AN ANALYSIS OF THE FINANCIAL VIABILITY OF MUNICIPALITIES IN THE NORTH WEST PROVINCE: THE CASE STUDY OF MAFIKENG LOCAL MUNICIPALITY

By

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Mini Dissertation submitted in partial fulfillment for the degree of Masters in Business Administration (MBA) at the North West University Graduate School

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November 2010

DECLARATION

I, Segomotso Phatudi, declare that this mini dissertation titled "An analysis of the financial viability of municipalities in the North West Province: The case study of Mafikeng Local Municipality" submitted for the Degree of Masters in Business Administration (MBA) at the North-West University has not been previously submitted by me for a degree at this university or any other university; that this is my own work design and execution and that all materials contained herein have been duly acknowledged.

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SEGOMOTSO PHATUDI

DATE ....

PLACE ....

ACKNOWLEDGEMENTS

I would like to express my sincerest appreciation to the following people. Without whose support, assistance and guidance, this study would not have been possible:

- Dr C.M Guduza, my supervisor, a very special word of thanks for your guidance and for sharing your experience and excellent insights.
- My family, thank you for your remarkable support.
- Ms B.A Mofokeng, thank you for your humour and encouragement in times of despair.
- Mr SC Williams, thank you for your support and encouragement.
- North West University Graduate School support staff, thank you for your support and fruitful discussions.
- All honour and praise be to God who gave me wisdom to compile my research.

DEDICATION

I dedicate this study to my family for their humongous support and encouragement during my studies.

ABSTRACT

Local Government in South Africa has undergone much transformation since the year 2000. Although much of the change has been to correct imbalances, inequities and disparities within our local communities as a result of apartheid, change has also been motivated by the National Government's realisation that, as with governments throughout the world, there is a need to modernise all spheres of Government. Part of this transformation process at the local government level in South Africa has been to ensure that municipalities become more responsive to the communities' needs.

The guiding principles for this transformation are contained in the White Paper on the Transformation of the Public Service (1995) and the Batho Pele White Paper (1997). This has informed the Municipal Systems Act: Act 32 of 2000 of which Chapter 6 determines that municipalities will have a Performance Management System to promote a culture of Performance Management amongst the political structures, political office bearers, councillors and administration. The Performance Management System must ensure that the municipality administers its affairs in an economical, effective, efficient and accountable manner.

A literature review contained in this research, indicates that nationally, ensuring effective and efficient Financial Management Systems at the local government level is impacted upon by a number of factors such as the organizational culture of an institution and its revenue base.

This research ends with recommendations for further research and it is argued that each organization has its own unique organizational problems impacting on its financial status. The conclusion is that no single typology, as contained in the literature, can account for the specific impact financial viability has on service delivery and organizational existence at the local government level in South Africa.

Consequently, implementers of the financial strategy and other financial management policies must assess the unique characteristics of each organization prior to implementation thereof, in order to evaluate its impact on the organizational culture and other variables.

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CONTEXTUALISATION AND PROBLEM STATEMENT

1.1 Introduction

This chapter sets out the contextual background and motivation for this research. In establishing the background, the reader will be made aware of the implicit objectives contained in the new local government legislation and specifically, the legislation relevant to financial management. Further, this chapter describes the organizational culture envisioned by the available municipal financial management legislation which aims at transforming municipalities into more efficient, effective and economical spheres of government.

The need to undertake research on the financial viability of the Mafikeng Local Municipality results from the gaps and challenges identified in the interrogation of the financial reports and the results of their external audits over the past five years. The reports referred to here are those required in terms of the Municipal Systems Act, 32 of 2000, Municipal Finance Management Act 56, of 2003 and the audit reports that were issued by the Auditor General over the past five years.

The financial status of the municipality encompasses the financial health and serious gaps that need to be addressed in order to curb failure in the provision of services to the communities within the municipality.

This chapter covers a brief background of the problem, a statement of the problem, main research questions and sub-questions, objectives of this research, assumptions of the study, delimitations as well as definition of the main concepts of the study.

1.2 An Overview of Mafikeng Local Municipality

Mafikeng, which means a place amongst the stones, is situated in the North West Province and is 20km south from the Botswana border. It is the capital city of the North West Province and was formerly known as the City Council of Mafikeng. The municipality is considerably a big local municipality as compared to the other four local municipalities (Ramotshere Moiloa, Tswaing, Ditsobotla and Ratlou local municipalities) located within the area of jurisdiction of the Ngaka Modiri Molema District Municipality.

Size and population

The total area of the Mafikeng Local Municipality is 3,703 square kilometers. It is divided into twenty eight (28) wards consisting of suburbs and villages. The population served by the municipality is 271,501, which is made up of the African, Coloureds, Indians, Whites and other community groups. The municipality is seventy five percent (75%) rural (www.mafikeng.gov.za).

Senior Management

The municipality has senior management positions filled in terms of the corporate governance reform requirements as outlined in the King II Report of 2002. This Report emphasises that there must be senior management structures in place within organizations as part of the international corporate governance requirements. The entire staff component of Mafikeng Local Municipality is one thousand and eighteen (1,018).

Education and unemployment levels

The level of education and literacy patterns indicate that the highest level of education and skills are concentrated in the formal or urban parts of the municipality. The very low skills levels in rural areas add to the unemployment levels.

An estimated 55% of the people in the municipality had no income in 2007. In general terms, the majority of households in the municipality earns less than the poverty line (about R1, 600 per household per month) and can be considered poor. Those classified as economically active are employed in the services sector. This sector is dominated by the services in terms of the various departments that render services such as health, justice, local government, education, SAPS, etc (StatsSA: 2007).

Affordability and Poverty Rate.

The average household income is R6,000 per household and R1,600 per household in urban and rural areas of the municipality respectively. There is still a high level of indigence especially in the rural areas as poverty levels are still very enormous (Mafikeng Local Municipality IDP:2010).

Water and Sanitation

Mafikeng Local Municipality is not a Water Service Authority, as this function currently lies with the District Municipality as prescribed by Municipal Structures Act, therefore the municipality is not reaping any revenue from the water sales. There are three (3) sources of water supplying Mafikeng; those are Molopo Eye, Grootfontein and Setumo Dam. Molopo Eye and Groofontein supply to Mafikeng water treatment works, which supplies the bulk of water to Mafikeng and peri-urban. There is a dedicated line that supplies to Signal Hill reservoir, which also gets supply from Setumo Dam. (Mafikeng Local Municipality IDP:2010).

Electricity

Many villages within the municipality have no accessibility to electrical infrastructure. In some urban wards, more than 90% of households do have access to electricity. Eskom is the electricity supplier in the Mafikeng Local Municipal jurisdiction.

Waste Removal

The formal waste removal services still serve the formal areas of the municipality only. In most rural areas, there is no proper waste removal services and refuse disposal. There is still a minimum number of households that benefit from the refuse removal services from the municipality. Statistic South Africa (2007 survey) presented that a total of 46,713 private companies enjoy such service atleast once a week. The statistics also indicate that there are atleast 12,815 communical dumps and 215,371 own refuse dumps within the municipality (Stats SA : 2007).

Housing

Approximately 80% of households reside in some form of a formal structure. The total proportion of households residing in backyards of informal settlements is relatively minimal. The municipality is a predominantly rural municipality and its rural economy is unable to provide individuals with remunerative jobs or self employment opportunities.

Telecommunications

In-house access to telephones or cellular phone services is mainly limited to the areas in and immediately around Mafikeng and some eastern parts of the municipality. Accessibility in the rural areas and villages is very limited.

Fire and Emergency Services

There is a directorate known as the Public Safety directorate which deals specifically with public safety and fulfills functions with regard to ambulance services, fire-fighting and prevention, licensing, security and traffic matters. However there is still a need to strengthen the emergency services as this is a community priority in most wards which are situated in the west and south of the municipality (www.mafikeng.gov.za).

Municipal Revenue

The municipality generates its revenue from rates and taxes received from 20% of the former Transitional Local Council. The municipality provides services to its communities with the available limited resources. By the end of the financial year 2006/2007, the municipality was owed a total of R298 million for assessment rates and services (Mafikeng Local Municipality IDP:2010).

Mafikeng local municipality, like other local municipalities was brought about by the new local government transformation in South Africa. Mafikeng Local Municipality is a category B (as per the national treasury categorization based on capacity levels in terms of the Municipal Financial Management Act reforms) municipality established in terms of section 12 of the Municipal Structures Act (1998).

Mafikeng local municipality is one of the five local municipalities in the Ngaka Modiri Molema District municipality. The municipality serves a total of 68,698 households and a total population of 290,229 which is 36,3% of the entire district population (The StatsSA : 2007).

1.3 Background to the problem

Local government came to being as a constitutional mandate emanating from Chapter 7 of the Constitution of South Africa Act, 108 of 1996. It is a sphere of government which is meant to enhance the status of local government as a form of government and gives them a new dynamic role as an instrument of service delivery. Therefore, South African municipalities have been given a constitutional responsibility to ensure the delivery and management of local services, which are key for economic growth and social equity.

Financial viability is at the heart of municipal performance in the South African Local Government. This subject is also highly emphasized as a municipal performance indicator by the Municipal Planning and Performance Management Regulations, R 796 of 24 August 2001.

The Ministerial Advisory Committee (2001:18) has defined financial viability as 'the ability of a local authority to fulfill constitutional and legislative responsibilities'. Municipal resources to fulfill these responsibilities come from two key avenues: The equitable share and the local revenue. It has been noted in the Ministerial Advisory Committee (2001) that in many municipalities, the equitable share is very low and even continues to decrease. According to the Medium Term Budget Policy Statement 2004, the equitable share going to municipalities is just over four comma five percent of their requested budgets or their expectations (National Treasury, 2004:55).

The municipality's ability to generate local revenue hinges on the level of wealth within its municipal boundaries and on economic activity. Where high levels of poverty exist, cost recovery is unlikely for municipal service provision. Where economic activity is low or declining, municipalities are unable to generate revenue from economic activity (Ministerial Advisory Committee (2001). This has important implications for urban local government, where poverty and unemployment have increased in recent years (Parnell, 2004; SACN, 2004). The State of the Cities Report notes that between 1996 and 2001 the twenty one largest urban centres in South Africa experienced rapid urbanization (SACN, 2004:37), yet this dynamic context and the associated rise in urban poverty and inequality is insufficiently taken into account in the intergovernmental grant system.

The management of finances at the local government level in South Africa is a highly structured process which is determined by various pieces of legislation. This is developed to present a comprehensive understanding of the impact that the municipal finances have on service delivery and community expectations. Furthermore, the focus has been on technical efficiency with emphasis on better or improved government services without an increase in taxes.

This transformation has required fundamental changes in the way Local Government exercises its role, and this shift is evident in the now transparent budgeting process, efficient tax administration and implementation of performance contracts of public sector managers, to improve accountability. To achieve the local government objectives the following pieces of legislation have been implemented:

- Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996).
- Local Government Municipal Structures Act (Act no 117 of 1998).
- Local Government Municipal Demarcation Act (Act no 27 of 1988).
- Municipal Systems Act, 2000 (Act No. 32 of 2000).
- Municipal Finance Management Act, 2003 (Act No.56 of 2003).
- Batho Pele White Paper (1998).
- White Paper on Local Government (1995).
- The Public Finance Management Act no 1 of 1999.
- Municipal Planning and Performance Management Regulations, R 796 of 24 August 2001.

In accordance with the new legislation, municipalities have since December 2000 embarked on a process of ensuring efficient, effective and economic financial management system. Mwita (2000) has argued that inter-alia, leadership, personnel, team and environmental factors influence financial performance in the public sector; while Buch and Rivers (2001) have shown that in a utility organization, leadership and culture are important factors impacting on financial status.

The current problems at the municipalities are emanating from various factors ranging from transitional issues to change of power. But mainly they could be due to financial mismanagement and lack of proper financial management also adds to the lack or inefficient service delivery.

1.4 Statement of the problem

The high demand for services at very minimum financial resources has placed a huge pressure on the financial stability of most municipalities. The inadequate financial management capacity, for example, budgeting skills, accounting and financial reporting, fraud and corruption, have added to the current financial deterioration of the financial status of municipalities in the North West Province.

