although there are shortages of appropriately qualified personnel in all three spheres of government, it is perhaps more acute in local government. This situation is aggravated by serious under-performance by some municipalities.

> The seriousness of the situation in some communities has even led to public protests by residents because they are not receiving the services that a municipality should provide.

An official *White Paper (Section G - Municipal Finance),* published in 1998, accurately captured the urgent need for remedial reform in local government financial management by observing that ‘budgeting, accounting, financial reporting and financial management practices suffer from a number of weaknesses’, including ‘unrealistic budgeting’, ‘poor credit control’ and ‘a lack of budgetary and financial discipline’.

In response the South African National Treasury (NT) embarked on a technical assistance capacity-building program in 2000. The NT website states that its ‘primary objective is to secure sound and sustainable management of the financial affairs of government, national, provincial and local, and to lead such policies and reforms’ (NT MFMA website). The NT’s Municipal Financial Management Technical Assistance Program *(MFMTAP)* was a ‘pilot’ program of local government reform and capacity building. MFMTAP was supported by numerous international expert advisors that commenced in 2003 with seven municipalities and later expanded to 36 municipalities in total. The expert advisors were required to guide the preparation and tabling (at meetings of the municipal council itself) of a multi-year budget. It can be reasonably implied that NT expected an improvement in budget outcomes from this process by achieving ‘substance as well as form’ and not merely ‘form’.

The content of the budget was determined by the Municipal Finance Management Act 56 of 2003 (MFMA). The MFMA was modelled on the Public Finance Management Act (PFMA) - similar in content to legislation applicable to the broader public sector - but modified for specific local government conditions. The MFMA aims to enhance budget, accounting and financial management practices by placing local government funding on a sustainable footing in order to maximise the capacity of municipalities to deliver services to communities (NT MFMA website 10/11) (emphasis added). The provisions of the MFMA directly relevant to this paper are:

Funding of expenditure

18. (1) An annual budget *may only be funded* from -

(a) *realistically anticipated revenues* to be collected;

(b) *cash-backed* accumulated funds from previous years' surpluses *not committed* for other purposes; and

(c) borrowed funds, but only for the capital budget referred to in section 17(2).

(2) *Revenue projections* in the budget must be *realistic*, taking into account -

(a) projected revenue for the current year based on *collection levels to date*; and

(b) actual revenue *collected in previous financial years*.

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 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*' (MFMA, 56 of 2003) (emphasis added).

These sections of the MFMA are intended to restrain municipalities from spending beyond their means, in terms of encouraging or restricting budgets to include only regular collectable revenue and only borrowing for capital expenditure (thereby implying that municipalities cannot borrow for operational purposes, since ‘operational borrowing’ would create a risk of unsustainable operations). These MFMA provisions are a good example of how the South African central government has responded to the local government financial management challenges described in general by Shah (2007) and in particular in its own White Paper.

Since the commencement of the MFMTAP program, the NT has regularly issued guidance pronouncements, known as *MFMA Circulars*, to provide direction to municipalities on the implementation of the reform process. Two of the key circulars relevant to the present paper are *MFMA Circular 28: Budget Content and Format* (2006-07 MTREF) and *MFMA Circular 42: Funding the Municipal Budget*. *MFMA Circular 28 (MFMA 28)* was one of the more significant MFMA circulars issued by NT, introducing a required format and content for the municipal budget. It emphasized that the ‘budget must be funded according to MFMA section 18(1); and that the budget must be credible’.

MFMA 28 and MFMA 42 defined a credible and realistic budget as including:

- ‘Contains revenue and expenditure projections that are consistent with current and past performance and supported by documented evidence of future assumptions (MFMA 28, 2005);
- Does not jeopardise the financial viability of the municipality (ensures that the financial position is maintained within generally accepted prudential limits and that obligations can be met in the short, medium and long term) (MFMA 28, 2005);
- A realistic, credible, viable and sustainable budget is achieved through simultaneous alignment of projected financial performance, financial position and cash flows (MFMA 28, 2005);
- The budget can only be funded by realistically anticipated revenue to be collected and cash-backed accumulated funds from previous years, not committed for other purposes (MFMA 28, 2005);

- The capital budget may be funded by cash-backed current year surplus in the Financial Performance budget, including capital grants and other contributions, cash-backed accumulated funds from previous years not committed for other purposes, and borrowing (MFMA 28, 2005);
- The term ‘realistically anticipated’ requires the budget to take into consideration previous years performance, and the likelihood of whether all revenue sources will be realised (MFMA 28, 2005);
- Capital expenditure must only be included in the budget if there is certainty that financing will be secured’ (MFMA 42, 2007).

These requirements are critical to the funding measurement approach which we will consider below.

In addition, the NT embarked on a project in early 2007 to prepare ‘Budget’ regulations, designed to regulate similar requirements to that contained in MFMA Circulars 28 and 42. The principal purpose of using these regulations was to ensure a greater level of municipal compliance, especially targeting municipalities that were less inclined to implement reforms on a voluntary basis.

Part of the regulatory agenda was to include an elaboration of the MFMA’s expenditure ‘funding’ requirements. The draft regulations, likely to be promulgated in 2008 after extensive stakeholder consultation, included a requirement for a ‘funding compliance’ table to be placed within budget documents. The ‘funding compliance’ table comprises a series of selected measures intended to provide the relevant council and the local community with confidence that the budget complied with the relevant sections of the MFMA, and was therefore both realistic and credible.

