

**SALGA comments on the FFC
recommendations on the Division
of Revenue for 2010/11**

Select Committee on Finance

6 August 2009

Outline of Presentation

- Introduction & Context
- SALGA Assessment
 - Differentiated Approach
 - Summary of Findings
- Comments on FFC Recommendations for 2010/11
- Issue not dealt with in the FFC Submission

Introduction & Context

- Note FFC's recommendations on issues that may have an impact on the allocation of resources to each sphere of government
- Recommendations should be considered before the 2010 budget allocations are finalised **proper response to the implications the implementation of these recommendations would have to the Division of Revenue**
- **The SALGA submission will reflect on the Commission's recommendations with distinct impact on local government finances as outlined below**
- **It is also our intention to highlight other key challenges and considerations as National Government deliberates on the Division of Revenue Act for 2010/11**

Introduction & Context

- Financial position of municipalities does appear to have stabilized but considerable challenges in financial management remain
- Some strides have been made in addressing service backlogs
- Sustainable financing and policy development for local government is necessary if they are to take up their developmental mandates
- Some of the financial challenges includes the following:
 - *Improvement of audit outcomes*
 - *Implementation of accounting standards*
 - *Revenue collection and management of debtors*
 - *Financial management capacity*

SALGA Assessment

The report provides an assessment and analysis of:

- Economic profile of municipalities and key service delivery indicators based on available national databases.
- Key financial ratios and expenditure efficiency ratios based on annual financial statements for the year ending 30 June 2008.
- Audit opinions based on the Auditor-general reports for each municipality.
- CFOs capacity, based on MDB data and a telephonic survey.