The Auditor General's Report on municipal financial performance, of September 2005, clearly indicated that the North West Province is one of the worst affected provinces in terms of financial management problems in the country. This report indicates that in each district municipality within the province, there is more than one municipality that cannot generate revenue or that cannot sustain itself. This report further states that, the bigger municipalities such as Mafikeng, Naledi (formerly known as Vryburg), Rustenburg and Ditsobotla (formerly known as Lichtenburg) are still receiving qualified and disclaimed reports from the Auditor General. This means that there are still problems in the financial management of local government (State of the Municipal Finance Report, 2004).

1.5 Main research questions and sub questions

The main research question for this study is:

- Is Mafikeng Local Municipality financially viable?

The sub questions in this study range as follows:

- Is the Mafikeng Local Municipality able to generate enough revenues to respond to the needs of its stakeholders?
- Are the assets of the municipality greater or less than the liabilities?
- Does Mafikeng Local Municipality monitor capital assets and depreciation?
- What are the financial trends of Mafikeng Local Municipality of the financial years 2006 – 2009?

1.6 Objectives of the study

The main objectives of the study are:

- To test whether Mafikeng Local Municipality is financially viable or not.
- To analyse the trends and patterns of the finances of Mafikeng Local Municipality between 2006 - 2009.

1.7 Assumptions of the study

Sufficient financial resource management is the backbone of every organization. If the finances in an organization are not well managed, then the sustainability of that organization is questionable and the general performance will be negatively affected. Availability of financial resources and reporting transparently on the financial processes by staff and stakeholders of the organization is extremely crucial for any organization.

Municipalities are expected to be transparent in managing their finances and reporting on them. These municipalities are directly involved with communities at the local level, and are obliged by the constitution of the country to provide basic services to the people. Service provision cannot be possible without sufficient financial resources and proper management of those resources. In other words, financial management and financial sustainability of a municipality are important as they affect the communities and not only the administrative functions of the municipalities.

The Municipal Finance Management Act, Act no 56 of 2003, fosters greater level of co-operation across and within the different spheres of government based on the system of mutual support, information-sharing and communication responsibilities with a view to improving outcomes for all.

The Constitution of South Africa stipulates that the local government system of our country should be developmental in nature, and therefore financial management is for this purpose also very important to ensure that municipalities remain sustainable and developmental.

Municipalities could be struggling financially because of lack of capacity at local level, and because there is no sufficient monitoring and evaluation systems in place to continually assess performance of these municipalities. The government (national through the provincial) are currently pumping money into the local sphere of government and sometimes without proper planning for those financial resources (www.idasa.org.za/media/uploads.outputs.pdf 21 March 2010).

1.8 Justification of the study

This research is meant to contribute to the existing body of knowledge in the area of the financial viability of municipalities in general and Mafikeng Local Municipality in particular.

The deteriorating financial status of municipalities in the province and in the country at large, as well as the continuous service delivery shortfalls have triggered the need for vigorous research in the line of local government finances and financial management. For instance, the National Treasury and other interested funders and stakeholders in the local government, would like to know how their vested interests are utilized by the local government. The Finance and Fiscal Committee of Parliament also depends on such researched views to be able to allocate revenues to various spheres of government.

There is therefore the need for rigorous research efforts to develop models that will monitor the financial condition of local governments in South Africa. This study also forms part of the ongoing debate on financial capacity of the local level of government to carry out its statutory mandate to sustain local development.

Although this study is only limited to Mafikeng Local Municipality in the North West Province, it is relevant to all other municipalities in the province and across South Africa and thereby contributes to a developing base of information on the body of literature on local government financial administration and management and prudent financial management practices.

1.9 The Research Approach

This study is a descriptive case study that studies the trends in the finances of Mafikeng Local Municipalities. The following are the methods that were used to carry out the study:

1.9.1 Data collection methods

The study used literature review and other practical investigations to collect data for the study.

1.9.2 Literature study

In the literature study, both primary and secondary sources were consulted to gather information on the nature and scope of municipal financial management and local government financial analysis. The search engines such as Google, Wikipedia and Ask.com were used to gather relevant information. Indicative words such as the following: Financial Viability; financial management; municipal finances; municipal revenue; indicators of financial viability; financial condition; financial analysis; financial position were researched and discussed. An analysis of financial information was mainly based on the financial statement analysis of the Mafikeng Local Municipality.

The study uses document analysis to collect data on the financial information and population statistics from Mafikeng Local Municipality.

The general structure of this analysis has the following elements:

1. Financial viability defined and discussed.
2. Revenue Management.
3. Assessing the sources and types of revenues on which the Mafikeng Local Municipality bases its costs.
4. Management of budget processes and the results thereof.
5. Working Capital Management - the management of cash, accounts receivable, and accounts payable.
6. The impact of financial viability on service delivery.

This research briefly describes and discusses the above elements. It does not imply that these are the only criteria that can be used to assess financial viability of an organization. However, based on the nature of the study, limited data and time scope, this framework is judged to be the most appropriate. A testing out method is taken in to test whether Mafikeng Local Municipality is financially viable or not including to also test whether the municipality is financially sustainable or not.

1.10 Scope of the study

The scope of this study aims to determine whether Mafikeng Local Municipality is financially viable by interrogating their annual financial statements and other financial reports to get a clear indication of whether the municipality is meeting its financial obligations or not. However, a comparison with other municipalities of the same size within the province or with the country as a whole may be performed.

This study defines the meaning of financial viability and the impacts of non financial viability towards meeting service delivery, with reference to the relevant financial management legislative framework and internal controls.

This study is organized into five chapters: Contextualization and problem statement; Literature review; Research design and methodology; Findings and data analysis; Conclusions. Chapter one covered the contextualization and problem statement, an overview of Mafikeng Local Municipality, a brief background of the problem, a statement of the problem, main research questions and sub-questions, objectives of this research, assumptions of the study, delimitations as well as definitions of the main concepts of the study.

Chapter two, looks at the literature review and the interrogation of any literature relating to financial viability. The chapter further looks at the various dimensions which can be used to assess financial viability of any organization, including the definition of financial viability; the outline and analysis of the revenue sources of Mafikeng Local Municipality and the impact of the financial viability on service delivery.

Chapter three is about the research design and methodology. The study follows a testing out type of research in an attempt to answer the research questions outlined. It further justifies the selection of the chosen methodology which aims to test whether there is financial viability or not at the Mafikeng Local Municipality.

Chapter four presents a summary of the findings according to developed categories. Results are presented and are discussed under central themes or categories. Data is also presented in graphic form, e.g. tables, ratios, charts and graphs. Themes and clusters also form part of data analysis. This chapter further interprets and discusses the conclusions reached. Results relate to research aims and questions.

Chapter five draws coherent conclusions from the data that was interpreted. It also recommends ways and strategies to change and solve the problem. The reference section lists alphabetically all the material cited for the study. Appendices are also highlighted.

1.11 Definition of key concepts

- BLA - Black Local Administration
- SDBIP - Service Delivery and Budget Implementation Plan
- Local Government - Local Government in terms of Chapter 7 of the Constitution of the Republic of South Africa.
- Municipalities - Municipalities in terms of the Constitution of South Africa and in terms of the Municipal Structures Act, Act no 117 of 1998.
- MFMA - Municipal Finance Management Act, Act no 56 of 2003
- MSA - Municipal System Act, Act no 32 of 2000
- Constitution - The Constitution of the Republic of South Africa, Act no. 108 of 1996.
- DoRA - The Division of Revenue Act, Act no 4 of 2006
- Revenue - Income collected by the municipalities
- North West Province - North West Province of South Africa
- Viability - Capacity
- Municipal Finance - Financial system and financial management at municipalities.
- AFS - Annual Financial Statements
- IDP – Integrated Development Plan
- MLM - Mafikeng Local Municipality
- MIG – Municipal Infrastructure Grant

1.12 Conclusion

The need for proper financial management contributes highly to financial viability of any organization. Chapter one above brings together the reasons for the study on financial viability of Mafikeng Local Municipality. The chapter formats the study with an introduction, the background to the problem, a brief problem of the statement. Main research questions and sub-questions are also described and outlined here.

Given the amount of protests and unhappiness of the municipal citizenry that is witnessed from the daily media, it shows that there problems with municipal finances in the country at large. The chapter concludes that there are various issues that contribute to non financial viability of municipalities in the province and in the country at large.

CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction

This chapter reviews the literature on financial viability, the factors that influence the financial viability of organizations and how financial viability impacts on service delivery and the operational existence of an organization. Aspects which influence financial viability such as revenue and financial management are also discussed. It can be argued that financial viability of municipalities has been regularly at the centre of the debate within the South African financial, political and social discourse since the advent of the democratic elections of 1994.

South Africa's post-apartheid governments have made remarkable progress in consolidating the nation's peaceful transition to democracy from the previous dispensation. Programmes to improve the delivery of essential social services to the majority of the population have been underway since then. Access to better opportunities in education and business is becoming more widespread. Nevertheless, transforming South Africa's society to remove the legacy of apartheid will be a long-term process requiring the sustained commitment of the leaders and people of the nation's incongruent groups (www.state.gov.za , 21 March 2010).

In this chapter, various pointers of financial viability are discussed to align them to a financial management environment and service delivery in general. A further investigation assessment of other factors such as revenue generation versus the debt payments of the municipality, the actual sources of revenue, the budget process, cash management as well as working capital management are discussed. A detailed overview of the organization in question is also discussed in this chapter.

2.2 Financial viability defined.

Lusthaus (2002:124) defines financial viability as the ability of an organization to raise the funds required to meet its functional requirements in the short, medium and long term. Financial viability is essentially about being able to generate sufficient income to meet operating payments, debt commitments and allow growth, while maintaining service levels. It is an unstructured concept that encapsulates many specific components. At the heart of the matter is the idea of capacity in as far as financial systems and financial management are concerned.

On the other hand, financial viability in local government cannot be discussed without taking into consideration the issues of transformation from the pre 2000 local government system to the developmental local government system of today. Also, financial viability at local government level cannot be discussed without taking the issues of the powers and functions which separate the local, provincial and national spheres of government into cognizance. A clear definition of powers and functions reduces the burden on financial management and allocation of resources between the responsible stakeholders.

According to Pillay, Tomilson and Du Toit (2006:122), financial viability is closely linked to powers and functions allocated to local government in terms of the Intergovernmental prescripts. It is vital that when the national and the provincial governments assign and delegate powers and functions to municipalities, they need to ensure that appropriate financial arrangements are in place to pay for such functions. In large part, it is brought on by the fiscal squeeze experienced by provincial and national governments. However, the assignment of core revenue generating powers and functions from local to district councils undermines the financial viability and capacity of non-metropolitan local governments whilst adding to the complexity of the intergovernmental fiscal system (Ministerial Advisory Committee, 2001).

In addition to the above, the municipality must be able to fulfill its constitutional mandate to its citizens for that municipality to be declared financially viable.

According to Lusthaus (2002:126), financial viability is an organization's ability to maintain the inflow of financial resources greater than the outflow. Assessing an organization's financial position is an increasingly important aspect of evaluating the organization's overall performance.

Lusthaus (2002:126), outline the following as the indicators of financial viability through which most organizations are assessed:

2.2.1 Indicators of financial viability

If the organization does not have financial indicators, it may be necessary to develop some preliminary indicators such as those that follow to guide an assessment.

2.2.1.1 Ratio of largest funder to overall revenues

The ratio of the largest funder over overall revenues is calculated as follows:

Largest Revenue Source /Overall Revenue

2.2.1.2 Ratio of cash to overdue revenues

According to Eisen (2007: 424) deferred revenue traditionally refers to cash which has been received for some restricted condition which has not yet been met. Under the new Statement of Financial Accounting Standards No.116 issued by the Financial Accounting Standards Board (FASB), most of these funds will be held not as deferred revenue, but as an addition to temporarily restricted assets.

The ratio is calculated as follows: -

Deferred Revenue /(Cash + Savings)

Or

Temporarily Restricted Net Assets/(Cash + Savings).

If deferred revenue or temporarily restricted net assets exceeds cash and savings, you may be spending restricted cash (Conditional Grants) for purposes other than those which the funder intended, or using monies designated for future purposes (such as magazine subscription fulfillment) to meet current expenses.

2.2.1.3 Ratio of current assets to current liabilities

According to Tracy (2008: p287), the current ratio determines the organisation's short term solvency. Will the organization be able to pay its debts in the next year? This ratio is calculated as follows:

Current Assets / Current Liablities

Tracy (2008) states that, businesses are generally expected to maintain the ratio of 2:1. Which means that the current assets are twice as much as the current liabilities.