As we have seen, the purpose of this paper is partly to assess whether these ‘funding compliance’ measurements achieved the stated objectives. The assessment must be based on whether the measurements, using the evaluation of our case study municipality, were able to highlight trends and levels of compliance and non-compliance.

MFMA 'Funding Compliance Measurement' Initiative

The thorny problem of understanding BPTA successes is a critical element as the MFMTAP reaches its conclusion in May 2008. During 2007, after over six years of the MFMTAP progressively providing *BPTA* to municipalities, and providing 'encouragement' to improve financial management practices, a decision was made at the NT to embark on the production of 'Budget Regulations' to support various aspects of the MFMA. A key question to be answered, as the MFMTAP moves to a scheduled completion in May 2008, is whether there has been discernable improvement in the quality of the budget documentation and the financial outcomes? It would also be relevant to ask whether there is a capacity improvement difference between the municipalities provided with direct BPTA and those that have not received assistance. The 'funding compliance measurement' initiative provides an opportunity to develop an improvement assessment technique. For example, is it possible to gain an understanding of the true financial position of a target municipality, something which was stated as not being possible at the time of the *White Paper*?

With respect to a similar local government technical assistance program in Hungary, Straussman (2001, 4) has observed that 'the ultimate test of this capacity-building strategy is whether one can discern an improvement in government performance'. In the present case, it is thus pertinent to ask if the 'funding compliance' performance of municipalities can be evaluated.

If improvement is generally a discovered outcome, then it could be argued that any improvement would have occurred regardless of the MFMTAP, simply by enforcement of the legislation, or that improvement would have occurred naturally as the South African local government restructuring program was consolidated and embedded. It would thus be useful to have a controlled test. However, in the real world of South African municipal government it would have been difficult to create a control group of municipalities that had not received any capacity-building assistance. Indeed, all municipalities have received at least some assistance funding and all have received the benefit of guidance circulars and various other publications. However, of the 283 municipalities in South Africa, only 36 received varying terms of a BPTA advisor and a much smaller number of local authorities were provided with an advisor for a considerable length of time. It is also worth noting that some municipalities have had more than one advisor, and some had more than one advisor for very short periods of time. Moreover, it is likely that there was a degree of variability in the ability, experience and acceptance of the advisors. It was not uncommon for municipalities to be resistant to receiving BPTA assistance, and in these cases the municipalities could also comprise a control group due to the minimal influence of the BPTA.

Sections 18 and 19 of the MFMA, as indicated earlier, include prescriptions of how a budget must be funded; revenue must be 'realistic', spending of accumulated funds can only take place if the funds were cash-backed, and borrowing can only occur for the capital expenditure (or refinancing earlier borrowing for capital). These constraints are embedded in this legislation because many municipalities were previously budgeting for fictitious or uncollectible revenue inconsistent with past collection performance, or were borrowing to fund operational costs with potential dire long-term financial consequences. By contrast, other municipalities had conservatively amassed reserve funds, but were not using these funds to deal with massive service backlogs in their communities.

However, despite the guidance provided in previous budget circulars, formal questions directed to the NT about the MFMA suggested there was still lack of clarity about how a budget would be considered 'compliant funded' in accordance with the MFMA. MFMA Circular 42 (issued in March 2007) attempted to add some clarity to the subject, but was probably too late to significantly influence the 2007-08 Medium-Term Revenue and Expenditure

Frameworks (MTREF) to be approved by the end of June 2007. The MTREF is the name given to the 3 year medium term budget that every municipality was required to approve every year.

The decision to proceed to issuing budget regulations was an opportunity to further prescribe aspects of funding compliance. Guidelines to be issued with the regulations would provide an expanded opportunity. A sub-project of the 'Budget Regulations' project was commenced to produce a 'funding compliance procedure' to test MFMA compliance of municipal budgets. The budget format was proposed to align to national and provincial government budget format, which are required to include 3 years of audited 'actuals', the approved budget for the current year, and adjustments made as comparative information, as well as a future 3 year medium-term budget.

The funding compliance procedure and its analysis provided a basis for evaluating specific aspects of municipal financial performance, but arguably an improvement in financial performance was an intended outcome of the MFMA, albeit implied rather than an explicitly stated. Accordingly, the funding measurement analysis could in turn provide an opportunity to discern evidence of BPTA success or otherwise (i.e. that if a municipality's performance improved during and after the program, then this may be evidence of BPTA success). However, it is recognised that this measure alone would not empirically validate the BPTA process due to the high possibility that performance change was caused by other variables.

The MFMA 'funding compliance procedure' is a potential BPTA measurement that forms the focus this paper; that is, to determine whether the procedure can be a measurement tool for assessing the BPTA process. The approach proposed here is to analyse the outcomes of the procedure for one metropolitan municipality that had been the beneficiary of a technical advisor from mid-2003, one year prior to the applicability of the MFMA, until 2006. The analysis will focus on measuring financial performance in the two financial years prior to the BPTA (i.e., the 2001-02 and 2002-03 financial years), analyzing the trends during the BPTA, and considering the status of the 2007-08 MTREF to understand the current post-BPTA position. Financial performance is considered to include 'format presentation' requirements (that the municipality has in fact budgeted for the next three financial years, as required by the MFMA), as well as the 'quality' and MFMA compliance of the financial information. A working hypothesis is that the sample municipality would indicate signs of performance improvement during and after the provision of BPTA.