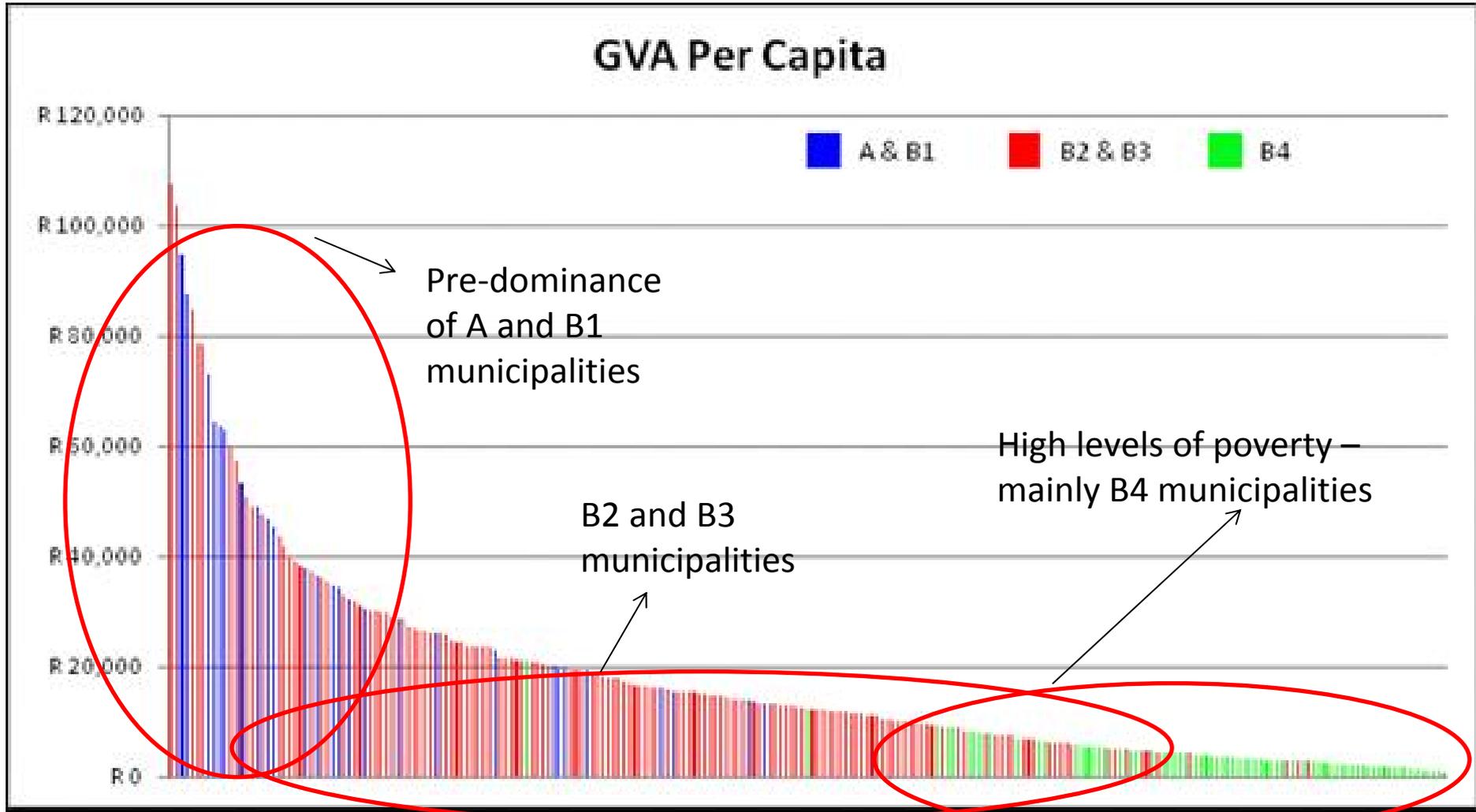
Elements of Assessment

- Categories of Municipalities
- Poverty differentials
- Backlogs
- Municipal revenues
- Municipal operating expenditure
- Financial capacity

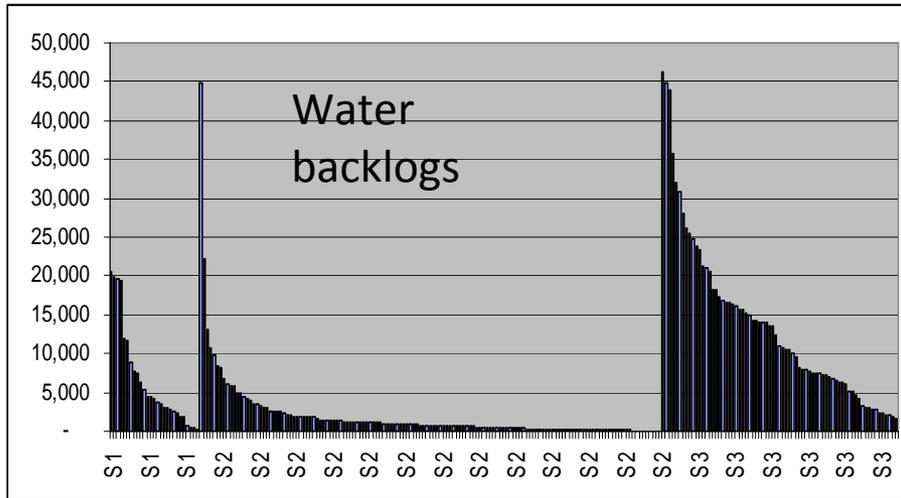
The suggested categorisation of municipalities

	<i>Municipal Sub-categories included</i>	<i>Comment</i>
S1	A (metros) and B1 (secondary cities)	Dominated by a large urban centre; high in-migration, high economic growth, varying levels of poverty
S2	B2 (large regional town) and B3 (small towns)	Larger and smaller towns typically surrounded by commercial farm land; high levels of poverty
S3	B4 (mostly rural with no significant urban centre)	Mostly rural areas: little formal urban economy, poor households, high service backlogs and staffing challenges
S4	C1 districts which are not water services authorities	The districts for the B1s, B2 and B3s. No direct service delivery obligations. No revenue raising challenges
S5	C2 districts which are water services authorities	The districts for the B4s but undertake water functions. Otherwise same profile as C1