2.2.1.4 Ratio of total assets to total liabilities

Pinson (2008: p210) defines this as a measure of a firm's assets which are financed by debt and, therefore, a measure of its financial risk. The lower this ratio, generally the better off the firm. The ratio is calculated as follows:

Total liabilities ÷ Total assets

2.2.1.5 Human resource capability and the percentage of personnel costs over the entire operating budget.

Another significant cost driver is the current system of nationally determined wage bargaining for municipalities which, in some municipalities, raised the minimum basic package of an employee to unaffordable levels. This makes it clear that municipalities must consider the affordability and sustainability of their salary expenditure in relation to their ability to deliver services. They must also consider the effect of such salary expenditure on local and national economic growth, and be prepared to fund increases themselves as national government continues to de-emphasise consumption spending.

The National Treasury prescribes that municipalities should spend not more than 33% of their total budget s on operational costs and on salaries in particular.

2.2.2 Dimensions to assessing financial viability

According to Lusthaus (2002: p124), there are three dimensions to assessing the financial viability of an organization. The first relates to the ability of the organization to generate enough cash to pay its debts, and in the case of not-for-profit organizations, to be prosperous and profitable. This refers to both short-term and long-term cash flow requirements.

Resources are generated through an organization's ability to create, supply and deliver products, services or programmes useful to customers, clients or beneficiaries (Henke:1992).

Organizations unable to meet their short-term obligations present a risk to their creditors, those to whom they provide services and people working in the organization (Lampe and Sutton:1997).

The second dimension of assessing financial viability deals with the sources and types of revenues on which the organization bases its costs. Traditionally, in government agencies, the source of revenue is anticipated taxes. Poorer countries and government departments also rely on various donors to provide funds for their work. The concern addressed by this dimension is the reliability of the flow of funds. With not-for-profit organizations, the diversity and reliability of the different funding sources needs to be analysed. Organizations that rely on a single funding source encounter more difficulty than organizations with multiple, reliable funding sources (Lusthaus 2006 : p125)

The third dimension is the ability of an organization to live within its allocation. Is the organization able to manage within its revenue sources without creating a deficit? This dimension focuses on the actual ability to manage a budgeting process, as well as the results of the process.

Financial viability depends on good financial management practices. This is true for both private and public sector organizations. The fact that organizations sell on credit means that it is possible to make profits on paper and still run out of cash, at least in the short term.

Lusthuas (2006: p126) outline that in a general sense, an organization is financially viable if it generates enough value (both internally and from external sources) to keep stakeholders committed to the organization's continued existence. In the case of many public and not-for-profit organizations (NGOs, foundations), staying financially viable depends crucially on management's ability to maintain existing linkages or create new ones to ensure a continued flow of funds over time from diverse sources.

According to Lusthaus (2002: p127), the starting point for such an assessment is to review the organization's financial statements. This is a simple procedure for private and not-for-profit sector organizations that involve reviewing income and expense statements over several years, together with the balance sheet and cash flow statements. These documents generally provide most of the information required. In assessing financial viability, lists of accounts receivable and actual contracts should also be requested. Both give insight into the future diversity of funding sources and cash flow schedules.

2.3 Revenue generation versus the payment of debts.

The Municipal Finance Management Act (MFMA) has the following impact with regard to revenue collection in municipalities. The revenue -

- Must have realistic income projection
- Must have a balanced cash budget and ensure sustainability
- 3-year budgeting must be in place
- All funds must be cash backed
- Adequate provision must be made for bad debts
- Must have an effective revenue collection system consistent with the Systems Act of 2000.
- Expenditure has to be reduced when revenue is anticipated to be less than projected.

As regards the new Municipal Property Rates Act, no 6 of 2004 has caused a shift in incidence due to the change in the basis of valuation (market value), but it has not necessarily resulted in an increase in income.

The following are some of the factors that currently impact on the ability of a municipality to improve on its revenue collection:-

- Non payment by consumers due to poverty and unemployment. The current economic climate in terms of rising fuel and electricity costs and rising interest rates that are eroding the value of household incomes will also have an adverse impact on the level of payments.

- Budget and tariff increases must be within the macro limit set by the National Treasury. However, tariffs cannot be below inflation. In fact, to eradicate the inherited backlog of services, tariffs should be 2% above CPI. Rentals should also be at market value.
- Little or no growth in the rates base.
- The absence of strong credit control, tariff and rates policies that are strictly applied
- The courts inability to handle a large number of debt collection cases
- Illegal electricity and water connections and meter tampering
- Water and electricity loss in distribution, mainly due to poor infrastructure
- The collection of business levies that was stopped by the National Treasury, and still to date there has been no replacement levy or tax. However, this has been partly covered in terms of the equitable share
- Outstanding accounts with regard to other spheres of government
- Restructuring of electricity distribution (REDs) will result in the loss of revenue and the disconnection sanction by municipalities. This will severely hamper the ability of municipalities to optimize the collection of revenue

2.4 Assessing the sources and types of revenues on which municipalities base their costs.

Municipalities have two main sources of revenue, namely own revenue and intergovernmental transfers. Own revenue consists primarily of revenue from property rates and surpluses generated on electricity and water accounts. It is important for municipalities to balance these revenue sources appropriately.

A recent study undertaken by the Financial and Fiscal Commission (FFC) has shown that some municipalities do not maximise some revenue sources while simultaneously over-utilising others. This can result in economic distortions. For example, some municipalities collect relatively little from property rates but have high electricity tariffs, which may discourage businesses that rely heavily on electricity from investing in that municipal area. Municipalities need to understand the crucial link between decisions on revenue sources and their attempts to promote local economic development.

The Commonwealth Local Government Handbook (2004:77) states that there are three general categories of intergovernmental transfers to municipalities, and each is evaluated below in terms of the prerogative to target resources to historically under-resourced areas.

The first category is the equitable share transfer, which is local government's entitlement to revenues that are collected nationally. Currently, the equitable share for local government is distributed according to a formula that has two components determined by the National Treasury. This formula determines that municipalities with high numbers of low-income households receive a greater proportion of the equitable share than municipalities with relatively few poor people.

The second and third categories of transfers are infrastructure and capacity-building transfers. The current trend with both types of transfers is to consolidate the numerous grants into one funding stream.

Municipalities, unlike provinces, are largely self-financing. This means that they raise most of the resources that they need from local taxes and user charges. The power of municipalities to directly raise revenue, as opposed to relying on national grants, is an important part of their direct, democratic accountability to residents in their areas. However, not all municipalities have the same ability to raise their own revenues (Local Government Budgets and Expenditure Review, 2008).

Bahl and Smoke (2003:249) classify the common sources of actual revenue for municipalities as follows:

2.4.1 Main sources of capital budget financing

- External loans - External loans (from a bank or other financial institution) form of financing the capital budget because of the high interest rates in South Africa. External loans may be used to finance the purchase of major capital items such as roads, buildings, sewerage works and water systems.
- Internal loans – These are fund which municipalities have internally such as the Capital Development Funds or Consolidated Loan Fund. These funds can make internal loans to the municipality for the purchase or development of capital items at a lower interest rate than for an external loan.
- Contributions from revenue - When purchasing a small capital item, the small total cost can be paid for from the operating income in the year of purchase. This financing source is known as "contributions from revenue".
- Government grants (Conditional Grants) - Municipalities may apply to national government for grants for infrastructure development. The two main funds available are:
    - CMIP (Consolidate Municipal Infrastructure Programme) – available from the Department of Provincial and Local Government
    - MIG – This is a consolidation of all grants given by the national government as a means of intervention on the infrastructural delivery gaps to municipalities.
- Public/Private Partnerships - Capital costs can be paid for by means of partnerships between the private sector and the municipality.

2.4.2 Main sources of operational budget financing

- Property Rates - All people and businesses who own fixed property (land, houses, factories, and office blocks) in the municipal area are charged "Property Rates" - a yearly tax based on the value of each property.
- Service Charges/Tariffs - For specific services that can be directly charged to a house or factory, the principle of "user pays" should be adopted
- Fines -Traffic fines, late library book fines, penalties for overdue payment of service charges: these fines are another source of income or "revenue", while at the same time motivating users of services to have a culture of obeying democratic laws, rules and deadlines.
- Equitable share – The local government equitable share is meant to ensure that municipalities can provide basic service and develop their areas.

2.5 Budget management and financial planning

Sound financial management practices are essential for the long term sustainability of a municipality. They underpin the process of democratic accountability. The key objective of the Municipal Financial Management Act (2003), (MFMA) is to modernise municipal financial management.

Van der Waldt (2007:185) defines a budget as a financial plan for a specific period, in which specific amounts are allocated for specific purposes i.e it is a financial plan setting out how objectives contained in a plan will be achieved.

Circular 19 of the MFMA as issued by the National Treasury outlines the following generic budget process which should be followed by all municipalities:

Figure 2.1 The budget process of the municipalities in terms of the MFMA.

Developed by author based on the National Treasury MFMA Circular 19 – The Budget Process 2006/2007.

The budget must be based on the planned service delivery objectives in the IDP, as expressed annually in the SDBIP, taking into consideration previous years and recent performance, assumptions regarding price movements for inputs to the budget (for example, inflation), other economic and demo graphic factors. If budgeted expenditure is underestimated, budgeted revenue may not be sufficient to fund the planned level of service delivery (MFMA Circular No. 42).

In analysing local government budgets, it is important to understand the concepts of revenue and expenditure. Revenue refers to the income of government. Expenditure refers to the ways in which the income is spent. Municipal Budgets are written documents, which show the municipality's sources of revenue, and its expenditure plans. They are classified into two basic parts, an operational budget and a capital budget (Local Government Budgets Toolkit : 2006).

2.6 Working Capital Management - The management of cash, accounts receivable, and accounts payable.

According to Chandra (2006: p387), short-term financial viability of organisations is largely influenced by how effectively the organization manages cash, accounts receivable, and accounts payable. Although there is a perception that financial management requirements are less stringent in the not-for-profit sector, organizations in this sector must nonetheless manage their resources well enough to convince donors and other stakeholders to supply additional funds in the future.

2.6.1 Cash management

Cash flow is essentially the movement of money into and out of a business, it is the cycle of cash inflows and cash outflows that determine the solvency of any organisation. Therefore, cash flow analysis is the study of the cycle of a business' cash inflows and outflows, with the purpose of maintaining an adequate cash flow for the business, and to provide the basis for cash flow management (http://sbinfocanada.about.com/cs/management/g/cashflowanal.htm 12 August 2010).

Longenecker, Moore, Petty and Palich (2006 p 487) describe cash flow analysis as a process which involves examining the components of a business that affect cash flow, such as accounts receivable, inventory, accounts payable, and credit terms. By performing a cash flow analysis on these separate components, the organisation will be able to easily identify cash flow problems and find ways to improve cash flow.

For investors, the cash flow reflects a company's financial health. Basically, the more cash available for business operations, the better. However, this is not a hard and fast rule. Sometimes a negative cash flow results from a company's growth strategy in the form of expanding its operations (www.investopedia.com/articles.asp 20 August 2010).

2.6.2 Accounts receivables and the municipal billing system

A substantial portion of any local municipality's revenue is derived from the delivery of services. It is imperative that the billing is done accurately, as invoices that do not reflect the true nature and quantity of services delivered will probably result in non-payment. The billing function is the principal mechanism that drives all cash flow, the main source of customer information, and critically fundamental to the success of any municipality.

Due to poor billing and revenue collection, municipalities are becoming increasingly dependent on intergovernmental funding to balance their budget. This component specifically focuses on billing integrity as the basis of municipal revenue. The phrase "garbage in, garbage out" does apply in this instance. For example, If the customer information and billing information is incorrect the municipality has no basis to effectively collect revenue. And if the billing information of the customer is incorrect, all other financial estimates and reporting of the municipality will be negatively affected (www.psu.co.za/images/Rev-Enhancement-Guide.pdf 20 August 2010).

2.6.3 Accounts payable management

It is advisable for municipalities to have a payments policy in place. This policy gives guidelines to ensure that the municipality pays for goods and services utilised by the municipality within the voted funds, and that correct amounts are paid at the correct times to valid suppliers.