The MFMA funding compliance procedure built upon the advice given to municipalities in MFMA Circular 42 (Funding the Budget) in March 2007. The aim was to provide a basis for independent analysis and municipality self-assessment of the level of compliance with the MFMA funding requirements of Sections 18 and 19. By examining various components of the level of funding over time, pre- and post-BPTA for the municipalities that had been provided with a technical advisor, conclusions may be possible on some aspects of municipal financial management performance and its relationship to MFMTAP.

A contentious part of municipal accrual accounting and budgeting, particularly related to Section 18 of the MFMA, resides in demonstrating whether a municipal budget complies with its requisite legislative funding requirements (i.e., that expenditure must be funded with legitimately expected collectible revenue). A common situation was that municipalities approved expenditure budgets supported by dubious claims about their ability to collect revenue that did not take into consideration past collection performance.

Municipal accounting requirements include relatively complex 'reserve' accounting to recognise various statutory and policy commitments. However, the reserving is predominantly 'accounting' results that need to be deliberately backed by cash and investments if required. If this cash backing is not done, then it is possible for a municipality to report on accumulated surpluses which are not cash-backed, and therefore funds are not actually available to be used to ‘fund’ future expenditure. This is most likely where surplus cash has been transferred to the capital budget. Moreover, timing is a crucial element of any evaluation, as an ostensibly favourable cash and investment position at year-end may rapidly dissolve as the municipality meets its creditor obligations.

A funding compliance procedure is intended to overcome the shortcomings of other measurement approaches by testing a number of elements. The procedure proposed includes a series of compliance tests. The order of the tests was deliberately sequenced from solvency to sustainability. For example, the first test was to simply evaluate for a positive cash/cash equivalents balance at year end, with a ‘negative balance’ providing some initial evidence that ‘all may not be well’. Towards the end of the procedure the focus turns to sustainability tests such as asset repair and renewal levels to ensure that revenue-generating assets are protected. For instance, whether electricity distribution infrastructure assets are maintained to ensure that electricity supply is not significantly disrupted. The intent was that favourable responses to the all of the tests will provide confidence that the budget is funded in accordance with MFMA requirements. The flowchart displayed in Appendix B illustrates the entire funding compliance procedure.

The procedure draws on various components of a municipality's annual and budgeted financial statements. Budgeted financial statements, which were required by MFMA Circular 28 from the 2005-06 MTREF onwards, are therefore an essential element of the calculations to ascertain compliance with the MFMA. Yet even some high capacity ‘metro’ municipalities displayed deficiencies in this aspect of their budgets. A key element of the procedure is the proposed introduction of a requirement to include in a medium-term budget the 3 years of prior-year audited outcomes, consistent with the requirements of national and provincial budgets. Without this history it would be difficult to analyse past municipal performance and trends. The ‘7 year view’, consistent with national and provincial budget formats, comprising the 3 prior years of actual financial information, the year in which the budget is being prepared and the 3 year medium term budget, provides a powerful tool for analysing trends. Since most 'metros' introduced Generally Recognised Accounting Practice (GRAP) or Generally Accepted Municipal Accounting Practice (GAMAP) from 2003-04, and some only in 2004-05, it was only for the 2007-08 MTREF that 3 prior years of 'actuals' are available for some municipalities on a comparable basis. However, it is possible to undertake a reasonably accurate translation of financial performance, financial position and cash flow outcomes prior to 2003-04 using municipal financial statements that used formats issued by the Institute of Municipal Finance Officers (IMFO), with the translation controlled by a reconciliation of the cash flow statement.

The measures used in the proposed funding compliance procedure include:

- Cash/cash equivalents at the year end;
- Cash equivalents plus investments less applications;
- Cash at the year end: per cent of monthly employee/supplier payments;
- Financial Performance (operating) Surplus/Deficit excluding depreciation offsets;
- Service charge revenue per cent change – macro-economic inflation target exclusive (how much the service charge revenue increase exceeded the macro-economic inflation target);
- Cash receipts as a percentage of Ratepayer & Other Revenue (i.e. an imputed collection rate);
- Debt impairment (doubtful debts) expense as a percentage of total billable revenue;
- Capital payments as a percentage of capital expenditure (cash versus accrual);
- Borrowing receipts as a percentage of capital expenditure (excluding grants) (MFMA Section 19 borrowing compliance);
- Grants as a percentage of government-legislated/gazetted transfers (have all transfers been budgeted for?);
- Current consumer debtors percentage change (i.e. collection or otherwise of last year's outstanding debtors);

- Long term receivables percentage change (i.e. collection or otherwise of long-term arrear debtors);
- Repairs and maintenance as a percentage of Property Plant & Equipment asset value;
- Asset renewal as a percentage of the capital budget (i.e. amount spent on renewal); and
- Finally, overall conclusions made about the budgeted financial statements and other key performance indicators and related trends.

