THE FINANCIAL ANALYSIS OF LOCAL GOVERNMENT INSTITUTIONS IN THE NORTH-WEST PROVINCE: THE CASE OF THE MAFIKENG LOCAL MUNICIPALITY.

BY

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The Financial Analysis of Local Government Institutions in the North-West Province: The case of the Mafikeng Local Municipality.

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Submitted in fulfillment of the requirements for the degree of Master of Administration in the Department of Public Administration in the Faculty of Commerce and Administration at the University of North-West.

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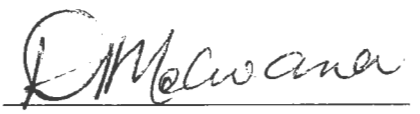
MMABATHO

Declaration

I declare that the dissertation for the degree of **Master of Administration** at the **University of North-West** hereby submitted, has not been submitted by me for a degree at this or any other university, that it is my own work in design and execution and that all material contained herein has been duly acknowledged.



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SUMMARY

This study was on the financial analysis of local government institutions in the North-West Province with specific reference to the Mafikeng Local Municipality.

The literature study on this study revealed that there is presently a dearth of research work on local government financial analysis in South Africa. Most of the literature found on the subject was from the United States of America and the World Bank Institute of Local Governance.

The available research work and literature referred to financial analysis as a financial tool with which municipalities can measure their ability to meet their financial and service delivery obligations in the short, medium and long term. . A local government that is in a good financial condition was defined as the one that can sustain existing delivery levels of services to the public, withstand economic slumps and meet the demands of the changing service needs. Revenues of such a local government should be sufficient to meet short-term expenditure commitments as well as finance major capital expenditures and long-term costs.

The study used a descriptive case study design, and data collected from Statistics South Africa and Mafikeng Local Municipality were analysed within the framework of the Financial Trend Monitoring System as established by the International County/City Management Association (ICMA) in the United States of America.

The analysis of the economic data revealed that the Mafikeng Local Municipality's economic base, which is predominately public-sector- dependent, is steadily shrinking and thereby losing businesses (creating more unemployment) and narrowing the property tax base. The Mafikeng Local Municipality is also realising a huge and increasing volume of service debtors - Mafikeng residents collectively defaulted on over R65 million of their municipal accounts in 2001. Compounded with the shrinking property market (consequently resulting in less property revenues) and the unwillingness of the locals to pay for services rendered, the exodus of businesses from Mafikeng is threatening the economic base from which the municipality should tap its revenues to defray/liquidate its expenditure needs without incurring any further budgetary deficits.

The analysis of the financial data revealed that above all accounts Mafikeng Local Municipality is still liquid and its financial condition is presently not endangered, but its economic base reflects seeds of possible financial crisis in the near future.

It is, therefore, recommended that the municipality put into place a thoroughgoing and effective billing and debt collection strategy and revoke legislative provisions available to it to recover delinquent revenues to enhance its liquidity (cash position). Moreover, the Municipal Council should as a matter of urgency protect the local economy by expediting a vigorous **Local Economic Development Plan (LEDP)** as part of its **Integrated Development Plan (IDP)** to attract correct businesses to the area and add value to the local economy by way of creating new job and enterprise opportunities.

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CHAPTER ONE

ORIENTATION AND INTRODUCTION

1.1 Introduction

This chapter introduces the study on the financial analysis of local government in the North-West Province with specific reference to the Mafikeng Local Municipality. It reflects of the background of the study, statement of the problem, specific objectives and research questions, research design, methods of research, significance of the study, the scope and organization of the whole study.

1.2 Background of the study

The recognition of local government in Chapter 7 of the Constitution of South Africa Act, Act 108 of 1996, as a sphere of government enhances the status of local government as a form of government and of municipalities in particular, and gives them a new dynamic role as instruments of service delivery. In other words, 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. Such services include bulk and reticulated electrical power, water and sanitation, roads and waste removal. In addition, they have responsibilities for community facilities such as sports fields and to some limited extent, some social services such as health clinics (Policy Framework for Municipal Borrowing and Financial Emergencies, 2000:5).

In order to consolidate the role of municipalities as vehicles of local service delivery, the White Paper on Local Government (1998:17-36) promotes a new kind of local government – developmental local government. This kind of local government is an initiative towards a more coherent programme of service delivery by municipalities in partnership with all municipal stakeholders.

1.2.1 Characteristics of developmental local government

According to the White Paper on Local Government (1998, 17-36) developmental local government distinguishes itself from ordinary local government through the following characteristics: -

1.2.1.1 Maximizing social and economic development

The powers and functions of developmental local government should be exercised in a way that has a maximum impact on the social development of communities, in particular meeting the basic needs of the poor and encouraging growth of the local economy. Local governments, therefore, need to have a clear vision for the local economy and work in partnership with local businesses to maximise job creation. As local governments are not directly responsible for job creation, they should rather take active steps to ensure that the overall economic and social conditions of the locality are conducive for the creation of employment opportunities. The awarding of tenders by local governments must also link municipal contracts to social and economic development through the provision of affirmative procurement policies.

1.2.1.2 Integrating and coordinating the development process

Developmental local government should also be able to integrate and co-ordinate the initiatives of different agencies that promote development at the local level. Such agencies may include trade unions, community-based organisations, non-governmental organisations, provincial departments and other developmental agencies available. Further, developmental local government has to provide leadership and a clear vision for all of the agencies mentioned. Since poor co-ordination can severely undermine the development efforts of developmental agencies, municipalities should actively develop some ways to leverage resources from all sectors of the community towards community development needs.

Integrated development planning, that is, including the contribution of local agencies in development plans is one of the most important methods for achieving greater co-ordination and integration. Integrated planning provides local government with a tool to facilitate integrated and co-ordinated delivery of services and goods within municipalities for the benefit of local

residents. Developmental planning that is not co-ordinated often results in haphazard efforts in service delivery and a huge waste of resources.

1.2.1.3 Democratising development and redistribution

Local governments as central role-players in promoting local democracy promote involvement of local communities in the design and delivery of municipal programmes. To achieve this, they should be aware of the divisions within local communities and seek ways to promote the participation of marginalized and excluded groups in community processes.