2.7 The impact of non financial viability on service delivery.

Poor service delivery and governance remain an overwhelming challenge in most municipalities. Of major concern is the degree of corruption, institutional capacity constraints relating to appropriate skills and staff, lack of transparency, dysfunctional ward committees, lack of accountability by councillors and municipal officials, lack of public participation in issues of governance, failure to comply with municipal legislation, failure to prioritize community needs and IDP and budgeting processes not aligned, tensions between the political and administrative sections of the municipalities and weak financial viability of the municipalities. These factors affect the functioning of municipalities tremendously and the financial viability thereof. As a result, this has led to the protests and disgruntlements at local government level. These governance challenges require robust interventions by the national government to expedite local government transformation.

2.8 Conclusion

In conclusion, financial viability is highly critical to a municipality as it can make or break the municipality. Chapter two above, defines financial viability and the factors that influence it. The chapter further demonstrates the relationship between financial viability, financial management, financial planning and service delivery. These issues cannot be separated when assessing and measuring the financial viability of any institution.

The literature presented in the above chapter also outlines the importance of sufficient revenue base for sustainability of an organization. For Mafikeng Local Municipality or any other organization to be sustainable, there must be enough revenue available to ensure that their obligations are positively addressed. This means that there is a need to continuously assess the existing sources of revenue and to enhance them to ensure that they are sustainable in the long run.

CHAPTER THREE
RESEARCH DESIGN AND METHODOLOGY

3.1 Introduction

This chapter sets out the research design and methodology that are used to look into the research questions and to find answers thereto. It also explains the rationale behind the methodology used and demonstrates how the research design and methodology were applied to assess the financial viability of the Mafikeng Local Municipality.

This is basically a desktop research study based on available secondary material. In an ideal world, research should be based on both secondary and more significant primary material. An in-depth fieldwork study would have been ideal to collect data that would have allowed one to measure the issues of financial viability rather, a more quantitative analysis of Mafikeng Local Municipality's financial viability and how it affects their service delivery was looked at.

3.2 The meaning of research

Everywhere, knowledge is incomplete and problems are waiting to be solved. This gap is usually addressed by asking relevant questions and seeking answers to them. The role of research is to provide a method for obtaining those answers by inquiringly studying the evidence within the parameters of the scientific method.

3.3 Research design

The research design is defined as "the plan for the study, providing the overall framework for collecting the data, outlines the detailed steps in the study and provides guidelines for systematic data gathering" (Strauss and Corbin, 1990:17). A research design is a plan through which reliable data is collected, analysed and interpreted for the benefit of the general audience. It is essential as it aims to attempts to answer research questions in an accurate and reliable manner.

Good research is not accidental. It requires careful planning as well as careful execution. Before launching a research project, it is important to prepare a research design, in which the plans for the research are set. A research design is a step in the research process that should not be bypassed. With a good design the researcher is able to foresee and avoid numerous obstacles and pitfalls, save time in the long run, and produce a superior finished product.

McCall and Bakersfield (1998) state that, the length and complexity of research designs obviously vary considerably, but any sound design, be it for a massive, government or foundation supported study, will do the following things:

1. Identify the problem clearly and justify its selection.
2. Review previously published literature dealing with the problem area.
3. Clearly and explicitly specify hypotheses central to the problem selected.
4. Clearly describe the data which will be necessary for an adequate test of the hypotheses and explain how such data will be obtained.
5. Describe the methods of analysis which will be applied to the data in determining whether or not the hypotheses are false.

Because this study is a basic research which does not limit any further research on the identified problem, a case study design is applied and forms the basis of planning the processes of this study.

3.3.1 What is a case study?

Yin (2009:123), describes a case study as an in depth study of a particular situation rather than a sweeping statistical survey. It is a method used to narrow down a very broad field of research into one easily researchable topic. Whilst it will not answer a question completely, it will give some indications and allow for further elaboration and hypotheses creation.

Fiske, Gilbert, Lindsey and Jogsman (2010:12) believe that a case study research design is also useful for testing whether scientific theories and models actually work in the real world.

3.3.2 Arguments for and against the case study design

Wiebe, Durepos and Mills (2009: 200) argue that a case study is a narrow field and that its results cannot be extrapolated to fit an entire question. They also believe that case studies normally show only one narrow example. On the other hand, Gerring (2000:73) argues that a case study provides more realistic responses than a purely statistical survey. He further states that the truth probably lies between the two and it is probably best to try and synergize the two approaches.

For example, a statistical survey might show how much time people spend talking on mobile phones, but it is case studies of a narrow group that will determine why this is so.

Bergh and Ketchen (2009:141) state that case studies are flexible in nature, that a case study might introduce new and unexpected results during its course, and lead to research taking new directions.

Wiebe et al. (2009) again argue that, the argument between case study and statistical method appears to be one of scale. Whilst many 'physical' scientists avoid case studies, for psychology, anthropology and ecology, they are an essential tool. It is important to ensure that a case study cannot be generalized to fit a whole population or ecosystem.

Finally, one peripheral point is that, when informing others of the results, case studies make more interesting topics than purely statistical surveys, something that has been realized by teachers and magazine editors for many years. The general public has little interest in pages of statistical calculations but some well placed case studies can have a strong impact (www.experiement-resources.com 30 June 2009).

3.4 Research methodology

Various authors define and explore various types of research methodology. Walsh and Lynne (2003:126) mentioned two classifications of research methodology. That is, the qualitative and quantitative methods of research. Quantitative is where statistical methods are used to analyze and interpret data, whereas the qualitative methods use other avenues to analyze data.

This case study can be regarded as an exploration or an in-depth analysis of a bounded system (bounded by time) or single or multiple cases over a period of time.

As Babbie (2005) points out, there is little consensus on what may constitute a case. The case being studied concerned to a process, activities, events, programmes or individuals or multiple individuals. It also referred to a period of time rather than a particular group of people.

Stake (2000) argues that the sole criterion for selecting cases for a case study should be the opportunity to learn and emphasizes that, a case study has both a process of enquiry about the case and the product of that enquiry. Where multiple cases are involved, it is referred to a collective case study.

The exploration and description of this case study was in terms of detailed, in-depth data collection methods, involving multiple sources of information that are rich in context. These included interviews, documents, observations or archival records. As such, the researcher needed access to, and confidence of participants.

This case study comprises the research strategies espoused by Creswell, 2006 in terms of in depth analysis of the financial position of Mafikeng Local Municipality. It involved in depth collection of information through the various available documentation, archival records, as well as through observation.

3.5 Data collecting techniques

Data collection techniques employed in any research paper ought to assist the researcher in answering the research questions. Therefore it was important to be systematic and not haphazard when collecting data.

Opie and Sikes (2004) stated that data collection is process of discovery and is influenced by the way in which a researcher views the world. This is important as a way of accumulating information, with the view of gaining answers to the research question. In this view, a combination of research methods were used. Data was gathered using three techniques, interview, questionnaires and reports. Both primary and secondary data informed this research project. The two prevailing forms of data collection associated with qualitative enquiry were interviews and observation.

In this study, existing data was used to analyse the financial viability of Mafikeng Local Municipality. Information from the annual performance reports, the integrated development plans, the budget plan, audited reports from the Office of the Auditor General and any other written material on the subject were scruitinised to back up the results of the impact of the financial viability study of Mafikeng.

3.6 Ethical considerations

Permission was granted from the Mafikeng Local Municipality to carry out this study. The respondents were informed of these conditions:

- Anonymity and confidentiality: respondents were given the assurance that their names would never be disclosed. All information received from them was treated with utmost confidentiality.
- Protection from discomfort: respondents were informed that they could terminate their interviews at any given time when they felt uncomfortable
- Publication of the findings: respondents were informed that, the results of the study would be made available at their request.

3. 7 Method of data analysis

Bogdan and Biklen (2003) define qualitative data analysis as working with data, organizing it, breaking it into manageable units, synthesizing it, searching for patterns, discovering what is important and what is to be learned, and deciding what the end results of the research would be.

This research analysed financial information employing various techniques to emphasize the comparative and relative importance of data presented and evaluated. These techniques included ratio analysis, common-size analysis and studying different components of the financial statements. The information derived from these types of analysis was blended to determine the overall financial position, which also informed the financial viability of the Mafikeng Local Municipality.

3. 8 Conclusion

Ethics that informed this study were briefly outlined in this section. The core concept underlying this research was its methodology. It was not enough to follow the research procedures without an intimate understanding of research methodology that directed the whole endeavour where critical decisions were made and where organizing, planning, and directing the whole project took place.

The methodology controlled the study, dictated the acquisition of the data, arranged data in logical relationships, set up the means of refining the raw data, contrived an approach in order for meanings that lie below the surface of data become to manifest, and finally presented a conclusion or series of conclusions that lead to an expansion of knowledge.

The entire process involved effort as well as an appreciation of its component parts. Thus, research methodology had two primary functions of controlling and dictating the acquisition of data, as well as corralling the data after acquiring it and making it meaningful.

CHAPTER FOUR
DATA ANALYSIS AND FINDINGS.

4.1 Introduction

This chapter presents the analysis and findings from relevant data to the study. Various methods of analysis are explored with the main emphasis of ratio analysis which is based on the annual financial statements of Mafikeng Local Municipality for the years 2006 – 2009. Results are presented and are discussed under central themes or categories. Data is also presented in graphic formats such as tables, charts and graphs. Themes and clusters also form part of data analysis. This chapter further interprets and discusses the conclusions that have been reached. Results relate to research aims and questions.

4.2 Financial analysis of Mafikeng Local Municipality

This analysis is made taking into consideration that a municipality is a form of business entity, which has commitments to its suppliers, personnel and financial institutions and that it is also a collector of revenue from its clients or community.

As a business entity, a municipality must prepare and submit financial statements as part of their annual report to the Office of the Auditor General for scruitiny and auditing. These financial statements are normally the source of financial information analysis for municipalities by the Auditor General and the National Treasury.

4.2.1 The balance sheet analysis

The International Financial Standards Board (2007: 919) explains the balance sheet as a statement which shows the financial condition of an entity as at a particular date. The balance sheet consists of assets (probable future economic benefits obtained or controlled by an entity as a result of the past transactions or events). The assets are derived from two sources, creditors and owners equity. In a healthy business environment, the assets of an entity must be equal to the contribution of the owners:

Assets = Liabilities + Owner's Equity

This ratio means, that the assets of the company should not be less than a combination of the company's liabilities and equity. Should the asset base of any company be less than its liabilities, then that company is faced with serious financial crisis.

Mafikeng Local Municipality's balance sheet as at the end of 30 June 2009 and 30 June 2008 amounted to R336,849.000 and R 293,232,197 respectively, an increase by 24% as compared to the previous year (2007). Of the total balance sheet amount, a total net asset base of R 200,735 in 2008 and R219,229.30 was presented in 2009 (MLM Annual Report, 2008).

Table 4.1 Extracts from a summary Balance Sheet of the Mafikeng Local Municipality for the past four years (2006 -2009).

Item	2009 *R'000*	2008 *R'000*	2007 *R'000*	2006 *R'000*
Fixed Assets	117,620	92,496	60,183	51,673
Plus: Current Assets:	264,437	228,359	188,970	213,267
Inventory	1,848	2,016	1,868	1,471
Consumer Debtors	232,189	172,562	150,744	180,798
Other debtors	9,763	12,956	20,852	12,542
Cash and Bank	-	10,589	917	2,116
Investments (Short-Term)	20,640	30,234	14,587	18,452
Less: Current Liabilities	45,208	27,624	29,624	76,821
TOTAL	**336,849**	**293,232**	**222,528**	**191,607**

Mafikeng Local Municipality Annual Financial Statements : 2009 and 2007.

The above table gives a summarized reflection of the status of the financial position of Mafikeng Local Municipality. There is an escalating trend in amounts owed to this municipality by its debtors. This amount leaped by 34,88 % from R172million in 2008 to R232million in 2009, which clearly shows that the payment levels are strongly deteriorating.

As at December 2007, municipalities in the country were owed a total of R44.2 billion. This represents an increase of 0.3 per cent from the same month in 2006. Metros were owed the biggest portion of the debt, amounting to R25.4 billion. While this is high, it does represent a decrease of about R2.8 billion from December 2006 (www.treasury.gov.za/publications/igfr.pdf 19 August 2010).