The depreciation 'offset' referred to above is the amount of depreciation attributable to assets purchased with external funds, which are mainly provided by national and provincial governments. The NT policy position is that this expense should be excluded from analysis that supports property rate and tariff proposals because its inclusion effectively means that the community is being taxed twice for the same assets. An alternative view is that the application of this principle will mean that a municipality will not generate sufficient funds to be able to replace the asset, and that when the asset's life is expired the municipality may require external funding to replace it.

A full description of each of the measures can be found in the 'MFMA Funding Compliance Guideline' on the South African National Treasury (MFMA website).

The funding compliance procedure was initially tested as part of the development of the proposed municipal budget formats, being created in conjunction with budget regulations, to ascertain if the measures were relevant and readily calculable from available data. The measures are intended to provide a basis for concluding that MFMA funding compliance has been achieved by municipalities in their approved budgets. When the development of the procedure had reached a reasonably robust stage, it was introduced to an investigation team within NT's 'Intergovernmental Relations', which applied the procedure on the 2007-08 MTREFs of three of the large metropolitan municipalities. It was then agreed that all of the six 'metros' would be specifically analysed for MFMA funding compliance for the 2007-08 MTREF and the municipalities advised of the results. The tool used was a part of the municipal budget 'template' being developed to test the proposed formats. This process was completed during November 2007 and the Municipal Managers of the each of the municipalities was advised of the analysis outcomes.

Funding Compliance Analysis of Case Study Municipality

We have 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.

One major metropolitan municipality was initially analysed for this purpose. This municipality, like all other metropolitan municipalities, represents an amalgamation of a number of previous local authorities (based largely on race under the former apartheid government) centred on a former large city municipality. Appendix A contains the output table of the analysis of our case study 'example' metropolitan municipality, including a short description of each indicator on which the information was based. The table presents the funding compliance measurements for seven years of actual outcomes and the 2007-08 MTREF.

The time scale of the output table can be divided into 3 distinct sections. The years 2000-01 to 2003-04 fell prior to the implementation of new accounting standards, requiring that financial statements be translated to the compliant format. The translation was imperfect as all equivalent information was not presented in this period. 2003-04 financial results were restated by the municipality when the new accounting standards were implemented and therefore are comparable to the financial years in the middle section of the chart. The ‘middle’ years are audited annual financial results. The final section - the years from 2007-08 - represents budgeted amounts. A medium term (3-year) budget is a fundamental target of the legislation and the compliance testing, and thus should be included in the comparison.

The change in trend in a number of measurements are worthy of further evaluation since these may appear to indicate non-compliance with the MFMA.

The ‘cash and cash/equivalents at year-end’ measure - a very basic measure of liquidity - is intended to only provide an immediate early warning in regard to MFMA non-compliance or solvency risks if it is negative. The measurement outcomes of ‘actuals’ approximate the measurement result at the time of the BPTA commencement base-line since the beginning of the measurement period, yet the 2007-08 budget forecasts increase substantially.

The 2007-08 MTREF cash/cash equivalent forecasts appear to be highly inconsistent with past actual outcomes, suggesting a risk of non-achievement. The next measure, which adjusts for non-current investments and planned applications of the funds is indicative of a funding shortfall, with the 3 years of the medium term budget all being ‘negative’ amount meaning that required applications of funds exceed available cash resources. This also suggests that the 2007-08 MTREF is in default of MFMA section 18, and possibly section 19, that budgeted expenditure is not funded. A related concern is the cash coverage of monthly average salary and creditor budgeted payments, with the ratio suggesting a high level of optimism compared to prior year trends with a 6.5 times coverage in 2007-08 compared to the previous highest ratio of 1.4 in 2003-04. This of course is directly related to the level of cash/cash equivalents previously discussed.

Other ratios of concern are the revenue collection rate and debt impairment percentage targets. The collection rate percentage is calculated by dividing cash receipts into the amount of total billing for property rates and service charges (for electricity, water, sanitation and hard refuse) and other direct revenue, such as building and planning fees, recreation facilities' usage, etc., adjusted for 'financial position' changes. The imputed collection rate for the 2007-08 budget is 95 per cent, compared to only 90 per cent achieved in the 2006-07 financial year and 90 per cent in 2005-06. In the first place, this suggests non-compliance to MFMA section 17 because the measures indicate that revenue collection assumptions do not appear to meet the definition of 'realistic', being greater than collection levels achieved in the year the budget was prepared and greater than collection levels in prior years. The *White Paper's* description of 'unrealistic budgeting' still appear to be continuing well into the decade following its publication, but crucially after direct BPTA had ceased.

The 'debt impairment percentage' (representing 'doubtful debt expense' as a percentage of billable revenue) has a direct relationship to the revenue collection assumption. As collection rates improve or deteriorate, the provision for doubtful and bad debts should generally move in the opposite direction. The reduced debt impairment percentage is consistent with an improving collection rate, but inconsistent with past and recent performance and also probably in default of the MFMA section 18 requirements. The significantly large tariff increases approved also put collection target rate improvement targets at risk.

The forecast reduction in consumer debtors is also consistent with the revenue collection assumption, but an improbable outcome considering past trends. If the revenue collection rate is less than 100 per cent the consumer debtors or long-term receivables balances will increase.