Narrow interest groups must not be allowed to capture the development process of local governments. Over and above all, developmental local authorities should be able to encourage local participation for better service delivery.

1.2.1.4 Leading and learning

Rapid changes at the global, regional, national and provincial levels often coerce local governments to rethink the way they are organised and governed. Developmental local governments are required to become strategic, visionary and ultimately influential in the way they operate. They should learn from previous mistakes and be innovators, because a developmental local government should play a strategic policy-making and a visionary role, and mobilise a range of resources to meet basic needs and achieve developmental goals.

According to Mufamadi, Minister of Local Government & Constitutional Development in the foreword to the White Paper on Municipal Service Partnerships 2000, the challenge for municipal service delivery in the country continues to be more daunting and achieving the objectives of the Reconstruction and Development Programme (RDP) requires municipalities to look at innovative ways of providing municipal services. In order to provide these services, there is a need for strong financial condition in municipalities and it is against this background that the Municipal Finance Management Bill was drafted in 2000. This Bill was introduced to regulate financial management in the local sphere of government, so that all revenues, expenditures, assets and liabilities are efficiently and effectively managed for better local government service delivery. The object of this Bill is to secure transparency, accountability and sound management of

revenues, expenditures, assets and liabilities of local government institutions to which the Act will apply.

As municipalities are lately also emerging as the fulcrum of South Africa's system of multi-sphered government, and as agents of local development, they are expected to be in a healthy financial position. Most of the South African municipalities are presently preoccupied with the introduction of prudent financial management practices with the view to improving the existing municipal finance system for better service delivery results (Policy Framework for Municipal Borrowing and Financial Emergencies, 2000: 23- 25).

The following section therefore discusses the state of local government finance in South Africa.

1.3 Local government finance in South Africa

Local government or municipal financing is presently a fundamental preoccupation of all municipalities across the world in general and in particular in South Africa. There is lack of literature on local government financial distress and its causes in South Africa at present. Most of the available material fails to integrate political realities of fiscal relations to other dimensions of local governance (Federation of Canadian Municipalities, 1998: 1-3).

Municipal financing is considered a reflection of the constantly evolving arrangements between municipal governments and their national and provincial governments, as well as the changing fiscal relations between these spheres of government. The main concern in intergovernmental relations is the capacity of municipalities to finance, predictably and responsibly, the increasing functions and responsibilities they are being given, either by statutes or by public expectations. In theory, the task of financing local government is a straightforward process, but in practice, municipal financing involves a number of complex issues ranging from economical to political factors. This is because of the fact that many municipal residents expect local governments to maintain high service quantity and quality levels even as they pay less or completely do not pay their monthly bills (Eric County Annual Financial Report, 1998: 1 & Policy Framework for Municipal Borrowing and Financial Emergencies, 2000: 23- 25 & Federation of Canadian Municipalities, 1998: 1 -3).

The increasing deterioration of the financial and fiscal stability of the municipal sphere of government in South Africa is a matter of concern. In recent years, both the national and provincial governments have used more than 30 provisions of Section 10(G)(2(m) of the Local Government Transitional Amendment Act, (Act 97 of 1996) which provides for a provincial government to issue instructions to a municipality to take measures to rectify its financial position when it is in an unhealthy financial condition. Eight interventions of section 139, Act 108 of 1996, which states that the provincial government should take care of the operations of a municipality, if it does not sustain municipal service delivery, were also instituted from 1999. In no case (aside that of Butterworth) was any intervention lifted because the concerned municipality was reinstated to a healthy financial position. Most of them were in an "insolvency" state, with no funds to pay municipal workers or to keep the municipal machinery working (Framework for Municipal Borrowing and Financial Emergencies, 2000: 26 - 28).

In fact, the problem in local government is not a new phenomenon. The creation of black authorities in the early 1980s largely segregated the problem along racial lines: core white municipalities not responsible for high-need low-revenue black residential areas found it relatively easy to manage their finances without problems, while black local authorities were almost uniformly in fiscal crises from the dates of their creation (White Paper on Local Government, 1998: 24).

A variety of ad hoc measures were taken to keep essential services running in black local authority areas. These measures included intergovernmental transfers and loans, grants from Regional Service Councils' revenues and on some occasions, grants from the private sector. The amalgamation of formerly segregated jurisdictions in the mid-1990s, coupled with a heightened emphasis on service delivery meant that the problems of black local authorities were imported into new municipalities. The new structural circumstances have been compounded by a range of other difficulties, **inter alia**, a lack of experience and capacity, non-payment of local taxes and service-charges and the persistence of an opaque accounting system, which aggravates the overall problem (Policy Framework for Municipal Borrowing and Financial Emergencies, 2000:30-34).

The above problems were mainly compounded by the previous municipal accounting system, which was deficient. One of the problems with the accounting system was that it failed to show the financial position of a municipality accurately. This means that municipalities were not aware of the deterioration of their financial position as it was occurring. This in turn meant that

municipalities were unable to take corrective actions in time (Green Paper on Local Government, 1997: 45).

The present South African government introduced Project Viability to help most local governments to monitor their finances and forecast any changes in their financial levels. As at 31 December 1998, the programme found that 151 municipalities were in fiscal crisis, with about 200 more facing financial problems which did not then amount to a crisis, but which contained seeds of serious difficulties in future. The main reasons were found to be institutional (no coherent framework for operations), financial (in every possible respect -accounting, internal controls, cash flow, asset management and credit control), lack of community co-operation (in form of non-payment) poor management of the revenue base and poorly maintained and inefficient infrastructure (Policy Framework for Municipal Borrowing and Financial Emergencies, 2000: 23- 25).

From an economic point of view, it is particularly alarming that some of the largest local authorities also experience severe financial difficulties. In 1997, Johannesburg had an urgent need of a large loan of R585 millions from the Development Bank of Southern Africa **(DBSA)** and less than a year later, it was in financial difficulty again. Pretoria has reportedly been facing an increasing financial problem and an increasing number of medium-sized towns like Welkom appear to be drifting into effective bankruptcy (Policy Framework for Municipal Borrowing and Financial Emergencies, 2000: 23- 25).