Distribution of poverty

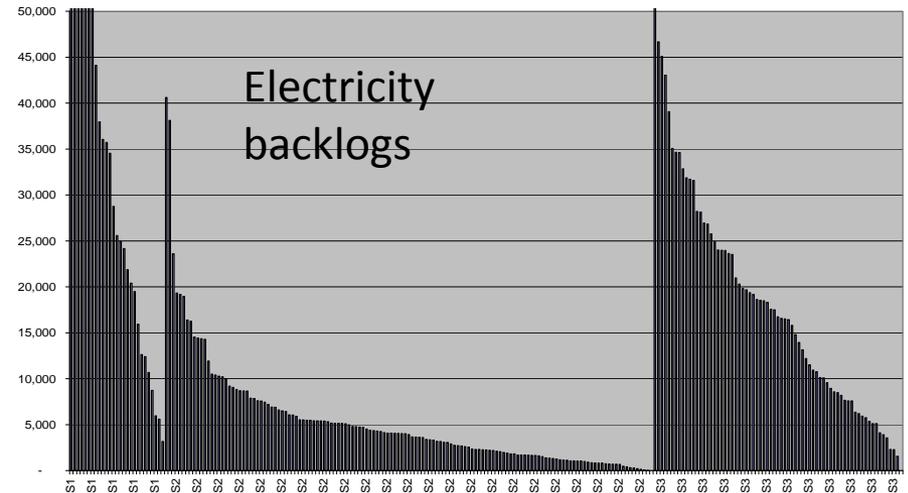


The justification for differential classification

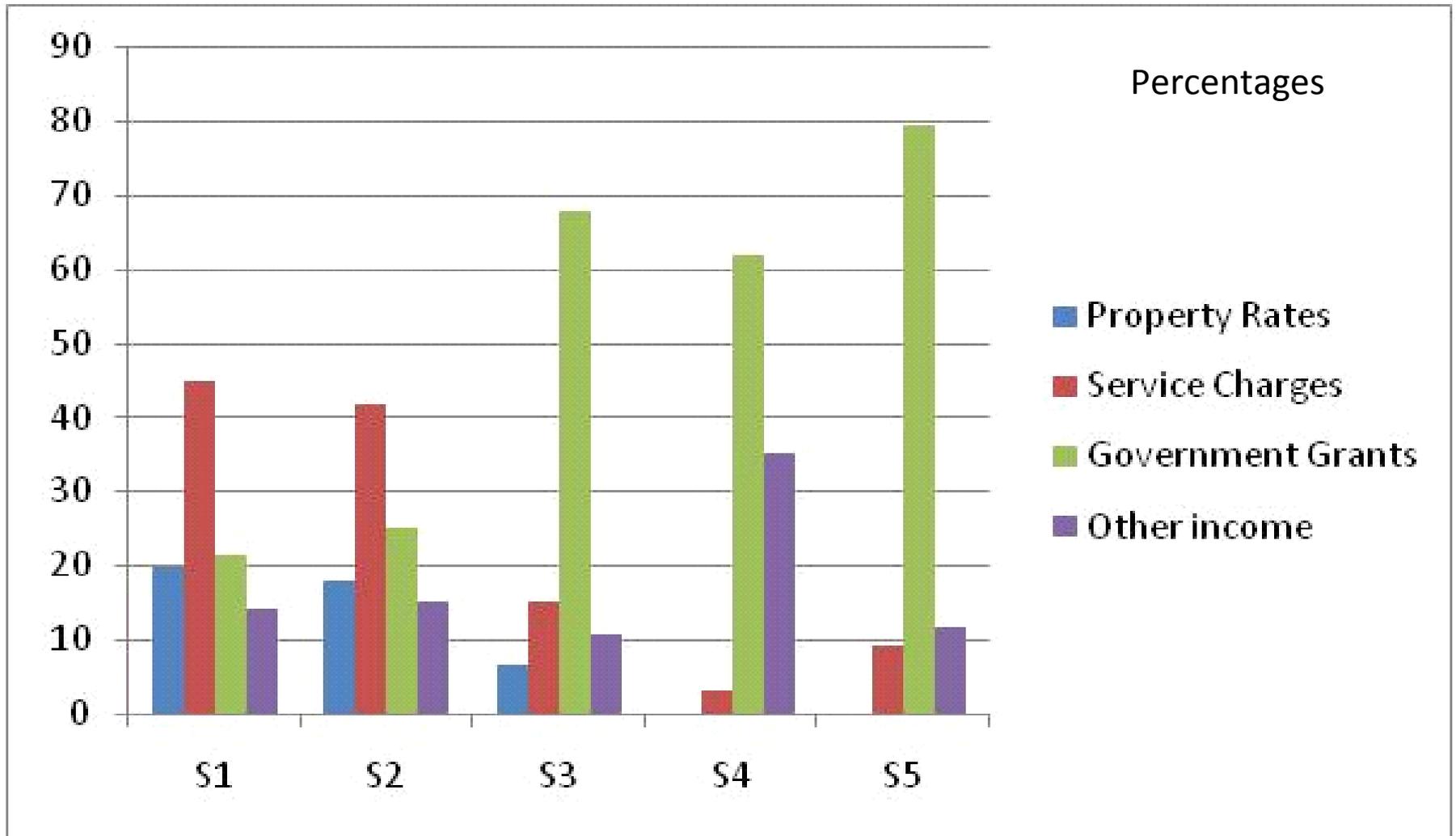


The S1 and S3 have similar characteristics from a backlog perspective. S1 is due to informal settlements. S3 is due to rural areas. S2 have limited backlogs

Electricity backlogs are also similar. The approaches, financing and densities to address backlogs will differ