Asset renewal capital expenditure was not disclosed, although the level of asset maintenance is being maintained at a relatively consistent level, suggesting there is some protection to revenue generating assets.

Concluding Remarks

Our general conclusion from the analysis conducted above is that there is evidence that the 2007-08 MTREF does not meet the basic requirements of section 18, and probably section 19, because expenditure budgets have been approved at a level that will be unlikely to be fully funded.

On the basis of our analysis, it is also concluded that, for the case study municipality analysed, there is sufficient justification for performance differentiation in the measurement results to justify extending this line of analysis to other municipalities (i.e. that budget formulation objectives consistent with MFMTAP objectives are not being achieved). If the same results are evident in a larger sample, then this would provide some support for a finding that the measurements could be used with complementary evidence as analysis of BPTA performance outcomes.

Our case study analysis does not support a conclusion that BPTA has assisted the municipality in question to improve the budgeting aspect of its financial management practice, management capacity improvement, and legislative compliance requirements in the medium term. On the contrary, there is a distinct suggestion that the most recent budget forecasting practices do not meet the requirements of the legislation. However, given that direct BPTA ceased prior to the compilation of the 2007-08 MTREF, it could also be concluded that any improvement resulting from BPTA diminished because of the BPTA withdrawal. This accords with the observation by Bremer (1984, 11) that 'long and short-term advisors can be effective in increasing the supply of policy analysis by actually performing the analysis themselves'. In other words, effective progress was achieved during the tenure of the advisor/s providing technical assistance, but diminished after these services were withdrawn. This conclusion could be further analysed by considering an expanded sample of municipalities that have had previous access to BPTA, which could be compared to analysis of municipal budgets with continuing BPTA support.