In the North-West Province, the Department of Developmental Local Government and Housing had to make some statutory interventions to save several municipalities from possible "insolvency". Section 139 of Act 108 of 1996 was revoked several times to save the municipalities of Stilfontein, Wedela and Ottoshoop from total collapse. In this regard, it was found that fiscal indiscipline and total absence of monitoring and analysis tools were the major cause of financial problems. Given the scale and nature of municipal problems and the importance of wider efforts to complete the overall reform of municipalities in South Africa, it has become imperative to develop and establish a thorough-going and coherent policy, legal and institutional framework for dealing with municipalities in financial distress (Policy Framework for Municipal Borrowing and Financial Emergencies, 2000: 33).

According to Berne & Schramm (1986: 67 & Gitman, 1997:110) such an analytic framework should be able to analyse municipal finances in order to gain a better understanding of their financial condition, monitor changes in their financial condition, obtain a clear picture of their cities' financial weaknesses and strengths and identify financial emergency problems before they reach serious proportions. These authors also state that for most municipalities, such an analytic framework should be able to mix financial components (revenues, expenditures, debts and pensions and internal resources) with pertinent information on the local population, to give the best possible reflection of the financial standing of local governments.

Therefore, in order for municipalities, especially those in South Africa, to play a meaningful and active role as local development agents, they have to establish sound financial monitoring systems to keep check on their financial conditions. This is because municipalities have to be in a sound financial condition in order to improve the quality of lives in their jurisdictions.

Several models for financial analysis are used worldwide, but the commonly used and predominant one is the Financial Trend Monitoring System (**FTMS**) which was developed by the International County/City Management (ICMA) to monitor the financial condition of counties in the United States of America. This analytic model employs 36 indicators to assess the financial health and strength of counties. These indicators are divided into the following categories - revenue indicators, expenditure indicators, operating position indicators, debt/liability indicators, capital plant/infrastructure indicators and community resource indicators. The object of this model is to mix pertinent information about municipal demographics with financial data, to develop some trends that can be used to measure the fiscal position (Carr, 1984: 46-47 & Alachua County Financial Report, 1998:1).

Municipalities in the United States of America and across the world use the FTMS to analyse and interpret financial, economic and demographic trends of all kinds. Not only is this model a valuable management information tool, but it can also provide a framework for improving the government's overall financial management and decision-making. This model, which is employed with the common size, index method and the percentage change, is fully discussed in Chapter 3.

1.4 Statement of the problem

The amalgamation and restructuring of the previous racially segregated local governments in South Africa had massively increased the demand for services without the corresponding increases in the financial resources. Combined with service backlogs and deteriorating infrastructure, this has put a burden on the finances of most municipalities. The inadequate financial management capacity, for example, budgeting skills, accounting and financial reporting, has given rise to the current deteriorating financial situation of most municipalities in the North West Province.

1.5 Aim and specific objectives

The aim of this study is to analyse the financial trends and patterns of the Mafikeng Local Municipality and to determine the impact of such trends and patterns on the financial condition of Mafikeng Local Municipality from 1998 to 2001.

The specific objectives of this study are:

- To determine from the literature, the scope and nature of the municipal financial management and local government financial analysis.
- To evaluate the economic base of the Mafikeng Local Municipality between 1998 and 2001.
- To analyse the trends and patterns of the finances of Mafikeng Local Municipality for the period 1998 - 2001 in order to determine the financial condition of the municipality.

1.5.1 Research questions

The study seeks to answer the following questions:

- What is the scope and nature of municipal financial management and local government financial analysis?
- What were the trends of the economic base of Mafikeng Local Municipality between 1998 and 2001?

- What were the patterns and trends in the finances of Mafikeng Local Municipality from 1998 to 2001 and how did they impact of the financial condition of the municipality?

1.6 Research design

This study is primarily a descriptive case-study research because it only studies the trends in the finances of Mafikeng Local Municipality without any form of intervention. The following are the methods that were used to carry out the study.

1.6.1 Data collection methods

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

1.6.1.1 Literature study

In the literature study, a thorough study of both primary and secondary sources was made to gather information on the nature and scope of municipal financial management and local government financial analysis. The **SABINET - http://www.sabinet.co.za** and **EBSCO - search.epnet.com** searches were conducted with the following keywords: Municipal financial management, municipal financial analyses, local government finances, financial trends and patterns, financial condition/position. Other material was obtained through the use of search portals such as www.google.com and www.yahoo.com. Literature on financial analysis was mainly sourced from the Financial Trend Reports of various counties in the United States.

1.6.1.2 Empirical investigations

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

(a) Document analysis

As mentioned above, this study is primarily a case study, so, all financial and population records that fall within the research period, 1998 to 2001 were studied with a view to gathering historical data on the finances and population statistics of the Mafikeng

municipality. This helped the researcher to bypass the costly process of collecting original data. The financial statements are exhibited in Annexure 3 (1-15) and the Integrated Development Plan of Mafikeng Local Municipality is depicted in Annexure 7 (Singleton, 1988: 337).

1.7 Data analysis

The study employs the Financial Trend Monitoring System and Time Series techniques as discussed in Chapter 4 to analyse the financial and population data of Mafikeng Local Municipality. The FTMS and the Time Series were used to determine the municipality's financial patterns and trends between 1998 and 2001.Such patterns and trends were graphically represented pie charts. Both qualitative and quantitative methods were used in analysing the collected data.

1.8 Significance of the study

The collapsing and deteriorating financial condition of municipalities in the North-West Province and across South Africa, as well as the need for sustainable service delivery and healthy financial position of municipalities has triggered a need for vigorous research in the field of local government finance and management. There is therefore an immense need for rigorous research efforts to develop models that will monitor the financial condition of local governments in South Africa. This study is therefore timely, for it addresses an issue that has attracted not only scholars of Public Administration, but politicians, practitioners and residents of municipalities. In other words, this research contributes toward the growing base of municipal financial management knowledge in South Africa. It forms part of the ongoing debate on the financial ability of the local level of government to carry out its statutory mandate of sustainable local development.

Although this study is only limited to the 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 Scope of the study

This study covers the financial analysis of Mafikeng Local Municipality but can be extrapolated to other municipalities across South Africa.