This is mainly due to debt write offs by some municipalities as part of debt management strategies, rather than this revenue actually being collected. These strategies include data cleansing, updating the indigent register and effective implementation of credit control policies. However, outstanding consumer debts owed to local municipalities have increased by nearly R3 billion between December 2006 and December 2007 as most of them have not yet instituted the same debt management strategies as the metros (www.treasury.gov.za/publications/igfr.pdf 19 August 2010).

According to the National Treasury's Local Government Budget Reviews of 2008, the debts owed to district municipalities are mainly outstanding RSC levies, which are still on the books of the municipalities as they were collectable until 30 June 2008. A closer scrutiny shows that as at 31 December 2007, metros were owed almost 35 per cent of their total annual budgets, local municipalities 39 per cent and district municipalities 11 per cent. A further breakdown shows that residents owe almost 60 per cent of the total.

The Mafikeng Local Municipality's total outstanding debtors and other receivables equals to R241,953,044 as at 30 June 2009. This is a combination of customer debts (R232,189,400) and other debtors which amounts to R9,763,644 (The Balance Sheet of Mafikeng Local Municipality : 2009).

4.2.1.1 Accumulated surplus/deficit

Accumulated surplus does not always mean that an entity is profitable or that it is doing well. Mafikeng has a total accumulated surplus of R9,121,041 and R48,942,510 for the 2007 and 2008 financial years respectively.
(Mafikeng Local Municipality Annual Financial Statements : 2008).

4.2.1.2 Statutory funds

Contributions to Funds constitute statutory and voluntarily contributions made by the municipality to capital development and other statutory funds. In previous years contributions to leave pay, bad debts and working capital were recorded as contributions to funds. With the introduction of Generally Accepted Municipal Accounting Principles (GAMAP) all contributions to allowed provisions are made through the statement of performance (income statement) as an operating expense.

4.2.1.3 Trust funds/reserves

In accordance with the Institute of Municipal Finance Officers(IMFO) accounting standards, "Trust funds" may have been controlled by the municipality. Several of these funds may however not be actual Trust funds in terms of legislation and all existing funds should be reviewed by municipalities.

4.2.2 The income statement analysis

An income statement measures a company's financial performance over a specific accounting period. Financial performance is assessed by giving a summary of how the business incurs its revenues and expenses through both operating and non-operating activities. It also shows the net profit or loss incurred over a specific accounting period, typically over a fiscal quarter or year (Gibson, 2001).

Mafikeng Local Municipality has submitted the income statement as part of their annual financial statements. The income statement presented a total income of R 285, 045,010.00 (for the 2007/2008 financial year) and a total expenditure of R 251,127,318 which leaves a net surplus of R 48,942,508 for the financial year ended 30 June 2008. The municipality's main cost driver is salary relates costs which is 47% of the entire expenditure. This is 12% higher than the National Treasury prescribed norm of 35%.

4.2.2.1 Revenue management

Mafikeng Local Municipality Budget Policy, 27 June 2007, Council Resolution No. A.41/06/2007 clears that at Mafikeng Local Municipality, service charges are levied to generate the necessary income to render services effectively. Forty-two percent (42%) of revenue is generated from property assessment rates, 15% is raised from the sale of water and the rest is generated from grants and subsidies (22%), while 21% of revenue is from other sources.

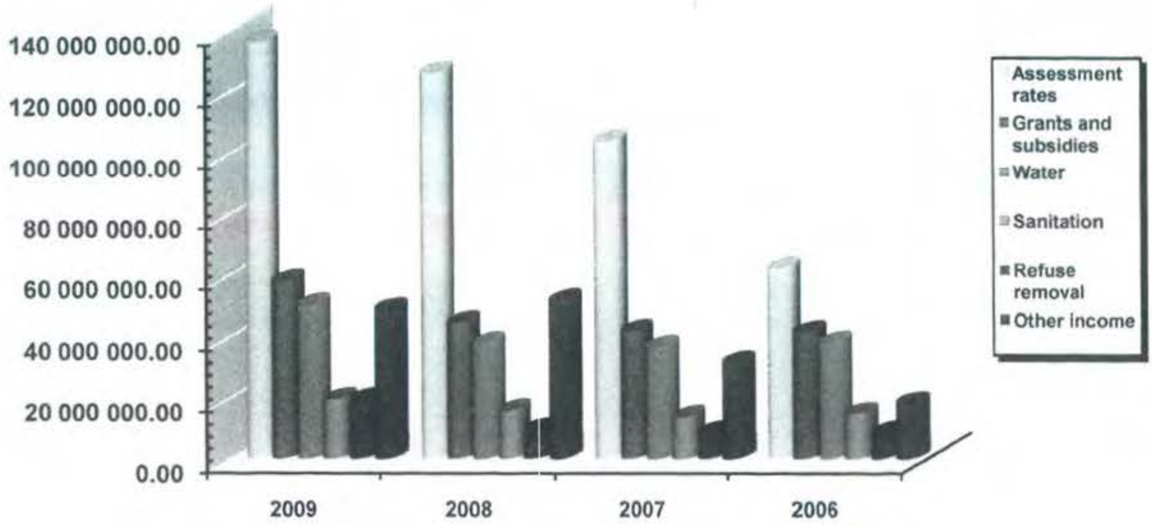
The municipality is not an electricity provider, this function is rested with Eskom. This therefore affects revenue collection in a huge way. By the end of the financial year ended 2008/2009, the municipality did not enjoy any significant increase in their revenue base. This was due to, amongst other factors, that there was no increase in tariffs during the financial year.

Table 4.2 Sources of revenue by major category for 2006 – 2009 for Mafikeng Local Municipality.

Source of Revenue	2009	2008	2007	2006	% of Total Revenue (based on 2009 figures)
Assessment rates	136,036,853	126,057,454	103,976,187	62,146,034	41%
Grants and subsidies	57,907,190	44,314,865	41,790,374	41,441,000	17%
Water	50,174,423	37,825,323	36,617,972	38,010,844	16%
Sanitation	19,328,619	15,711,959	13,628,983	14,755,578	6%
Refuse removal	19,328,619	9,486,165	8,651,890	8,595,016	6%
Other income	48,654,736	51,649,244	31,595,431	18,267,070	14%
TOTAL	331,430,440	285,045,010	236,260,837	183,215,542	100%

Mafikeng Local Municipality Annual Financial Statements :2009 and 2007.

Graph 4.1 Revenue per source for the years 2006 - 2009



Adapted by the author from table 4.2

As indicated in graph 4.1 above, Mafikeng Local Municipality generates a greater percentage of its income from rates and taxes. This is, unfortunately, not an ideal situation for most municipalities in the province. Mafikeng is made fortunate in this instance by the fact that it is made up of both rural and urban areas, unlike other municipalities such as Kagisano, Ratlou and Molopo which are hundred percent rural and therefore generate no income at all. For such municipalities, conditional grants from the national and the provincial governments are their only hope and means for survival and existence.

4.2.2.2 Expenditure trends

Generally, municipalities spend 80 percent of their capital budget on infrastructure development and maintenance. However, municipalities are still spending huge amounts on their salary bills. Some municipalities are even tapping into their capital budgets or conditional grants to curb their high personnel costs.

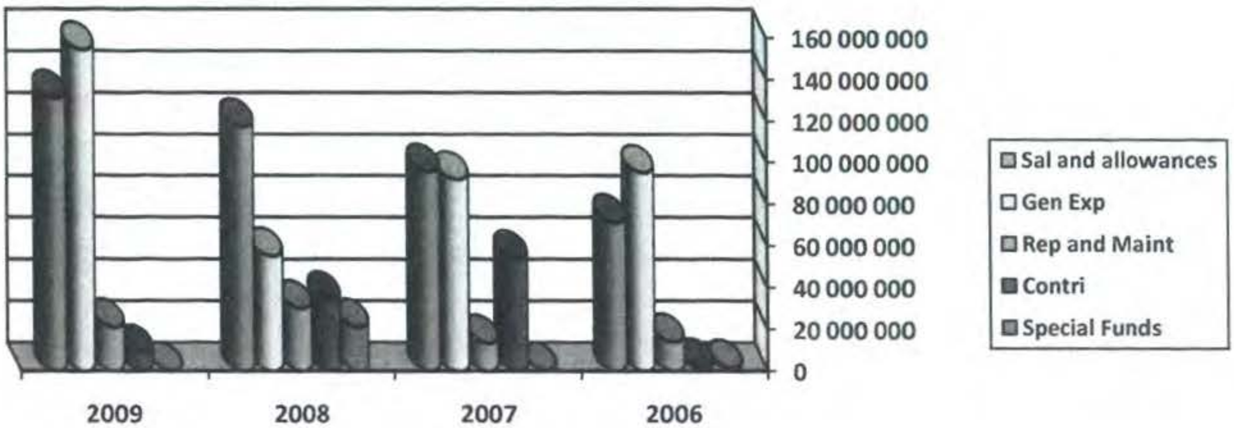
Mafikeng Local Municipality has increased its expenditure from R256,340,526 in 2008 to R314,047,243 in 2009 and this was mainly influenced by the salary increases as agreed to by the bargaining council. Water losses also contributed highly to the high expenditure. The expenditure trends for Mafikeng Local Municipality for the past four years classified by category are presented below:

Table 4.3 The cost drivers per category as classified by Mafikeng Local Municipality for year 2006 – 2009.

Expenditure Item	**2009**	**2008**	**2007**	**2006**
Salaries and allocations	130,761,192	117,139,529	95,322,607	70,972,320
General expenses	154,088,255	54,898,638	91,695,221	94,807,283
Repairs and maintenance	20,795,062	29,805,415	13,227,947	13,842,988
Contributions	8,402,734	34,009,312	53,579,247	2,000,000
Special funds	-	20,847,635	-	1,364,135
Expenditure	314,047,243	256,340,526	256,198,885	187,486,564
Departmental Charges	-1,752,648	-5,213,208	- 27,583,802	-26,740,700
Departmental charges	19,135,845	33,917,692	2,373,863	4,499,838
TOTAL	**331,430,440**	**285,045,010**	**228,615,083**	**160,745,864**

Mafikeng Local Municipality: Annual Financial statements 2006 – 2009

Graph 4.2 The expenditure pattern for the Mafikeng Local Municipality for the financial years 2006 -2009



Adapted by the author from table 4.3 above

4.3 Ratio analysis

According to Moyer et al (2009: 59) , ratio analysis was developed to determine the stability of various financial aspects of a business. It shows the relationship between two figures, or two aspects of your business. It helps you work out your business' financial weaknesses and strengths, so that you can take appropriate action.

Gibson (2001), also states that ratio analysis also offers the view of an organisation's competitive performance in relation to similar businesses in a particular industry. Essentially ratios include the following:

4.3.1 Liquidity ratios

These ratios analyse the available liquid assets a business has at any given time to meet current liabilities. In other words, it tells you how much cash-on-hand you have, as well as assets that can readily be turned into cash.

The acid test ratio is calculated as current assets minus inventory divided by current liabilities. The accepted acid test ratio is considered to be 1:1. In other words the institution is able to meet its current credit obligations without disposing of its inventory. (Thukaram Rao : 2007 p 87).

For Mafikeng Local Municipality, the quick ratio and the current ratio are presented below:

- The quick ratio = Cash + Accounts receivables / Current liabilities.
  = (R10,589,633.00 + R185,516,641) /R 27,622,131
  = 6.72 : 1

Gorman (2003:27) states that, the Acid-test or quick ratio or liquid ratio measures the ability of a company to use its near cash or quick assets to immediately extinguish or retire its current liabilities. Quick assets include those current assets that presumably can be quickly converted to cash at close to their book values. A company with a Quick Ratio of less than 1 cannot currently pay back its current liabilities.

A quick ratio less than one implies that there is dependency on inventory and other current assets to liquidate short-term debt. Therefore a quick ratio which is more than one indicates that the organization is doing well in terms of the cash and accounts receivable as a percentage of their current liabilities.

- Current ratios = Current Assets / Current liabilities
  = R228,357,345/R27,622,131
  = 8,27 : 1

This ratio is a comparison of current assets to current liabilities, commonly used as a measure of short run solvency. That is, the immediate ability of a business to pay its current debts as they come due. Potential creditors use this ratio to measure a company's liquidity or ability to pay off short term debts. The ratio less that 1 implies that the company is struggling to keep up with their liabilities and therefore that their liabilities are more than their assets, and that situation is not good.