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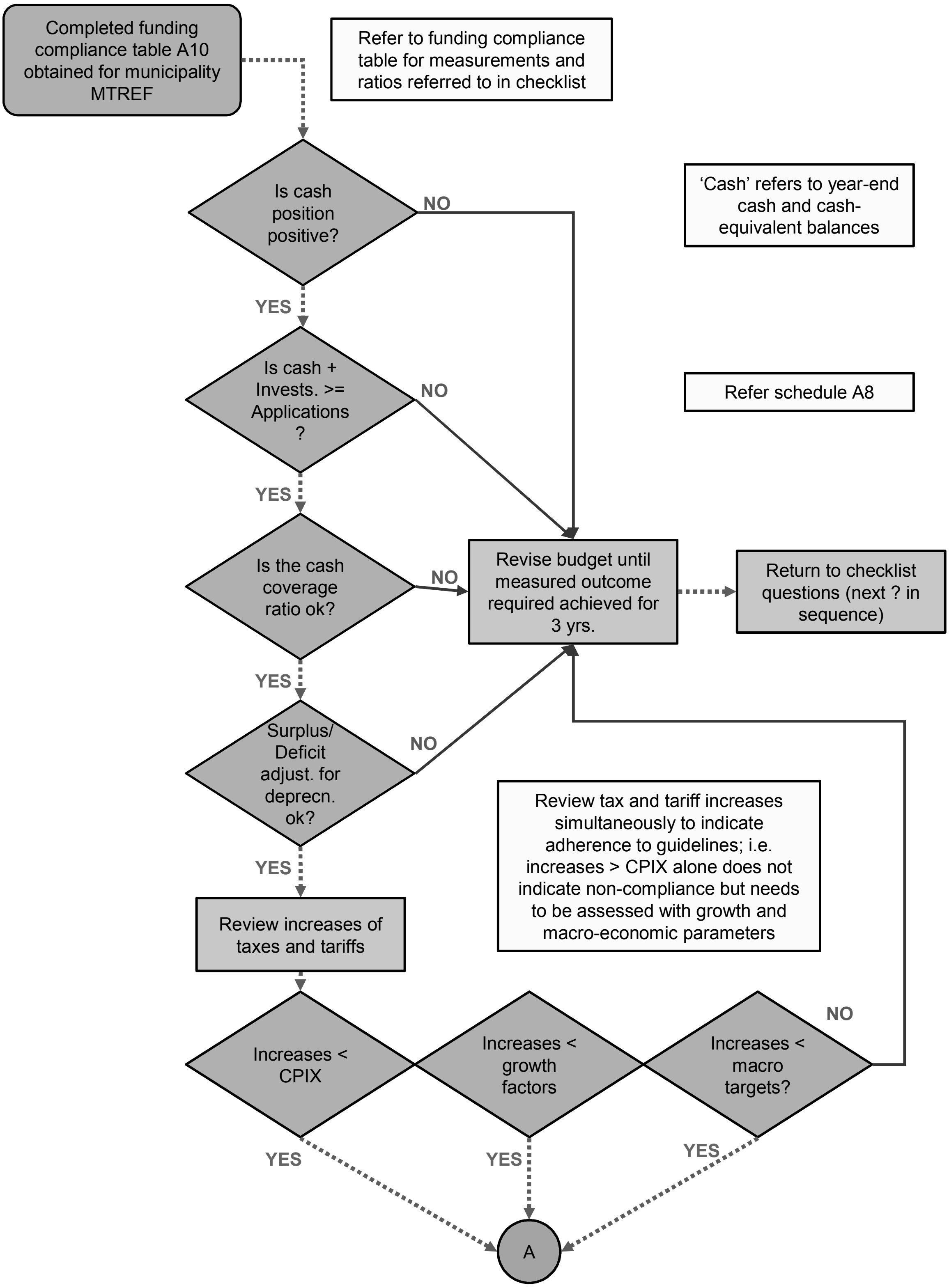
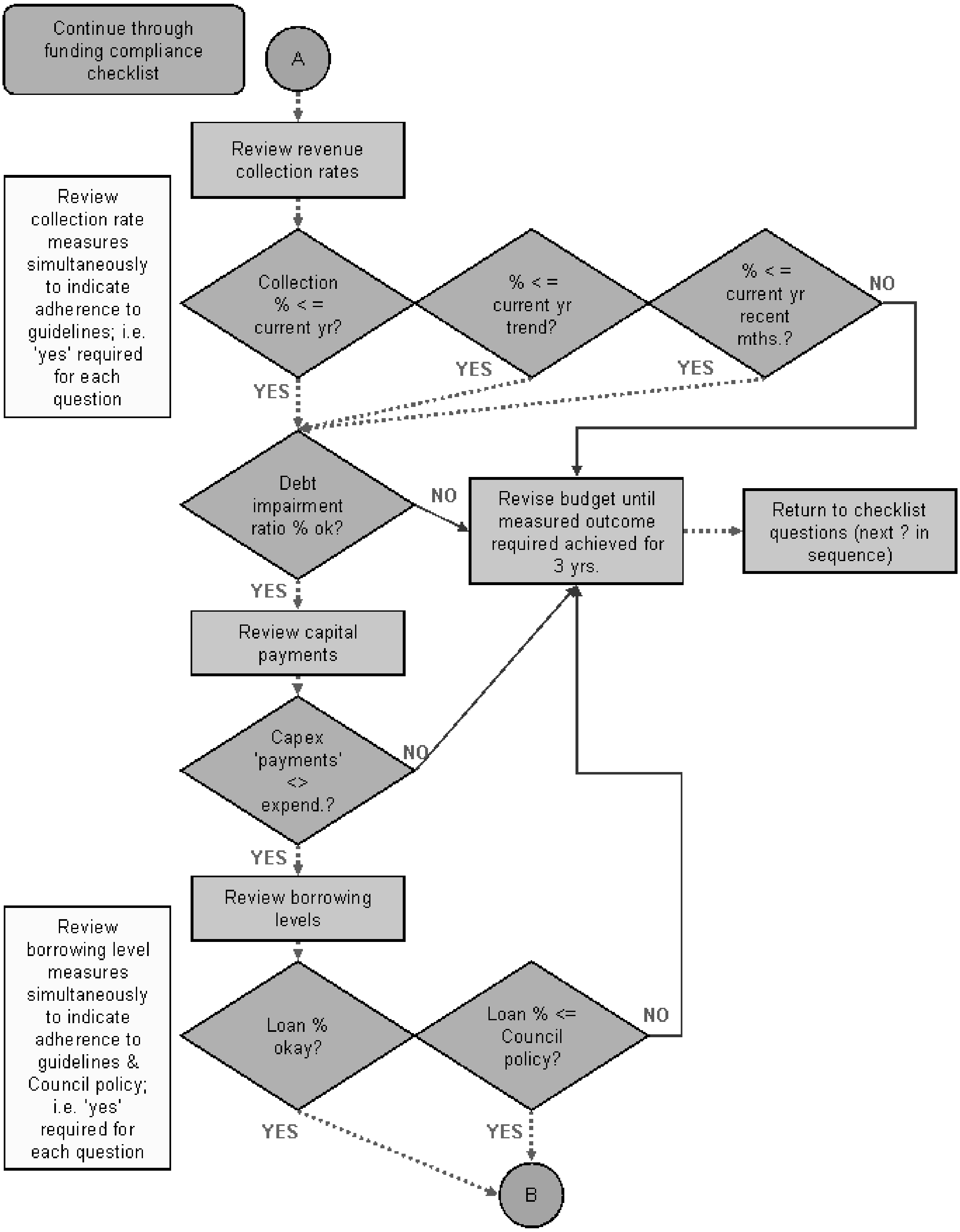
Annexure A – MFMA Funding Compliance Table (Example Metropolitan Municipality)