1.10 Organisation of the study

The study is organized as follows: -

CHAPTER 1

Orientation and introduction

CHAPTER 2

The scope and nature of local government finance

CHAPTER 3

The analysis of local government finances

CHAPTER 4

Research design and methodologies

CHAPTER5

The finances of Mafikeng Local Municipality

CHAPTER 6

Financial Analysis of Mafikeng Local Municipality

CHAPTER 7

Summary, findings and recommendations

1.11 Summary

This chapter presented the background to the study, statement of the problem, specific objectives and research questions, methods of research, significance of the study, the scope and organization of the study. Chapter two presents literature on the scope and nature of local government financial management.

CHAPTER TWO

LITERATURE REVIEW ON THE SCOPE AND NATURE OF LOCAL GOVERNMENT FINANCE

2.1 Introduction

This chapter presents literature review on the nature and scope of local government finance. It commences with the definition of the term local government and progresses with purposes of local governments and the nature and scope of local government finances. It also discusses the various components of municipal financial management and how they complement each other.

2.2 Nature and scope of local government

Local governments affect the lives of residents in many ways in that they provide services like water, fire protection, schools, parks and libraries. In most studies of local government and administration, the question that arises is: what should be emphasised or not. Since current and future local governments will be called upon to render increasingly extensive services to the citizens who control and finance their operations, one approach or method of study accepts local government as level of government or institutions with service obligations and seeks to ascertain how adequately and efficiently are local governments fulfilling their obligations. This is called the **service test.** In this instance local governments are defined as local agencies of development of rural and urban areas through programmes of service delivery (Phillips, 1960:8 – 9).

A second approach to the study of municipal government and administration is the **fiscal test** approach. Carried to extremes, this approach entails that the reasons for the existence of local government institutions are appraised in terms of their tax capacities and burdens, bonded indebtedness, per capita expenditures, balanced budgets and fiscal organisation and practices. Some local governments may rate well on the fiscal charts but fail miserably when subjected to the services and facilities test. In this test, the cessation of an area to be a local government is based on the amount and type of economic activities resident in that area. The assumption is that areas with weak economic base and consequently weak

resource bases perform badly in delivering quality basic services to their residents, and therefore cannot be ceded as local governments (Phillips, 1960:9).

The last approach to the study of localities is of the **democratic character** of municipalities. According to this approach, municipalities have been designed to ascertain their strengths and weaknesses as democratic institutions and how they determine and take steps to meet the needs of the people more effectively and more efficiently than other competing spheres of government. This approach measures the ability of municipalities to be agencies of local delivery by involving the local populace in the design and delivery of development programmes (Phillips, 1960:9).

In the following discussion, an effort is made to maintain a proper balance among the above three approaches to the study of municipal governance. The term local government will in this study refers to the level of government commonly defined as a decentralised, representative institution with general and specific powers devolved to it by a higher tier of government within a specified geographical area (Ola, 1989: 7 in Ismael et al, 1997:2-3).

Reddy (1993:39) argues that it is very important to conceptualise the difference between the terms "local authority" and "local government" because they are frequently used and misused when municipal affairs and topics are discussed. Local government on the one hand can be observed as an independent sphere of government with its own statutory obligations, but functioning in interdependence with other higher levels of government, within the limits of the powers and functions conferred to them by such higher spheres. On the other hand, a local authority is a statutory body that is a constituent part of local government, and derives its power from a higher source and is bound by the terms and conditions upon which it is created. For example, Cape Town city on itself is a city within a local authority and its municipality is a constituent part of the local government sphere.

Mbeki (1991:1) refers to a local government as "... .a municipality like Johannesburg, London or New York, which has a high tax base and a functional economy. However, in the broad sense being an authority at the local level or at a remote village where there are rules and regulations governing spatial development, economic activity, law and order and people-to-people relations." He further stats that in every local government there should be democratic systems of governance, the genuine empowerment of the people, wherein all

people decide who their leaders should be, where people participate actively in matters affecting their daily lives and where there is a social contract of service delivery and payment thereof. The above definition by President Mbeki integrates the service test and the democratic approaches to local governments.

Cloete (1992:187) concurred with the above views of local authorities by saying that the principal reason of the devolution of power to local government units is to give citizens an opportunity to provide for those matters which are of a local nature and affect the local citizens daily.

It is against these definitions that the World Bank (2000: 30) defines local governments as consisting of governmental units exercising quasi-independent competence in various urban or rural jurisdiction of a country for quality life.

The foregoing perspectives on local government were further supported by Kithakye at the SADC Local Government Conference held in 1999. Kithaye stated that local government by definition is the level of government that is closest to the people and therefore responsible for serving the political and material needs of people and communities at specific local areas. Such areas could be a rural setting or an urban setting, a village, a town, a suburb in the city or a city.

The Municipal Systems Act, Act 32 of 2000 in section 2 (a) - (d) provides a legislative definition of **a municipality** as

> "... An organ of the state within the local sphere of government exercising legislative and executive authority within its area of jurisdiction and **it** (sic) consists of the political structures (wards) and the administrative arm of the municipality; and the community of the municipality."

For this study, the term local government is used synonymously with the terms locality, local authority and municipality because all of them refer to bringing governance nearer to the people.

In South Africa, The Green Paper on Local Government (1997:1) ushered a new trendy challenge for local government to be development-oriented, both in the economic and social contexts. According to the Green Paper on Local Government municipalities should exercise their powers and functions in a way that maximises the social and economic growth of communities. They should also plan and manage development in an integrated and sustainable manner to promote spatial and social integration. Residents of municipalities also expect responsive and accountable municipal institutions to deliver services that specifically meet the community needs in an efficient and equitable manner. As mentioned above, they should also seek to promote democratic values, within both the communities and municipal institutions.

From a financial perspective, local government should be an independent and accountable sphere of government with clear revenue and expenditure responsibilities. The role of other spheres is to provide an enabling regulatory environment within which municipalities can manage their financial affairs responsibly to meet their purpose as discussed below (Intergovernmental Fiscal Review, 2000:102).