Mafikeng Local Municipality presents a positive ratio of 8,27 to 1 for the 2008-2009 financial year. This means that the municipality is in a position to take care of their financial commitments. The creditors or current liabilities of the municipalities are reasonable at R27,622,131.

4.3.2 Profitability ratios

Brighman and Houston (2007:113) define the profitability ratios as those ratios that are used to measure the income or operating success of an enterprise for a given period of time. Brighman and Houston (2007), further classify these ratios into three main categories which are:

4.3.2.1 The gross profit margin

This measures the gross profit of the organization as a proportion of their revenue. It is calculated as follows:

Gross Profit Margin = Gross profit/Revenue X 100
= R 48,942,508/R 285,045,010
= 17%

This ratio means that for every R1 a percentage calculated above represents the amount of money which is used to cover expenses other than direct expenses of a company.

4.3.2.2 Return on capital employed (R.O.C.E)

Walker (2008:362) explains the ROCE as the primary accounting ratio that expresses the annual percentage return that an investor would receive on their capital. It basically relates the profit to the size of the business and it is calculated using the following formula:

R.O.C.E = Net Profit/Capital Employed X 100
= R 48,942,510 / R 180,428,165
= 0.27
= 27%

MLM presents a return on capital employed of 27%. This means that for every R1 employed on capital, there is a 27% return. Financially, this is a good return because it means that the municipality is receiving back their investment on assets. (http://en.wikipedia.org).

4.4 Interventions by other spheres of government

On 3 September 2003, the Provincial Executive launched an intervention in the Mafikeng Local Municipality in terms of section 139(1)(b) of the Constitution. The then MEC for Developmental Local Government and Housing, on behalf of the provincial government, submitted a notice to the National Council of Provinces to approve the intervention, which effectively commenced on 4 September 2003, in compliance with section 139 (2)(a)(ii) of the Constitution.

The North West Provincial Government implemented this intervention on the following terms:

- To produce a service delivery plan for the entire municipal area in terms of all its powers and functions as stipulated in Schedule 4 Part B and Schedule 5 Part B of the Constitution, subject to the Minister's authorisation and MEC's adjustment of powers and functions as provided for in Section 84 of the Municipal Structures Act, 1998 (Act 117 of 1998).

This intervention clearly displayed that there were constraints at the municipality. Mafikeng municipality was not the only municipality that had problems which led to this kind of intervention in the province. Other bigger municipalities such as Naledi Local Municipality, Ditsobotla Local Municipality and Lekwa Teemane Local Municipality, just to mention a few had to go through this type of intervention due to various reasons, but mainly due to lack of proper institutional arrangements and capacity.

4.4.2 The equitable share

The equitable share of revenue for local government is determined pursuant to the Division of Revenue Act of 2009, which is modified annually to take account of the current fiscal situation. The Act determines the vertical division of nationally raised revenue among the three spheres of government. The local government's equitable share is then distributed to individual municipalities by the Department of Provincial and Local Government based on a formula that ensures an equitable and predictable system of transfers.

The equitable share for local government is meant to enable municipalities to provide basic services to low income households and ensure that basic services are provided. It is the responsibility of municipalities to establish appropriate targeting mechanisms for passing this subsidy to the poor.

The equitable share for local government amounted to R1,867 billion for the 2000/01 financial year for the entire country. Including R293 town funding for staff transferred to municipalities (approximately R400 million), the allocation rises to R2,6 billion for the 2001/02 financial year. The allocation will rise to R3 billion from the 2002/03 financial year and to R3,6 billion in the 2003/04 financial year. This represents an average annual increase of 11 per cent over the period. The increase in the equitable share will assist municipalities in improving the provision of basic services to low income households and to perform their functions *(www.treasury.gov.za)*.

As a result of the demarcation process, the previous 843 municipalities were replaced with 284 newly-demarcated municipalities. The baseline demographic and socio-economic information used in the formula was reworked in line with the new municipal boundaries. The basic structure of equitable share transfers was, however, retained in order to ensure transparency, stability and predictability in allocations to municipalities.

From the 2001/02 financial year, two major improvements to the equitable share have been introduced, namely, the introduction of three-year allocations to municipalities and improved targeting through the refining of data based on which poor households are defined.

The release of the three-year allocations will increase predictability of allocations and will improve budgetary and planning decisions by municipalities that, in turn, will lead to improved service delivery.

Municipalities will therefore be able to enhance the targeting of the equitable share towards the provision of services to low income households. When the equitable share was initially distributed, income distribution from Census 1996 was the only method available at that stage for estimating the number of poor households in each municipality. During 2000, STATS SA in collaboration with the World Bank, reviewed alternative methods of measuring poverty. It is generally agreed that data on household expenditures provides, particularly for households with limited economic resources, a better measure of total income (or, more generally ability to pay) than data on cash income. By combining various data sources, it was possible to determine imputed household expenditures for individual municipalities. This improved data on which poor households are identified will be used from the 2001/02 financial year.

Currently, the Department of Water Affairs and Forestry administers an operating subsidy for water schemes in, mainly, rural areas. Steps are being taken to transfer these schemes to municipalities and the concomitant funding will then be incorporated into the equitable share. A transitional grant has been established for the 2000/01 to 2002/03 financial years to assist municipalities to meet the once-off costs associated with municipal amalgamations. After this period, the transition grant will be incorporated into the equitable share and distributed through a formula.

Government has long made a commitment to ensuring the delivery of at least a basic level of municipal service to all households. The provision of free basic services to all South Africans poses a number of key challenges to local government. There are currently a number of fiscal mechanisms that subsidises service delivery to poor households, including infrastructure grants (such as the Consolidated Municipal Infrastructure Programme) and the equitable share for local government. Various municipalities have used rising block tariffs to finance the delivery of a free basic level of service to low consumption households (www.info.gov.za).

4.4.3 Project consolidate

Project consolidate is one of the interventions that the national government puts in place with one of its objectives being to achieve financial viability at municipalities. It was a hands-on programme to improve local government. So far, 136 of the country's poorest municipalities have been targeted. The initiative is to use the skills of individuals with a thorough knowledge of local government, so as to mitigate the learning curve (www.projectconsolidate.gov.za).

The aim was to accelerate the provision of free basic services - such as sanitation, water electricity and refuse removal - by training municipal staff. Civil, electrical and water engineers have been made available to poor and understaffed municipalities to help stabilise electricity and water networks.

Rustenburg Local Municipalities (LM), Mafikeng LM and Matlosana LM are provincial pilot sites for the development and implementation of debt collection/credit control measures which have done considerably well. Rustenburg registered the highest debt collection rate over a period of 18 months netting R74 million on the above and all 60 day-accounts. Human resource experts have been provided to develop organisational structures and assess the skills and competencies of municipal staff. Legal skills are being used to resolve labour disputes that have hampered service delivery (South Africa info reporter : 2008).

4.4.4 Municipal Infrastructure Grant (MIG)

The National Government provides infrastructure subsidies to ensure that all households have access to a basic level of infrastructure services. The benefits of this intervention are well-known, particularly in relation to the public good characteristics of many municipal services.

The key objectives of the Municipal Infrastructure Grant are to:

- fully subsidise the capital costs of providing basic services to poor households: this implies that priority must be given to meeting the basic infrastructure needs of poor households, through the provision of appropriate bulk, connector and internal infrastructure in key services,
- distribute funding for municipal infrastructure in an equitable, transparent and efficient manner which supports a co-ordinated approach to local development and maximises developmental outcomes;
- assist in enhancing the developmental capacity of municipalities, through supporting multi-year planning and budgeting systems; and
- provide a mechanism for the coordinated pursuit of national policy priorities with regard to basic municipal infrastructure programmes, while avoiding the duplication and inefficiency associated with sectorally fragmented grants (www.dplg.gov.za/subwebsite/mig/docs.1.pdf).

4.4.5 The Vuna awards

The Department of Provincial and Local Government (DPLG), together with the Development Bank of Southern Africa (DBSA), the National Productivity Institute (NPI) and the South African Local Government Association (SALGA) initiated the Vuna Municipal Performance Excellence Awards in 2003, as a way of encouraging municipalities to improve performance and service delivery, the word Vuna comes from the Nguni family of languages and means 'harvest together'. The award seeks to encourage service excellence and to celebrate municipalities which are sowing the seeds of genuine development and by so doing laying the basis for a harvest of a better life for ordinary citizens of our country.

The specific objectives of the Vuna awards are:

- To motivate municipalities to enhance their performance and productivity;
- To find creative ways of enhancing municipal viability;
- To promote learning and sharing of best practices amongst and between municipalities;
- To improve the profile and publicise good practices by municipalities;
- To promote a culture of performance measurements and benchmarking;
- To promote commitment to service delivery;
- To highlight municipal best practices and experience; and
- To meet stakeholders expectations and statutory obligations (www.dplg.gov.za).

It is through these types of initiatives where a culture of accountability and a culture of performance to improve service delivery is encouraged and enhanced. Also to encourage work on the developmental goals, focusing on poverty alleviation through the Local Economic Development programme and creating jobs through capital or infrastructural programmes that make use of local labour or local contractors targeting youth and women especially job creation.

4.4.6 Other interventions

The Minister of Provincial and Local Government Mr Sydney Mufumadi, in his speech in December 2003 during VUNA Awards made an observation that a fair level of understanding and appreciation has been reached about the importance of municipal financial viability and management. He expressed that this level of understanding and appreciation is evidenced by the several initiatives that are ongoing in every province to support their respective municipalities - and also by the several strategic interventions that are driven by either municipalities themselves, or by the national government. The initiatives to support the achievement of sound financial management and viable municipalities include:

- The intergovernmental fiscal transfers reform programme - which focuses on simplifying and rationalising transfers to municipalities and introducing three-year allocations of these transfers so as to stabilise municipal budgeting processes by improving predictability;
- The budget reform programme - which focuses on improving resources allocation planning and management;
- The Municipal Support Programme - which provides technical assistance to municipalities in the areas of financial management,
- Human resources management, organisational development,
- community and development planning;
- New and refining national policies and legislation - aimed to improve the flexibility of the legal framework within which municipalities are expected to operate, and to improve the leadership, management an accountability in municipal governments; and
- The Municipal Revenue Enhancement Programmes - a nationally coordinated programme aimed to assist municipalities with revenue enhancement and management through a series of targeted Intervention (http://www.polity.org.za. 19 August 2009).

4.5 Conclusion

No municipality will be successful without adequate financial resources and financial management and therefore, attention needs to be paid to the operating and capital budgets. The finances of the Mafikeng Local Municipality are relatively unhealthy in comparison with many other municipalities. Key financial trends prevailing in the Municipality, driven in particular by personnel costs and rising arrears, are placing increasing pressure on the Municipality's finances.

Important services are being squeezed out by expenditure increases elsewhere (Mafikeng IDP 2002-2007).

Financial viability represents an important feature when evaluating the overall situation of the local government sector as it demonstrates the significance and the reason for municipalities' existence. Quality financial management and the sustainability of municipal finances are important for financial viability. One key variable and precondition that helps achieve financial viability is the clear division of powers and functions between the Districts and Local Municipalities. Within the context of the Local Government Municipal Structures Act, 1998 and the Municipal Systems Act, 2000, the critical trading functions include electricity, refuse removal, water and sanitation. In terms of the Municipal Property Rates Act of 2004, all the local municipalities' posses full rights to levy on property within their areas of jurisdiction.

Whilst financial viability of municipalities is critical, the realization of financial sustainability by many municipalities is still the greatest challenge requiring commitment to sound financial management by both political and administrative arms of the municipal institutions.

CHAPTER 5
CONCLUSIONS

5.1 Introduction

This chapter draws together the various themes and arguments that have run through this dissertation. The research question was to determine whether municipalities in the province are financially viable, focusing mainly on the status at Mafikeng Local Municipality. In order to explain the financial viability of a municipality the research followed both theoretical and empirical ways to analyse available information.

This study was prepared and divided to fit into five chapters. The first chapter is preceded by the abstract and table of contents. Chapter one of the research sets out the contextual background and motivation for this research. In establishing the background, the reader was made aware of the implicit objectives contained in the new local government legislation and the legislation relevant to financial management. Further, the chapter described the organizational culture envisioned by this new legislation, which aims at transforming municipalities into more efficient, effective and economic spheres of government.