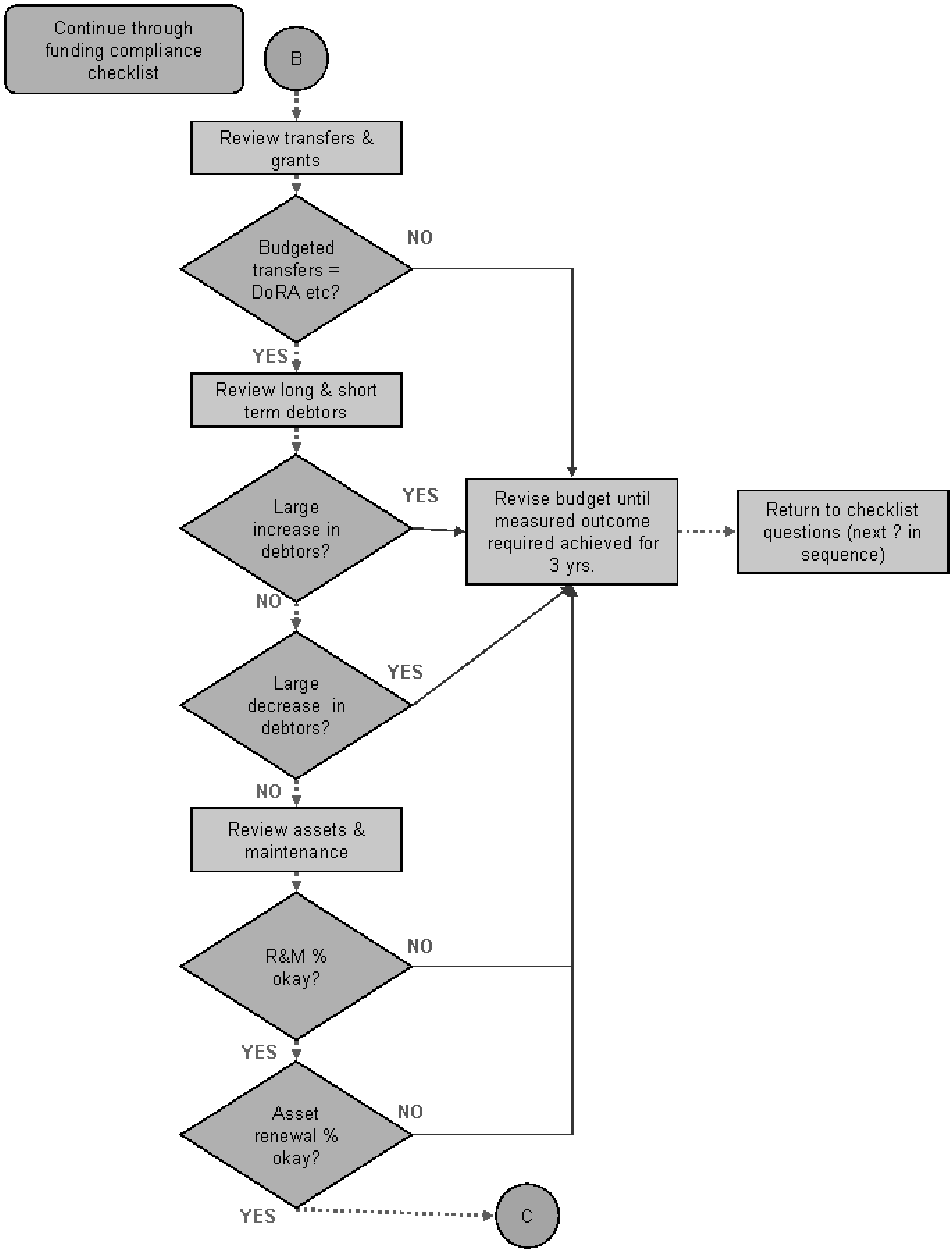
Example Metropolitan Municipality – Funding Measurement- Table A10											
Description	MFMA section	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08 Medium Term Revenue and Expenditure Framework		
		Audited Outcome	Audited Outcome	Audited Outcome	Audited Outcome	Audited Outcome	Audited Outcome	Pre-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	(84,299)	(917,219)	(179,285)	752,943	27,074	42,790	370,101	2,934,348	2,682,847	2,580,967
Cash + investments at the year end less commitments – R'000	18(1)b	624,301	584,651	686,123	1,394,955	(265,182)	392,518	(330,348)	581,051	871,829	(31,279)
Cash year end/monthly employee/supplier payments	18(1)b	-0.2	-1.9	-0.3	1.2	0.0	0.1	0.5	3.8	3.3	2.9
Surplus (Deficit) excluding depreciation offsets: R'000	18(1)	212,847	620,589	426,345	(206,239)	783,493	351,354	1,327,462	1,719,070	2,740,081	1,865,186
Service charge rev% change – macro target exclusive	18(1)a,(2)	-6.0%	1.0%	-6.1%	5.1%	2.7%	-1.5%	3.0%	2.8%	1.9%	1.1%
Cash receipt s% of Ratepayer & Other venue	18(1)a,(2)	113%	103%	108%	91%	92%	89%	92%	104%	104%	104%
Debt impairment expense as a % of total billable revenue	18(1)a,(2)	7%	6%	6%	5%	6%	5%	4.1%	2.6%	3.1%	3.9%
Capital payments % of capital expenditure	18(1)c,19	100%	98%	76%	100%	100%	101%	106%	100%	100%	100%
Borrowing receipts % of capital expenditure (excl grants)	18(1)c	20%	99%	15%	21%	27%	94%	41%	39%	45%	52%
Grants % of Govt. legislated/gazetted allocations	18(1)a	100%	100%	100%	100%	100%	100%	100%	127%	114%	117%
Current consumer debtors % change – incr(decr)	18(1)a	NA	56%	(16%)	(11%)	7%	11%	26%	(16%)	(21%)	(34%)
Long term receivables % change – incr(decr)	18(1)a	NA	(22%)	(44%)	48%	78%	14%	(32%)	2%	2%	2%
R&M of Property Plant & Equipment	20(1)(vi)	0%	0%	0%	15%	8%	7%	7%	8%	7%	7%
Asset renewal % of capital budget	20(1)(vi)	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%