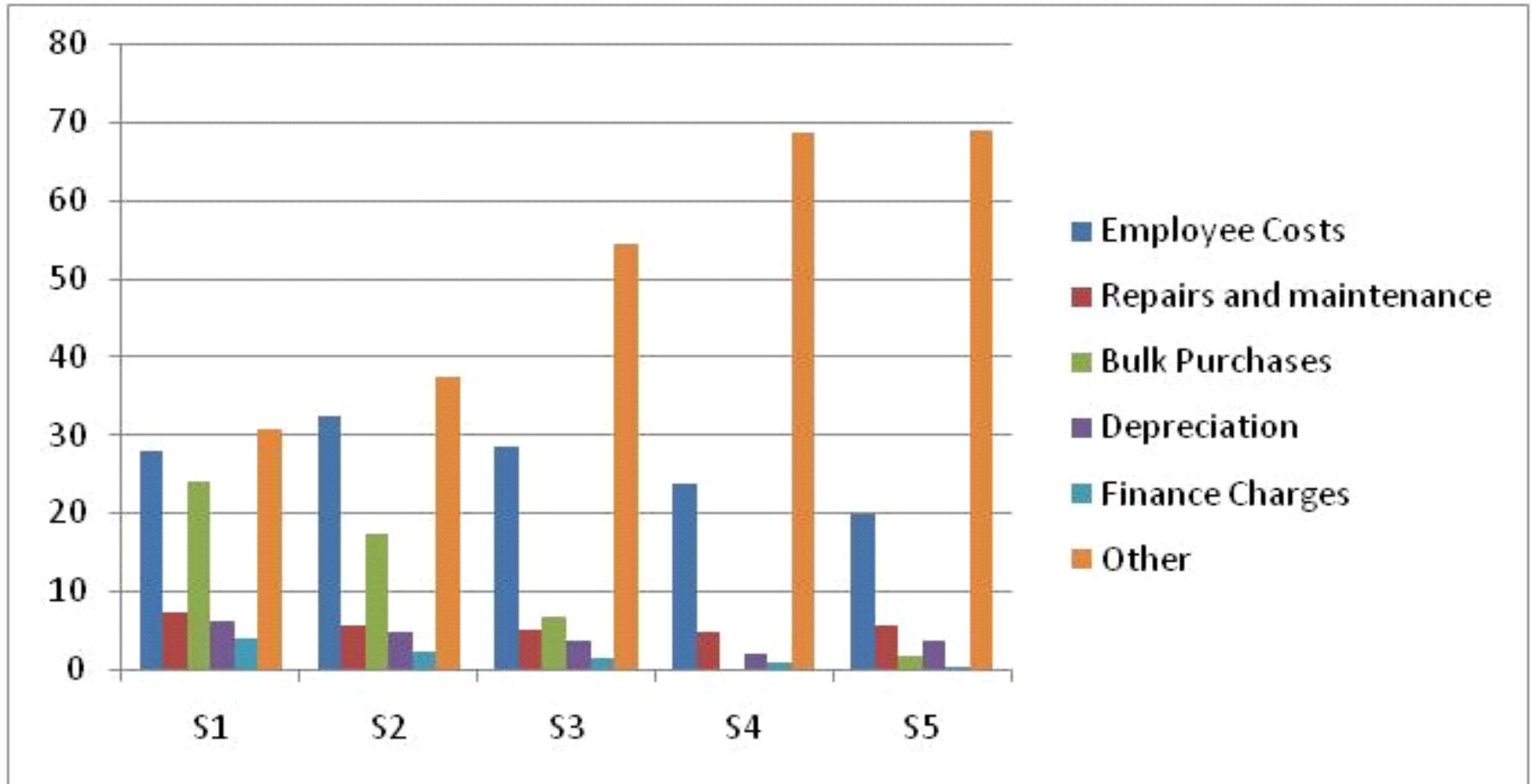
Revenue mixes



Preliminary findings

- There is a high risk of high government grant revenue particularly in the Category S2 and S3 municipalities – which may not be sustainable
- The Category S1 municipalities have a diversified revenue base and are may likely be adversely impacted by the electricity restructuring. The impact on Category S2 municipalities will also be significant.
- Current economic crisis poses a greater risk to municipalities with low own revenue sources S3 (reduction on the rate of grants growth)
- There are unintended consequences of government grants – crowding out of own revenue sources (increases are lower than inflation) and collection of debtors' balances (debtors' days have deteriorated)