This concluding chapter attempts to conclude on all the findings of the study and on answering the research questions and the subquestions. The chapter further outlines the research design and methodology used in the study. It further justifies the selection of the chosen methodology.

In chapter two, various indicators of financial viability are discussed to align them to a financial management environment and service delivery in general. A further investigation and assessment of other factors such as revenue generation versus the debt payments of the municipality; the actual sources of revenue; the budget process; cash management as well as working capital management are discussed. A detailed overview of the organization in question is also discussed in this chapter.

Chapter two also interrogates the difference and relationship between financial management, financial administration and the control procedures that are necessary within the financial management environment. It tests whether there are policies and procedures in place necessary for the management of a financial directorate within the Mafikeng Local Municipality. The existing legislation was reviewed to assess what ought to be as compared to the current or existing situation.

Chapter three of this dissertation presents the design and methodology that are used throughout the study. It also looks into the research questions and the approach as well as ethical considerations. This is where the case study as a method used in this research is explained and described and defined. Furthermore, in this chapter, data collection techniques and are discussed and elaborated upon.

Chapter Four of this study shows the analysis of the empirical findings. Various methods of analysis are explored, especially ratio analysis which is based on the annual financial statements of Mafikeng Local Municipality for the years 2006 – 2009. Results are presented and are discussed under central themes or categories. Data is also presented in graphic formats such as tables, charts and graphs. Themes and clusters also form part of the data analysis. This chapter further interprets and discusses the conclusions that have been reached. The results relate to the research aims and questions.

Chapter five draws logical conclusions from the data that is interpreted. It also recommends ways and strategies for change. The reference section lists alphabetically all the material cited for the study.

5.2 Theoretical findings

The theoretical approach outlined in chapter two of this study looks at the meaning of financial viability, aligning it to the municipal environment. This study showed that, financial viability impacts on the day-to-day operation of the municipalities and on service delivery. The study further revealed that financial viability is not an isolated subject, it has to be discussed taking into consideration the concepts of financial management.

The theoretical findings further revealed the following:

- The pre local government transformation had an impact on the financial viability of the current local government system. That is, the previously rural towns are now expected to urbanise and respond to the needs and requirements of their citizenry. This requires a lot of economic and financial spins which will enable these rural areas to become on par with the urban areas within the same municipal demarcations. Looking at Mafikeng Local Municipality, there are both rural and urban areas within the municipality, therefore this also applies fully to Mafikeng Local Municipality.

- The rural areas are still lagging behind when it comes to issues such as revenue generation and municipal services provision. Therefore, financial resources which are partly derived from the urban areas are now channeled to these rural areas to develop them into urban areas which can now bring some revenue into the municipality. Table 4.2 presents the sources of revenue for Mafikeng Local Municipality for the period under study. In that table, a greater percentage of revenue collected is from the assessment rates at 41 %. These assessment rates revenue is derived from the more urban areas of the municipality because the rural parts of the municipality are not yet in a position to produce any revenue from their assessments.

- Financial viability closely relates to the powers and functions which are given to the different spheres of government in terms of the intergovernmental relations prescripts of South Africa. This subject cannot be discussed without taking such into consideration the fact that the issues of fiscal relations amongst the three spheres of government play a pivotal role in deciding how revenue is allocated and distributed to the various spheres of government. Most municipalities generate a large amount of money from the provision of electricity and water sales. This is not a case with Mafikeng Local Municipality in as far as electricity is concerned as indicated through the study. The fact that Eskom is the electricity provider, deprives the Mafikeng Local Municipality some revenue, thus also affecting the revenue base of the municipality in a negative way.

- The literature demonstrates that, a clear definition of powers and functions reduces the burden of financial management on stakeholders. The assignment of powers and functions to municipalities needs to be done and backed by the necessary financial resources to enable them to fulfill their mandate. This is not always hundred percent possible because, the financial resources are not always enough to cater for all the demands of the citizenry at local government level.

- Municipalities must have in place financial measurement indicators to be able to assess their financial viability and financial performance to their stakeholders and interest groups. According to the literature reviewed in the study, for a municipality to be declared financially viable, that municipality must be in a position to maintain the inflow of financial resources greater than the outflow of such financial resources. Therefore, a positive cash flow is crucial in the measurement of financial viability of organizations. The Mafikeng Local Municipality has been presenting a mixture of both positive and negative outflows from the year 2006 through to 2009. In 2006, their net cash and cash equivalents as presented in the Cash Flow statement was a negative amount of R23,792,011, which improved slightly to a positive balance in 2007 at R917, 275.00. The Mafikeng Local Municipality cash flow also presented an improvement in 2008 with a positive balance of R10, 589,633.00 and a decline in the year 2009 with a negative net cash flow of R4,527,295. This means that in 2009, the municipality overspent themselves. They had more cash outflows than they could produce cash inflows, that indicates that they were experiencing cash flow problems from time to time and this impacted also on their financial status.

- The study also revealed that ratio analysis is important in assessing the financial viability of any business organisation, be it a private or public enterprise. The ratio of the largest funder to the overall revenues demonstrates the level of dependence of the municipality on external funders, and therefore displays the financial strength or weakness of a municipality. The largest funders of Mafikeng Local Municipality are their customers and the government. Should the government withdraw their grants, the municipality will not be in a survival mode. It is therefore important for municipalities to keep coming up with new revenue raising mechanisms to avoid dependency on one major source which might drastically hamper their financial viability should it be withdrawn.

- The literature further elaborates that ratio analysis scrutinizes the financial statements of the municipality to determine the municipality's financial performance and financial position within a competitive market. The current ratio as explained in the literature, demonstrates the ability of the municipality to respond to the debts which it might be faced with. A negative current ratio therefore means that a municipality is in financial problems. The current ratio for the Mafikeng Local Municipality as analysed in chapter four of this study, presented a positive ratio. This means that the current assets of Mafikeng Municipality are more than their current liabilities. This is not necessarily a good thing for Mafikeng because, in the balance sheet attached in annexure A, the larger part of the current assets is debtors, that is, money owed to the municipality. The question of recoverability of such debts will determine the verdict on the current ratio situation of the municipality.

- The study further revealed that, the capacity of the human resources of any organisation has an impact on the financial viability of such institution. The literature indicated that, the salary bills of municipality continue to take a larger chunk of their operational budgets, therefore this affects their capital budgets in a negative way. The total salary costs for Mafikeng Local Municipality as highlighted in Table 4.3 in chapter four were at R130,761,192.00 in 2009 a total rise in this cost item by 56% from the 2006 amount which was R70,972,320.00.

- Another revelation from the literature was that, the number of revenue sources at a municipality affects the financial viability of that particular municipality. For instance, if a municipality does not have sufficient sources of revenue, that municipality's income base will be negatively affected and therefore operational issues and service delivery will also be negatively affected. The concern raised was that the municipalities are highly dependent on grant funding from both the national and the provincial governments as well as from external loans. This dependence impacts on the growing concern and financial stability of municipalities as business enterprises and service delivery vehicles to the communities which they serve. The threat of organisations which depend on single source of funding and the reliability thereof was further outlined and presented in the literature review. Table 4.2 in chapter four, indicates that Mafikeng Local Municipality has only six sources of revenue, which made up a total consolidated revenue of R331 million in 2009.

- The study continued to present a concern that the resources available to the municipalities are often not enough to enable them to deliver all the services that are required from them. The management of the financial resources allocated to municipalities is very vital, therefore the literature emphasizes the proper management of financial resources as a matter which drastically affects financial viability. The study also revealed that an organisation is financially viable if it generates enough value to keep their stakeholders happy.

- According to the literature reviewed in chapter two, it was also presented that, staying financially viable is affected by the organisation's ability to maintain existing linkages and creating new ones to enhance cash flow and funding sources.

According to the literature, financial viability covers a wider spectrum of areas of operation within a municipality. Lack of financial viability also affects the developmental nature of the local government institutions as outlined by the Constitution of South Africa.

5.3 Empirical findings

The empirical findings in this study are based on the practical findings, experiments, evidence and observations as indicated throughout the study. The empirical findings are as outlined below:

5.3.1 Revenue

This study found that, Mafikeng Local Municipality has six sources of revenue which are:

- Assessment rates which contributed forty one percent to the total revenue of the municipality during the year ended 30 June 2009;

- Grants and subsidies at the end of the financial year 2009, accounted for seventeen percent of the total revenue budget of the Mafikeng Local Municipality;

- Water sales revenue at the end of the financial year 2009, presented a sixteen percent revenue to the municipal revenue base;

- Other sources of revenue combined (sanitation, refuse removal and other taxes) added to make the remaining twenty six percent of the municipal revenue.

The study also found that:

- Municipalities in a democratic local government are supposed to be self financing. The amount of available funds must be enough to ensure that all the goals and objectives of a municipality are achievable.

- There is an imbalance between rural and urban areas of the Mafikeng Local Municipality and this has a negative impact on the revenue collection.

- Weaknesses in revenue management constraints the ability of a municipality to provide services adequately.

- Mafikeng Local Municipality is not an electricity provider, instead Eskom is the electricity provider. This impacts negatively on the revenue collection of the municipality.

- The total increase in revenue over the four years of 2006 - 2009 was significantly small. That is an increase of 22% from 2006 to 2007, an increase of 17% from 2007 – 2008 and an increase of 13% between 2008 and 2009.

- The lack of increasing of municipal tariffs over the years affected the municipal revenue negatively over the years.

- Customer records are not regularly updated and this lack of update affects the collection of revenue as the municipality has got no updated information of some of the properties within its jurisdiction.

- The personnel costs of the municipality are higher than the norm as set by the National Treasury, this means that some service delivery is affected by the funds which are now channeled to this expense.

Containment of personnel costs is crucial for the long term sustainability of any municipality and Mafikeng Municipality. The overall administrative costs must also be minimized at all costs, this will save and add up to the municipal infrastructural budget.

In 2009, the Mafikeng Local Municipality's expenditure was at R331million with the main cost drivers being salaries and wages, maintenance costs and general expenses. The salary bill is at thirty nine percent (39%) of the total expenditure, which is above the national treasury threshold by two percent (2%).

The municipality is also investing a lot of money in the water losses and maintenance of water provision infrastructure. This costs the municipality dearly and the general expenses as at 2009 stood at forty seven percent (47%) of the total costs of the municipality.

There is a need to develop strategies to reduce costs. These strategies must be developed and employed immediately to see if the savings made from these cannot be invested on infrastructure development.

5.3.2 Financial analysis

The analysis of the balance sheet and the income statement presented a positive outcome on the municipality's finances. The balance sheet shows that the municipality's liabilities are less than the municipality's debts, which is good because it means that the municipality is not yet at a state of bankruptcy. However, this also has a shortfall because the asset base of the municipality is made of among other current assets the debtors. Which could turn out to be bad debts and could negatively affect the current ratio of the municipality.

The balance sheet presented a positive bank balance and some reserves. Even though the outstanding accounts are still high, a good debt management strategy needs to be put in place. This strategy should include an emphasis on the monitoring of the Top 100 debtors and the pursuance of government debt with possible intervention by the National Treasury in terms of deducting outstanding amounts from the relevant equitable shares. Addressing the issue of returned mail, using rates clearance certificates to ensure that all outstanding debt is collected, is also important.

The income statement also presented a positive surplus at the end of the financial year ended 30 June 2009.

5.3.3 Ratio analysis

Ratio analysis is not the one and only method that could be used to analyse the financial operating status of the municipality. However, in this study, ratio analysis has been the preferred analysis method.

Ratios that determine liquidity and ratios that determine profitability were used in this study. In terms of these ratios, the Mafikeng Local Municipality presented a positive outcome for the periods that were analysed. These ratios indicate that in as far as liquidity is concerned, Mafikeng was liquid and a growing concern for the period under study. The profitability ratios also indicate that the municipality is profitable as the ratios present positive results.

5.4 Conclusion

Local Government financial viability is gradually showing signs of collapse instigated by the macro-economic factors and challenges outside the control of municipalities and cannot be mitigated. Such factors which include primarily the negative economic indicators in the form of rising inflation and unemployment leading to increased level of indigents cannot be left to the sole tackle by municipalities but require concerted effort and contribution by the three spheres of government. The above factors logically affect the revenue raising ability of municipalities and ultimately exert pressure on government for an increase in the quantum of intergovernmental fiscal transfers.