2.2.1 Purpose of local governments

From the previous discussion on the definitions, nature and scope of local government, it can be inferred that municipalities have both political and economic purposes. Politically, they, being the level of government closest to the people, are suitably situated to provide a way for ordinary citizens to have a say in how their communities should be governed since local government provides opportunities for democratic participation of citizens, in matters that affect them directly. They facilitate closer interaction between citizens and elected representatives (SADC, 1999:2).

Economically, local governments provide basic services that affect people of their areas of jurisdiction. The economic role of local government differs from place to place and through levels of economic sophistication. Summarily, local government is that level of government whose purpose is to identify and try to meet needs of the local area better, and not only through what the people can contribute but also how to engage them in economic activities aimed specifically at job creation and poverty alleviation (SADC, 1999: 1).

It is, therefore evident that municipalities have been and are still benefactors by delivering the basic housekeeping services necessary to ensure the survival of their communities. These services include fire protection, water supply, collection and disposal of garbage and sewerage, maintenance of streets and highways including the provision of street lighting and public health measures for the prevention and detection of infections and other serious diseases (Caraley, 1977:3- 4).

City governments are also gradually beginning to provide various services and facilities that go beyond merely guaranteeing survival. These can be considered "amenities" which are intended as Aristotle states, " to allow people in cities not only to live but to live well". Such amenities include facilities like museums, concert halls, municipal parks, playgrounds and swimming pools which are an attempt to provide enjoyment and thus enhance the quality of local life (Caraley, 1977: 4).

Over and above the amenities mentioned above, local governments are also faced with a variety of intensifying and serious social problems which among others include lack of better housing, poverty, unemployment, juvenile delinquency and deteriorating infrastructure. To cope with this tangle of pathology found in their slums, city governments have to provide welfare services in a form of foodstuffs, subsidized housing, hospital care and enrichment programmes to help disadvantaged children (Caraley, 1977:4).

The basis for giving such a central role to local authorities and their leaders is that they alone can mobilize and reconcile all of the varied and often competing interests within a community. Governments of the cities, towns and villages have the potential to act on a whole range of issues that determine the health of communities. Where there is no effective local authority, there may be no one with the capacity to act for the entire community (SADC, 1999:3).

Through their traditional responsibilities of service delivery and regulation, local governments exert a great influence over the social and economic well-being of local communities. Each year municipalities collect large sums of money in rates, user charges and fees. They also employ thousands of people across the country and they are in most cases responsible for the price and quality of water, electricity and roads. They also control

the use and development of land. They purchase goods and services and pay salaries to their employees (Henly, 1986: 14-15).

Through all of the above, there is a reflection on what the objectives of local administration should be. Such objectives are outlined by Berne & Schramm (1986:2-6) in the following discussion.

Firstly, local governments are expected to provide all of their services and goods equitably to their residents and by "equity" it is entailed that municipal services should be distributed fairly across municipal residents, especially to those who dearly need them. In the South African context, equity could mean that most attention be given to the townships and rural areas where there are squalid conditions, which require an immediate attention of local authorities. This objective therefore implies that, for the present South African scenario, local government should play a pivotal role in the distribution of resources coupled with the reconstruction of black urban and rural life.

Secondly, local governments are expected to be efficient in using the local resources in the delivery of municipal programmes. They should be able to account and respond to the way they raise and expend resources. This therefore requires of them to develop information needed to evaluate their operations and put it into understandable and accessible manner for the appropriate review of their activities. In this regard, municipal government structures have to be transparent and report to the community to foster community partnership in all developmental issues.

In the case of South African local governments, their unique objectives also include the integration of towns and townships. In the previous political era, municipal life was segregated according to race, colour and ethnic affiliations. Parks, museums, theatres, halls and even bus stops for the use of Blacks, Whites, Coloureds and Asians were separated. Therefore, in an initiative to normalise race relations in local governments, an additional task is to integrate all these previous racially-segregated towns into single homogenous local governments that promote equal treatment of all citizens. This integration was partly achieved in 2000 through the local government elections whereby black, Indian and white

municipalities were integrated to form single homogenous structures (Local Government White Paper, 1998:17-22).

Lastly, municipalities should be able to provide their goods and services in a financially sustainable manner. This implies that local governments are expected to be in a healthy financial position. A financial position or condition is defined as the probability that municipalities or any operational entity can meet its financial obligations in the short, medium and long terms. This approach has presently drawn more attention from municipal officers, politicians, scholars of Public Administration and local residents. This approach also implies that finance plays an important part in municipal service delivery, especially for those that inherently have weak resource bases. In other words, finance is a golden thread that runs through all activities of municipalities. The following section will deal comprehensively with the role of local governments as vehicles to achieve the ideal of sustainable localities, and presents the four dimensions of sustainable local livelihoods (Berne & Schramm, 1986:2-6).

2.2.2 The vision for sustainable local government

If South African cities, towns and rural areas are to promote the welfare of their residents and of the country's citizens, they must be sustainable, and functional, in four respects. First, they must be *liveable*, that is, ensuring a decent quality of life and equitable opportunity for all residents. To achieve that goal, they must also be *competitive, well governed and managed*, and *financially sustainable*, or *bankable*.

2.2.2.1 Liveability

Liveability is a household's criterion for a municipality that works. A local government's commitment to improve liveability should be aimed at ensuring a healthful and dignified living standard for the poor that permits them to share the resources of a community - a goal that requires participatory, gender-sensitive planning for meeting priority needs. The agenda for improving liveability includes reducing urban poverty and inequality, creating a healthy urban environment, enhancing personal security (minimizing the risk of crime, violence, traffic accidents, and natural disasters), establishing an inclusive system of political representation and making cultural and recreational amenities available to all.

Satisfying this agenda for the poor would enhance the well being of all urban residents (World Bank, 2000:46-48).

To address the multiple dimensions of urban poverty, local governments should establish and implement policies and programmes for employment and training, social safety nets, land tenure, housing finance, primary education, and health care. Local officials have varying degrees of responsibility and face varying influences from higher-level government for regulation of commerce and industry, which can have important effects on the small-scale and informal sectors providing much of the employment for low-income workers. Local governments also affect the delivery of services critical to the poor - housing, basic infrastructure, public transport, child care, community centres and programs for youth, street children, and the homeless- even if the services are often provided by private, non-profit, or community organisations (World Bank, 2000:47).