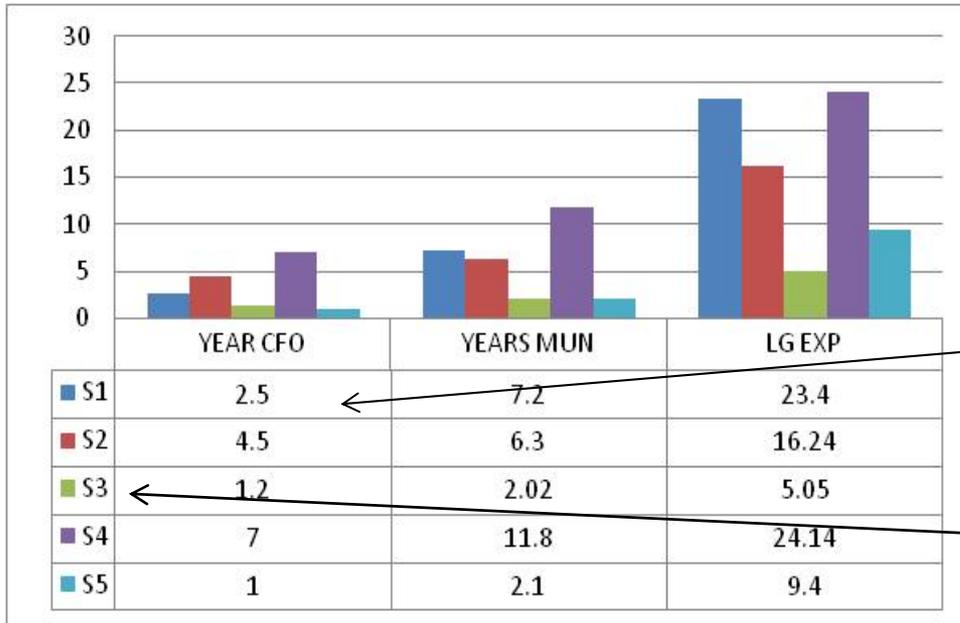
Operating expenditure



Preliminary findings

- Repairs and maintenance at 7% of total operating expenditure appears low. In 2007, 6.2% of total operating expenditure was spent on repairs and maintenance, indicating that more resources are being allocated to this activity in 2008.
- The Category S4 municipalities in particular have a high level of discretionary expenditure. There is a need to address the role of Category C municipalities in their supportive role to local municipalities.

Municipal financial management capacity



Overview of the skills and experience of CFOs by category classification

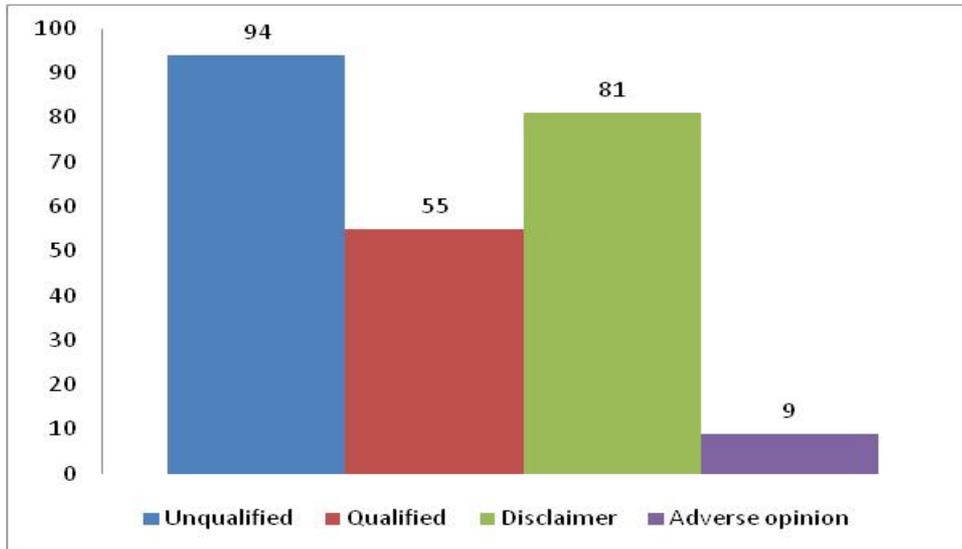
The distinguishing factor is the depth of skills and experience within finance departments – larger municipalities have access to more skills and staff

Major challenges in implementing reforms

Filled and vacant positions

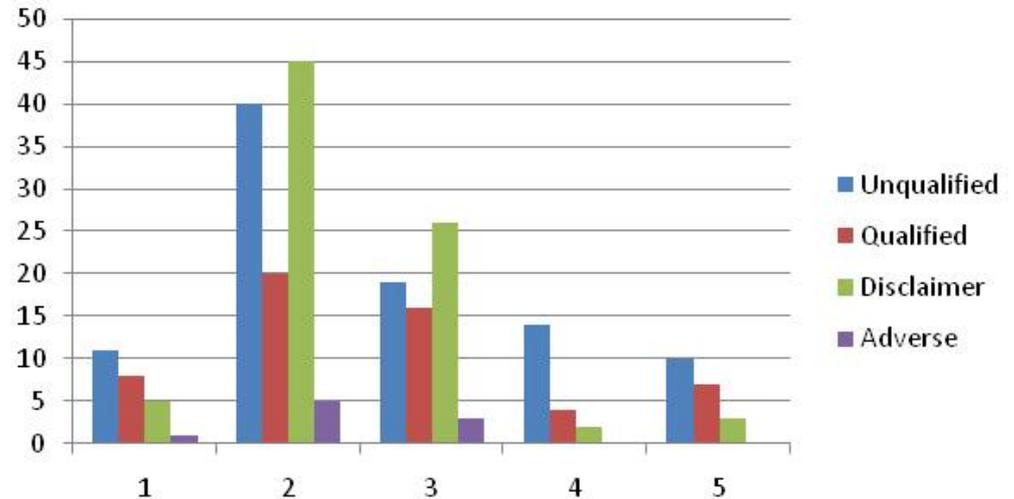
	<i>Filled</i>	<i>Vacant</i>	<i>Not available</i>
S1	10	1	16
S2	62	14	63
S3	23	6	42
S4	14	0	11
S5	7	2	12