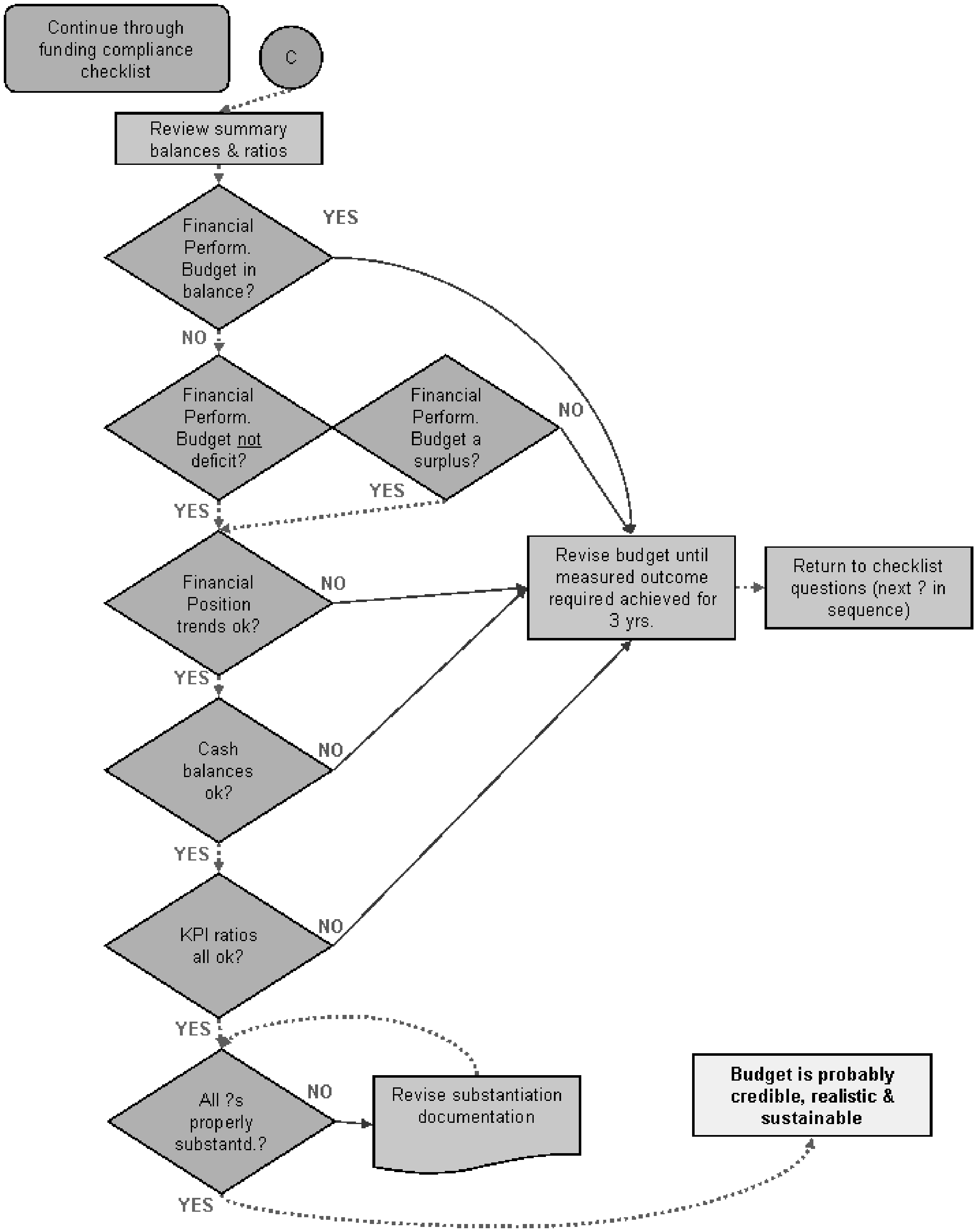
Note: R'000 = thousand South African Rand

Annexure B – MFMA Funding Compliance Flowchart




Continue through funding compliance checklist
A
Review revenue collection rates
Review collection rate measures simultaneously to indicate adherence to guidelines; i.e. 'yes' required for each question
Collection % < = current yr?
% < = current yr trend?
% < = current yr recent mths.?
NO
YES
YES
YES
Debt impairment ratio % ok?
NO
Revise budget until measured outcome required achieved for 3 yrs.
Return to checklist questions (next ? in sequence)
YES
Review capital payments
Capex 'payments' <> expend.?
NO
YES
Review borrowing levels
Review borrowing level measures simultaneously to indicate adherence to guidelines & Council policy; i.e. 'yes' required for each question
Loan % okay?
Loan % <= Council policy?
NO
YES
YES
B


Continue through funding compliance checklist
B
Review transfers & grants
Budgeted transfers = DoRA etc?
NO
YES
Review long & short term debtors
Large increase in debtors?
YES
NO
Revise budget until measured outcome required achieved for 3 yrs.
Return to checklist questions (next ? in sequence)
Large decrease in debtors?
YES
NO
Review assets & maintenance
R&M % okay?
NO
YES
Asset renewal % okay?
NO
YES
C



Source: MFMA Funding Compliance Guideline (2008).