Poverty assessments need to focus on the many dimensions of urban poverty including the vulnerability of the urban poor to breakdown of families and social support as well as coping strategies that poor households and communities use. Urban transport and urban water and sanitation works are needed to address environmental issues with an immediate impact on human health (air pollution from lead and particulates and waterborne diseases). Local governments need to encourage policies that promote efficiency in the use of water, energy, and waste disposal, for example, by ensuring that users cover full costs (with well targeted subsidies where appropriate) and that negative externalities are internalised where possible ("polluter pays" approaches). Such policies can contribute to the liveability of cities while increasing equity in the use of public funds. They also need to develop adequate instruments to help cities assess and reduce their vulnerability to natural disasters (World Bank, 2000:41).

2.2.2.2 Competitiveness

Building liveable cities requires buoyant, broad-based growth of employment, incomes and investment. Approaches to promoting urban equity and social safety nets also need to be consistent with incentive systems that foster productive and competitive firms of all sizes. Urban development requires an enabling environment for and within cities that permits firms and individuals to become productive or in a world of liberalized and integrated markets. In competitive cities output, investment, employment and trade respond dynamically to market opportunities. The basic conditions for competitiveness of cities are

efficient markets for land, labour and for inputs (particularly transport, communications, and housing), to ensure that the benefits of urban agglomeration are achieved and the diseconomies (from congestion and pollution) are minimized. Dysfunctional regulations and fragmented infrastructure systems, which create high transaction costs for producers, can be especially debilitating for small firms, a significant and undervalued source of employment and entrepreneurial energy (World Bank, 2000:48).

A highly productive urban economy can be resilient in the face of internal or external shocks because of its ability to fully exploit its sources of comparative advantage (including cultural richness) and to enhance its asset base by fostering information exchange and innovation. A traditional port city like Durban or Richards Bay can sharpen its competitive edge by improving its transport and logistic services. An urban economy based on manufacturing assembly could expand into related technology services or research if it has high-quality labour, or redirect its productive resources toward emerging markets. Cities that can support firms in achieving their economic potential and weathering adverse developments also provide a good platform for workers by offering flexible labour markets, efficient services, and good education and training. Through all this, they enhance the country's competitiveness (World Bank, 2000:48 – 49).

Local economic development is better served by mobilizing the city stakeholders to identify local strengths, bottlenecks and market opportunities and to commit to appropriate joint actions. Local government managers can facilitate citywide economic analysis and strategy development with urban clients and help ensure that the process includes the perspectives of the small-scale and informal sector, explores the potential for non-traded as well as traded production and finds ways to share the benefits of growth with the poor and unemployed. Such managers and their staff can also help to develop and disseminate analytical instruments to support the process, such as urban regulatory assessments and policy-relevant urban indicators. It also can maintain a strong macroeconomic dialogue to ensure that basic country conditions for local economic growth are in place (World Bank, 2000: 49).

In brief, urban competitiveness refers to the ability of an urban or local area to produce and market a set of products (goods and services) that represent good value in relation to comparable products of other urban areas. The urban economy that produces goods and services of high value relative to prices, supports the export economy of the city, thus

making it more competitive, as well as directly raising the quality of life and the standard of living of people living in urban and local centres (Webster & Muller, 2000:1).

2.2.2.3 Good governance and management

Improving the liveability and competitiveness of cities places big demands on urban governance and management. Good governance implies inclusion and representation of all groups in a community and accountability, integrity, and transparency of government actions in defining and pursuing shared goals. Capable urban management means the capacity to fulfil public responsibilities, with knowledge, skills, resources and procedures that draw appropriately on partnerships. Where local governments have been given new functions and powers and the public has been granted opportunities for participation and oversight many have become more professional, have tapped the skills of the private sector in new ways, and have encouraged innovative approaches to service delivery (Campbell 1997:56).

Fostering regular, formal interaction between local government and residents (including through community-based and nongovernmental organizations) in approaches such as participatory planning and budgeting, and public oversight of expenditure and service delivery should be a major focus of municipal development activities. Frameworks for intergovernmental relations and for the sharing of responsibilities between the local public and private sectors help. Here *local government or locality is* used to refer to the economic unit consisting of an urban area and its surrounding sub-region. In many cases, such an economic unit extends beyond municipal boundaries to encompass a metropolis or even an adjacent urban area (World Bank, 2000: 49 - 50).

The lack of effective inter jurisdictional management entities, such as metropolitan-wide authorities, complicates work with mega cities and on services that cut across administrative boundaries, such as public transport and water supply. All local governments should act as catalysts in solving this problem by encouraging city strategy exercises in metropolitan cities in which a coalition with vision and broad credibility exists, to identify shared interests and concerns of stakeholders. Such exercises could prove useful even in the absence of a formal executive agency (World Bank, 2000: 50).

In South Africa, the city of Johannesburg is in a process of restructuring itself as a metropolitan government. Labelled Igoli 2002, its plan includes fundamental changes in the overall governance and structure of the city operations and involves radical management and governance manoeuvres of the fiscal, institutional and regulatory framework for the delivery of municipal services (World Bank Development Institute, 2000:11).

In addition, the city is also undertaking bold reforms in the areas of local economic development and the establishment of metropolitan health and policing districts. The whole implementation of Igoli 2002 is aimed at achieving the best possible management and governance for excellent urban development in Johannesburg and its areas of jurisdiction (World Bank Development Institute, 2000: 11).

Recent attempts to improve governance and to adopt more strategic approaches to the economic, social and environmental sustainability of cities are leading to the emergence of what is sometimes termed the "entrepreneurial city". This is a proactive city, which aims at mobilising social, political and economic resources in a coherent institutional framework to develop and sustain long-term support for a clear social and economic strategy (OECD Observer, 2000:3).