Status of audit opinions



Of the 239 audit opinions, 39% unqualified, 23% qualified, 34% disclaimed and 4% adverse

25 out of 27 S1, 110 out of 139 S2, 64 out of 71 S3, 20 out of 25 S4 and 20 out of 21 S5



Preliminary findings

Improvements in financial management required to strengthen SALGA's stakeholder negotiations

- High number of qualified audit opinions
- High CFO turnover
- High number of vacant CFO positions

Summary of findings

- Levels of economic activity (measured as GVA per capita) vary greatly across municipalities in South Africa from less than R1000 per capita to over R100 000 per capita. This has a fundamental influence on the resources available to a municipality to undertake its service delivery mandate and on the ability of a municipality to achieve revenue self-sufficiency and financial viability
- All categories of municipality have municipalities with very high proportion of households who are poor (greater than 60%)
- There is a striking inverse relationship between levels of economic activity and service backlogs, with high levels of GVA per capita being associated with low backlogs and vice versa. This also pertains to the relationship between municipal revenue per household and backlogs
- There is a very strong relationship between economic activity and municipal (own) operating revenue. This is also the case with the proportion of high income households in the municipal area
- Whilst all municipalities have to convert to the GRAP standards by 2010, only 7% of municipalities have fully converted to the new accounting standards. 59% have partially converted whilst 34% have still to convert. Smaller municipalities will have difficulty in implementing the accounting standards and the possibility of simplifying the standards should be considered
- There is a high turnover of CFOs particularly in Categories S1, S3 and S5 municipalities. The retention of qualified CFOs in smaller municipalities poses a challenge

Differentiation: a key basis for policy making

Urban municipalities face different challenges to rural municipalities and to district municipalities:

- Urban have a diversified revenue base and different financial sustainability issues. Rural are unable to generate significant wealth due to small economic base
- Rural municipalities have different service delivery challenges in respect of backlogs and how those backlogs are addressed
- District municipalities have a substantially different financing mechanisms and less clearly defined roles
- Choices between investing in backlogs, economic development and maintenance of existing services in urban areas are more pronounced

FFC recommendations: rental housing

- Salga supports the FFC recommendation that there be a review on the eligibility criteria for accessing the Social Housing Capital Restructuring Grant to allow projects falling outside the Designated Restructuring Zones to access funding.
- The review will improve access and supply of rental housing stock
- The review on the income band should take into account current global economic recession and increase level unemployment

FFC recommendations: management & financing of road infrastructure

- Priority must also be given to clarification of roads responsibility between Category C (Districts) and Category B (Local) municipalities in areas outside metros
 - Roles, responsibility and functions not clear
 - Maintenance and repair work therefore falling through the ‘cracks’
 - National Department is of the view that the process of classification is a provincial responsibility
 - Not to be based on class of roads as this classification is not complete and still underway
- Historical funding for road maintenance was assumed to be from the local fiscus – this is however not possible for largely rural municipalities
- Salga support the recommendations for increased and stable provision of funds for construction, maintenance and rehabilitation backlogs of roads in the long term (based on clearly defined baselines)