There is a great opportunity for improved financial viability and financial management by municipalities. Mainstreaming hands-on support to local government to improve municipal governance, performance and accountability have been encapsulated as a key focus through the Local Government five year Strategic Agenda.

Ensuring Local Government financial viability is of paramount importance and strategies should be drawn from the relationship existing between municipal powers and functions and the macro-economic factors. The review of powers and functions between Category B and C municipalities and boundary re-demarcation process should align for creation of sustainable institutional make-up and the established local fiscal independence combined with fiscal transfers from the national government. Clearly, an assessment of the revenue base in terms of total income per capita, grant dependency, trading and economic services is important to undertake intermittently within every five years including an assessment of efficiency factors such as salaries costs to operating revenue.

In mitigating for the pressures such as increasing level of indigents, that could collapse the local government fiscal independence, continued efforts should be accelerated by the National Treasury and the DPLG to conclude the work on defining poorer municipalities and mechanisms to fund poorer municipalities outside the Equitable Share and MIG formula as part of the review processes. The reality with this formula will always be that the most receiving municipalities will always receive the most in any event where the quantum increases.

There is still a great need for a multi-faceted approach to address the debt crisis faced by municipalities. The approach should be underpinned by continued debt analysis and a focus on the credibility of billing data. It has become imperative to look at data cleansing and indigent management pragmatically.

Government should, through the Provincial Premier's Offices or Provincial Legislatures, enforce measures to ensure that all the provincial governments settle their debt with municipalities. All these requires the national and the provincial massive education programmes covering the reasons for the introduction of free basis services as well as the importance of paying municipal services. The campaign should also embrace the role of the Ratepayers Associations which in some cases have been the proponents of boycotting the payment of service fees to municipalities opting to establish trust accounts. The role and commitment of Councillors is central to credit control and debt collection.

In conclusion, a strong linkage of financial viability to local economic development is becoming increasingly inevitable. A sharper synergy between these two KPAs should be documented in relation to the indicators to measure the actual relationship and contribution between local economic development and financial viability.

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Appendices

Appendices 1

The Annual Financial Statements of Mafikeng Local Municipality for the year ended 2008 and 2009.

The annual financial statements attached here include the balance sheet, the income statement and the cash flow statement for the years 2006 – 2009. The information contained in the financial statements is used in data analysis and the ratio analysis used in the study.

Appendices 1.1

The balance sheet of Mafikeng Local Municipality presents the financial position of the municipality for the period 2008 – 2009. The information from this balance sheet was used to analyse the ratios in chapter four and also as reference in other chapters throughout the study.

MAFIKENG LOCAL MUNICIPALITY

BALANCE SHEET AS AT 30 JUNE 2009

	NOTE	2009 (R)	2008 (R)
CAPITAL EMPLOYED			
FUNDS AND RESERVES		184,604,202	180,428,165
Statutory Funds	1	181,718,693	177,148,541
Reserves	2	2,885,509	3,279,624
(Accumulated Deficit)/			
Retained Income	19	73,519,143	48,942,510
		258,123,345	229,370,675
TRUST FUNDS	3	27,870,825	27,965,339
LONG-TERM LIABILITIES	4	45,742,855	31,311,305
CONSUMER DEPOSITS:			
SERVICES	5	5,112,284	4,584,878
		336,849,310	293,232,197
EMPLOYMENT OF CAPITAL			
FIXED ASSETS	6	117,620,000	92,496,982
		117,620,000	92,496,982
NET CURRENT			
ASSETS\LIABILITIES		219,229,310	200,735,215
CURRENT ASSETS		264,437,770	228,359,291
Inventory	9	1,843,832	2,016,694
Consumer Debtors	10	232,189,400	172,562,583
Other Debtors	11	9,763,644	12,956,003
Cash & Bank	0		10,589,633
Short-term Investments	7	20,640,894	30,234,377
CURRENT LIABILITIES		45,208,460	27,624,076
Provisions	12	13,892,784	11,860,592
Creditors	13	20,560,414	13,193,478
Short-term Portion of Long-term			
Liabilities	4	6,227,967	2,570,006
Bank Overdraft		4,527,295	
		336,849,310	293,232,197

Appendices 1.2

The income statement of Mafikeng Local Municipality presents the financial performance of the municipality for the periods under review. This information is included here to support the ratios and information analysed throughout the study.

Mafikeng Local Municipality

Income statement as at 30 June 2009

SERVICES	Actual 2007/08			Actual 2008/09		
	Actual Income (R)	Actual Expenditure (R)	Surplus /Deficit (R)	Actual Income (R)	Actual Expenditure (R)	Surplus /Deficit (R)
Rates & General Services	247,219,686	215,723,122	31,496,565	280,871,613	274,345,633	6,525,980
Community Services	231,498,203	189,499,419	41,998,784	261,539,838	249,736,769	11,803,069
Subsidised Services	9,525	13,999,235	(13,989,710)	3,157	10,114,523	(10,111,366)
Economic Services	15,711,959	12,224,467	3,487,491	19,328,619	14,494,341	4,834,277
Trading Services	37,825,323	35,404,197	2,421,127	50,558,827	37,948,960	12,609,866
TOTAL	285,045,010	251,127,318	33,917,692	331,430,440	312,294,594	19,135,846
Appropriations for the Year: Refer to Note19			5,893,778			5,440,787
Net Surplus\(Deficit) for the Year			39,811,469			24,576,633
Accumulated Surplus/(Deficit):Beginning of Year			9,131,040			48,942,508
ACCUMULATED SURPLUS /(DEFICIT):YEAR END			48,942,508			73,519,143

Appendices 1.3

The Cash Flow Statement presents the movement of funds for a municipality throughout the financial years under review. The net cash and cash equivalents of the municipality are the net effects of the cash flow statement.

MAFIKENG LOCAL MUNICIPALITY

THE CASH FLOW STATEMENT AS AT 30 JUNE 2009

	NOTE	2009 (R)	2008 (R)
CASH FLOW FROM OPERATING ACTIVITIES			
Cash received from Ratepayers, Government and other		331,430,440	247,219,686
Cash Paid to suppliers and employees		(317,823,230)	(243,873,813)
Cash generated from/(utilised) by operations		13,607,210	3,345,873
Changes in working capital		(69,318,683)	(16,140,235)
Cash Contributions from the Public and the State		-	-
Interest Received		41,508,043	29,934,251
Interest Paid		(4,408,994)	(2,376,387)
NET CASH FLOW FROM OPERATING ACTIVITIES		(18,612,424)	14,763,502
Cash flows from Investing Activities			
Purchase of Property, Plant and Equipment		(47,792,979)	(25,092,190)
Proceeds on Disposal of Plant, Property and Equipment		725,074	1,055,738
Long-Term Debtors		-	2,964,595
Increase in Call Investment Deposits		9,593,483	(15,646,686)
NET CASH FROM INVESTING ACTIVITIES		(37,474,424)	(36,718,543)
Cash flow from Financing Activities			
Increase\(Decrease) in Long-term Loans		18,089,512	13,713,501
Transfer from Reserves			
Trust Frunds		22,353,000	17,663,963
Increase in consumer deposits		527,406	249,936
NET CASH FROM FINANCING ACTIVITIES		40,969,918	31,627,399
NET INCREASE IN CASH AND CASH EQUIVALENTS		(15,116,929)	9,672,358
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF PERIOD		10,589,633	917,275
CASH AND CASH EQUIVALENT AT END OF PERIOD		(4,527,295)	10,589,633

Appendices 2.1

The Annual Financial Statements of Mafikeng Local Municipality for the year 2006 and 2007.

Presented below are the balance sheet, income statement, and the cash flow statement of Mafikeng Local Municipality for the financial years 2006 through to 2007.

Mafikeng Local Municipality

BALANCE SHEET AS AT 30 JUNE 2007.

	NOTE	2007 R	2006 R
CAPITAL EMPLOYED			
FUNDS AND RESERVES		181,093,980	181,866,744
Statutory Funds	1	177,148,541	177,148,541
Reserves	2	3,945,439	4,718,203
(Accumulated Deficit)/Retained Income	19	9,131,041	1,488,840
		190,225,021	183,355,584
TRUST FUNDS	3	10,301,377	(2,553,115)
LONG-TERM LIABILITIES	4	17,667,430	8,760,287
CONSUMER DEPOSITS:SERVICES	5	4,334,942	2,044,402
		222,528,770	**191,607,158**
EMPLOYMENT OF CAPITAL			
FIXED ASSETS	6	60,218,613	51,673,025
INVESTMENTS	7	-	-
LONG-TERM DEBTORS	8	2,964,595	3,487,655
		63,183,208	55,160,680
NET CURRENT ASSETS\LIABILITIES		159,345,562	136,446,478
CURRENT ASSETS		188,970,345	213,267,647
Inventory	9	1,868,173	1,471,749
Consumer Debtors	10	150,744,592	180,798,689
Other Debtors	11	20,852,614	12,542,975
Cash		917,275	2,116
Short-term Investments	7	14,587,691	18,452,117
Short-term Portion of Long-term Debtors	8	-	-
CURRENT LIABILITIES		29,624,783	76,821,168
Provisions	12	10,091,041	6,767,059
Creditors	13	17,033,364	36,210,128
Short-term Portion of Long-term Liabilities	4	2,500,379	10,049,854
Bank Overdraft		-	23,794,128
		222.528.770	191,607,158

Appendice 2.2

Mafikeng Local Municipality

Income statement as at 30 June 2007

SERVICES	ACTUAL 2005/06			ACTUAL 2006/07		
	Actual Income (R)	Actual Expenditure (R)	Surplus\ Deficit (R)	Actual Income (R)	Actual Expenditure (R)	Surplus\ Deficit (R)
Rates & General Services	**145,204,698**	**124,301,706**	**20,902,991**	**199,642,865**	**191,372,660**	**8,270,203**
Community Services	130,437,670	100,201,910	30,235,759	186,003,703	167,348,878	18,654,825
Subsidized Services	11,450	9,152,041	(9,140,591)	10,179	10,575,228	(10,565,049)
Economic Services	14,755,578	14,947,755	(192,177)	13,628,983	13,448,555	180,428
Trading Services	38,010,844	36,444,157	1,566,687	36,617,972	37,242,421	(624,449)
TOTAL	**183,215,542**	**160,745,863**	**22,469,678**	**236,260,837**	**228,615,082**	**7,645,755**
Appropriations for the Year: Refer to Note18			(53,670,007)			(3,554)
Net Surplus\(Deficit) for the Year			**(31,200,329)**			**7,642,200**
Accumulated Surplus/(Deficit):Beginning of Year			32,689,170			1,488,840
ACCUMULATED SURPLUS\(DEFICIT):YEAR END			**1,488,840**			**9,131,041**

Appendices 2.3

MAFIKENG LOCAL MUNICIPALITY

THE CASH FLOW STATEMENT AS AT 30 JUNE 2007

	NOTE	2007 R	2006 R
CASH RETAINED FROM OPERATING ACTIVITIES		14 926 076	44,560,517
Cash Receipts from Customers		169,814,017	138,213,574
Cash Paid to suppliers and employees		(224,143,054)	(166,203,523)
Cash from Operations	20	(54 329 037)	(27,989,949)
Changes in working capital	21	5,495,252	26,341,609
Cash Contributions from the Public and the State	20	41,790,374	39,354,830
Interest Received	20	24,343,350	12,501,164
Interest Paid	20	(2,373,863)	(5,647,137)
		-	-
Cash flows from Investing Activities		(5,946,725)	(49,587,588)
Purchase of Fixed Assets		(11,685,896)	(53,670,008)
Proceeds on Disposal of Fixed Assets		2,397,804	8,750,607
Long-Term Debtors		(523,060)	(2,175,160)
Investments Purchased		3,864,427	(2,493,027)
CASH FLOWS FROM FINANCING ACTIVITIES		15,729,935	(12,221,001)
Increase\(Decrease) in Long-term Loans	22	1,357,668	(10,202,033)
Transfer from Reserves		(772,764)	11,116,499
Trust Funds		12 854 492	(13,134,331)
Increase in Consumer Deposits		2 290 539	(1 136)
NET INCREASE IN CASH AND CASH EQUIVALENTS		**24 709 286**	**(17 248 072)**
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD		(23,792,011)	(6,543,939)
CASH AND CASH EQUIVALENTS AT END FOR PERIOD		917 275	(23,792,011)