According to The OECD Observer (2000:3) achieving the right mix between policies that favour competitiveness and policies that support social cohesion and liveability is a major dilemma for municipal leaders and officials. They have to strike a delicate balance between development and redistribution, national objectives and local aspirations. In today's world, the role of local governments in local economic development and resource redistribution is even more and the following are characteristics that serve as benchmarks against which urban areas can measure their governance and performance with regard to economic development, social cohesion and redistribution. Entrepreneurial cities tend to have more rather than less of:

- Economic diversity in the manufacturing and sector services, preferably in the high value-added and the export or import-substitution sectors;
- **A supply of skilled human capital** - Successful cities are those that have people who operate effectively in the knowledge and information based industries;

- **The right institutional networks** - Competitive cities need a range of links between institutions of higher education, research institutions, private industry and government, to exploit the intellectual knowledge of skilled people. Over and above the above links, competitive cities are also for living as well as working and therefore need economic, social, environmental and cultural conditions which will assist in retaining and attracting the potentially mobile workforce. This clearly means that the right physical , economic and social environments are very important for local governments because economic prosperity cannot be sustained in a sea of vast inequality. Social cohesion and economic competitiveness are mutually sustaining, not mutually exclusive (OECD Observer, 2000: 3- 4).

2.2.2.4 Bankability

Most infant and small cities do not have potential resources because they are poor, especially in their ability to mobilise resources when vast segments of the urban society operate in a shadow economy. Therefore, integrating informal and marginal communities as full local residents, taxpayers, and service customers is an important goal. Also essential is an equitable and sustainable local finance system, to support income and employment growth. Most cities lack the economic strength and financial capacity to access capital markets. For these cities, the first step towards bankability is financial soundness, as reflected in the judicious use of their weak resource bases. For the cities that can access capital markets, bankability can be defined in terms of creditworthiness (World Bank, 2000:54-55).

For some cities, as mentioned above, bankability represents the aim of becoming sufficiently creditworthy to access banks and capital markets. For example, the city of Ahmedabad in India turned its financial performance around in a few years to become the first city in India to be rated by a domestic agency and issued an investment bond. However, for all cities, bankability can simply be defined as financial soundness, reflected in respect of hard budgets and efforts to mobilise and use resources judiciously, even from weak resource bases. Both sound financing and good city management involves establishing links between the services provided by the city and the payment for them by users and beneficiaries through tariffs or taxes. This "social compact" is weak or missing in

many urban areas and is key to restoring accountability and responsibility on the part of city officials and the citizenry, especially in the South African municipalities where non-payment for services was part of the campaign to defeat the ends of apartheid (World Bank, 2000: 115).

Given the above purpose of and expectations from local authorities, most local authorities across the whole world and in South Africa are facing a diversity of pathological financial problems chief among which are the following:

- Limited revenue sources,
- Poor revenue collection with the result that sometimes staff salaries, creditors and suppliers are not promptly paid;
- The non-payment or delay in payments of government grants or share of tax revenues to local authorities,
- The non-viability of certain local authorities, especially those whose areas have small populations,
- Rising costs and increasing demands for improved service delivery, and
- Ineffective financial control and management, both internally and externally (Adedeji & Rowland, 1972:11).

Not all of these problems apply to all local authorities in South Africa, but some are common and face every local authority. It is against this state of financial pathology in the South African local authorities that the following section discusses various components/activities of municipal finance.

2.3 Local Government Finance

Local government finance is presently a major concern of local authorities in South Africa and elsewhere across the world. It is not a new phenomenon because after the World War II, the role of local government in reconstructing urban and local life became so important that in the United States, $105 billion was spent on local government programmes in 1971

as compared to $30 billion in 1957. This expenditure trend kept increasing due to the central role given to municipalities to deliver services that are basic for human survival in rural and urban enclaves (Moak & Hillhouse, 1978: 1-2)

2.3.1 The nature and scope of local government finance

There are three major ways to present the nature and scope of local government finance, namely, the direct approach, the comparative approach, and historical approach. The direct approach focuses the definition of the scope of local government finance as a subject area, the size of the units involved and its special characteristics. This approach affords a comprehensive listing of those activities, overall revenues and expenditures included and excluded within local finance and is a necessary step towards the knowledge of the subject (Moak & Hillhouse, 1978:2).

On the other hand, the comparative approach presents municipal finance from the perspective of its sharp contrasts with provincial and national government finance. This approach, therefore, allows evaluations of trends in the allocation of functional responsibilities and growth trends in financial statistics among various levels of government. Lastly, the historical approach advances local finance by developing patterns of urban finance. In this instance, the major emphasis is placed on the examination of major conditions that have influenced the development of special features of local finance (Moak & Hillhouse, 1978:2).

All the above three approaches to the nature and scope of municipal finance are important, but the direct approach is relevant to the present study and will be discussed to the exclusion of the other two.

2.3.1.1 The direct approach to the study of municipal finance

As defined earlier, the direct approach involves a long look at the scope and characteristics of local finance and the size of the units involved. Local finance embraces the affairs of a wide range of local governments, some geographically dispersed, others concentrated within expanding metropolitan areas. The subject, then, is as broad as the local finance laws, regulations and practices, of central and provincial governments, within both urban

and rural areas. Therefore, local government finance is public finance exemplified and applied at one level of government, that is, the local level. It relies heavily on other allied disciplines such as economics and accounting. Municipal finance is therefore an art or applied science (Moak & Hillhouse, 1978:2 – 3 & Correia et al, 2000:3).

Again, the scope of local government finance might be explained in terms of the specific financial activities embraced within the four main traditional divisions of revenues, expenditures, debt and financial management and administration, namely: -

- Revenue administration, including the assessment of property for taxation and the many faceted elements on non-property revenues,
- Accounting,
- Auditing,
- Financial reporting,
- Debt Administration, and
- Intergovernmental finance

The above activities or components of local finance are discussed later in this chapter.

Viewed from a theoretical perspective, local government finance contains all the main elements of the general area of public finance. To be more specific, it is concerned with: -

- The selection, levy, incidence and effects of local taxes,
- The size of the local finance segment in the public sector,
- The economic impact of local taxation, expenditures and borrowing upon the private sector of the economy,
- The contributions which local government finance may make to the actions of national government's fiscal policies,

- The effects of local government finance in developing equity in our society through the redistribution of money and/or services among citizens, and

- The administration of the financial affairs of local governments (Moak & Hillhouse, 1978:3 - 4).