Assessment of universal access to water and sanitation services

- SALGA support the Commission's recommendation on the establishment of a National Water Regulator
- It is proposed that one of the responsibilities of the proposed National Water Regular be Economic regulation (setting of pricing rules and price adjustment) of the water sector value chain as a whole
- Areas responsibility should include:
 - Primary sector : raw water (dams)
 - Bulk purification of water: Water Boards in mainly urban areas and other areas municipalities (no funding for rural municipalities – what does it say about rural development)
 - Distribution by municipalities
 - Waste water management (bulk and distribution)

Assessment of the institutional and fiscal capacity support mechanisms of local government

- The current institutional and fiscal capacity support mechanisms of local government treats all municipalities in the same manner, regardless of the significant differences in their contexts and capabilities
- Salga supports the Commission's recommendations that local government should be central to setting the agenda for capacity building programs
- Salga support the need for coordination and alignment of grant support to ensure comprehensive programmes impact on overall performance taking into account different financial capacities of municipalities
- It is proposed that FFC undertake an assessment to measure the impact and rate of return of capacity building grants
- Total allocation for FMG amount to R500 million in 2009/10 and expected to increase to R609 million in 2011/12) at local level.
- The assessment of capacity building grant must include LGSETA funding for training, Municipal Systems Improvement Grants and Siyenza Manje support from DBSA

Issues not dealt with in the FFC submission

a) Unfunded mandates

Salga would like to emphasise that further research need to be undertaken by the FFC on the impact of unfunded mandates that have been passed on to LG over the last 15 years . These are :

- Functions that are not local government functions (in terms of the constitution) get assigned to local government by way of sectoral legislation, without related adjustment to the fiscal framework eg. Disaster Management
- Local government functions that are not part of the basket of the four basic services which must be provided especially to poor households. This are not catered for in the Equitable Share (further include public transport)
- There is also no clarity as to how the costs, especially operating costs, associated to providing services related to concurrent functions should be funded. These include, Libraries, Health, housing , municipal public transport and Environmental functions (e.g. Biodiversity and Air pollution)

Issues not dealt with in the FFC submission

b) Adaptation and mitigation to climate change

- Local government will have to play a key role in the implementation of the country's mitigation and adaptation to climate change. There should be mechanisms of funding mitigation to climate change adaptation

c) Financing of infrastructure refurbishment and replacement backlogs

- Municipalities receiving water subsidy are largely receiving schemes whose operating costs are unreasonably high. (including 1994 water supply schemes, homeland schemes, or from districts)
- The effect of this was that there was no national funding for investing in refurbishing and replacing infrastructure to ensure continued provision to services to the relative developed areas of the country
- This is largely because the total life cycle costs of the scheme were not adequately taken into account during the design stages of the scheme.
- It is proposed that funding mechanism be developed to address this problem
- Policy of transfers: operating subsidies for 3 years (cost of producing is too high R25 per kl) - equitable share and MIG not designed to fund this

Issues not dealt with in the FFC submission

- d) Assessment to measure the impact and rate of return of capacity building grants (MSIG, FMG LGSETA funding & Siyenza Manje) at local level
- e) Municipalities are required to prepare the Annual Financial Statements based on the new accounting standards. All municipalities are required to convert to GRAP by 2010
 - It is proposed that FFC undertake research on the impact of reformed accounting standards on municipal finances
- f) Municipal public transport revenue source
 - Salga proposed that FFC undertake a dedicated public transport revenue source for municipalities such as local fuel levy and other appropriate instruments e.g. (levy or tax on commercial or workplace parking and various value capture mechanisms)
- g) 2010 Funding
 - It is proposed that FFC undertake research adequacy and impact of 2010 funding on municipal finances especially host cities

Conclusion

- Considerable service delivery challenges and backlogs remain – increasing efficiency and improving local capacity to rise to this challenge
- Government policy and budget allocations need to incorporate a differentiated response
- Budget allocations in the form of the Local Government Equitable Share, Municipal Infrastructure Funding and other conditional grants need to reflect this policy principle
- Improve intergovernmental cooperation in service delivery especially in poorer rural municipalities (particularly provinces)
- Increasing local revenue bases (other revenue sources, improving collection of outstanding debt and other efficiencies)

Questions