Finally, local finance has many distinguishing characteristics including the following:

- Property tax remains the main source of revenue for most local governments, but has lost its former dominant position in many individual local government revenue programmes,

- Many of the larger urban municipalities have adequate economic resources within their geographical boundaries but are restricted by national government and provincial statutes to tax these sources. The result is often inadequate locally-collected revenues to support a high standard of local services,

- Local finance is partially dependent, and is usually supplemented by financial help from higher levels. Currently, with more devolution of power and responsibilities to local governments, such assistance has become increasingly necessary,

- Local government financial policy is always conceived, planned and executed within (1) a restrictive constitutional and statutory framework, (2) an administrative supervisory network from the higher spheres of government and (3) controls imposed by the national government as a condition of the receipt of loans and other assistance (Moak & Hillhouse, 1978:9-10).

In South Africa, local finance has had to overcome serious obstacles (some mentioned above), and because there are so many local governments, this area of public finance has been a fertile field for innovations. Many new financial improvements have sprung from this area: the standardization and improvement of governmental accounting, and the revenue bond investment programmes, to name but a few.

The following section deals with the definitions and importance of municipal financial management, including the components/activities of local government financial administration.

2.3.2 Local Government Financial Administration

Local government financial management refers to the sound planning and application of municipal financial resources with a view of ensuring value for money in providing goods and services. (Moak & Hillhouse, 1975:1). Rawlison & Tanner (1990:1) define local government financial administration as an economical use of local government revenues to achieve goals of effectiveness and efficiency in the provision of municipal goods and services. The importance of sound and effective administration of finances in local government cannot be overemphasised, because without effective financial management and administration, the policies adopted by the local councils may not be successfully implemented. Where there is proper financial management, residents benefit in form of continuous service delivery processes and healthy surroundings (Adedeji & Rowlands, 1972:33).

Local finances are considered an overriding factor in local governments, because without sound financial management systems, local governments will be forced to discontinue their operations. In South Africa, the problems in the financial management of local governments have delayed the progress of the Reconstruction and Development Programme (RDP). It is against this background that Fox et al (1996:118) state that, the present amalgamated local governments in South Africa must revamp their financial management processes and policies in the areas of accounting, revenues, supervision and monitoring, credit controls, expenditure controls, debt management and investment administration to adjust to the new and acute demand for municipal services.

As mentioned in the direct approach to the study of local finance, financing local governments had been often looked upon to include a series of processes **inter alia** the collection, budgeting, appropriating and expending public funds; auditing income, expenditure receipts and disbursements; accounting for assets and liabilities and for the financial transactions of the government; reporting on incomes and expenditures; receipts and disbursements and the condition of funds and appropriations. In essence financial

management involves the co-ordination of the above process for the harmonious production and delivery of public services (Bhambiri, 1992/1993; 536- 537).

The diversity of responsibilities of local governments to their residents also include the important financial responsibilities of accounting for public funds, prudent management of public funds and an adequate planning for meeting the desired services of municipal communities, which include the maintenance of public facilities. In these economically trying times, these responsibilities become even more important since those services desired by communities are mostly for their general welfare (City of Rye, 1995:1).

In order to carry out these responsibilities successfully, local government are firstly expected to have financial goals which in many instances entail goals of delivery of quality services in an efficient and cost-effective basis, thus providing full value for each **Rand** spent. According to The City of Rye (1995: 1-2) the other goals may include:

- to have the ability to withstand local and regional economic shocks, to adjust to changes in the service requirements of communities and to respond timely to changes in government funding structures and formulae;
- to maintain an adequate financial base to sustain a sufficient level of municipal services, thereby preserving the quality of life in municipalities; and
- to maintain a good credit rating in the financial community to assure the city's taxpayers that the city government is well managed and financially sound.

Financial goals are broad timeless statements of the desired financial position of a municipality. In order to attain such a desired financial position, there is a need for some policies to steer the finances of the cities. These policies are general statements that guide decision-making in specific situations to ensure that all decisions are directed at the attainment of the financial goals. According to Moak & Hillhouse (1978:49) at the core of successful urban financial administration lies a financial policy, which may consist of the following: -

- The balancing of budgets on a current basis, maintaining of reserves for emergencies and maintaining of sufficient cash to defray bills on a timely basis (liquidity);

- The use of short-term borrowing to finance operating needs in cases of extreme financial emergencies, and the use of long-term debt for capital improvements that cannot be financed from current revenues; and

- The auditing of the municipality's accounts and financial statements on an annual basis -through both internal auditing and external auditing.

According to Musgrave & Musgrave (1984:20), the financial responsibilities of local government in South Africa include the allocation, distribution and stabilization of municipal resources. In terms of section 178 (1) of the Constitution, Act 108 of 1996, a local government must be managed on sound principles of public administration, good governance and public accountability, to render efficient services to the local community and most centrally to ensure effective administration of its affairs. This legislative provision therefore creates an internal environment within which municipalities have to run their finances. Moreover, in line with the constitutional framework, Section 10 (g) of the Local Government Transition Act, Second Amendment Act, 1996 (Act 97 of 1996) provides the following principles in respect of local government finance,

> "That every municipality: -
>
> 1. Conduct its affairs in an effective, economical and efficient manner with the view of optimising the use of its resources in addressing the needs of the community;
>
> 2. Conduct its financial affairs in an accountable and transparent manner;
>
> 3. Prepare a financial plan having regard to the integrated development plan in respect of all its powers, duties and objectives, and finally
>
> 4. Manage its financial resources to meet and sustain its objectives."

Over and above these provisions, the internal environment of municipalities is composed of the nature and scope of functions and services to be performed, the jurisdictional area and other related resources, distribution or reticulation of functions and services and other needs of the community and the level of infrastructure base and development of the local communities (Evans, 1991: 302).

In brief, the above factors are those that have to be internally managed and recognized by municipalities before venturing in any municipal programmes. Municipalities have to respond positively to this internal environment so that all of their activities can be adjusted to the prevailing conditions in areas of jurisdiction.

As shown in figure 2.1 below, financial management of local governments is not a single once-off process; it is a continuous dynamic process, which involves various components of the financial process. All such components are aimed at the delivery of municipal goods and services to municipal residents and the creation of liveable conditions for the poor.

The following are some of the components of a municipal financial framework:

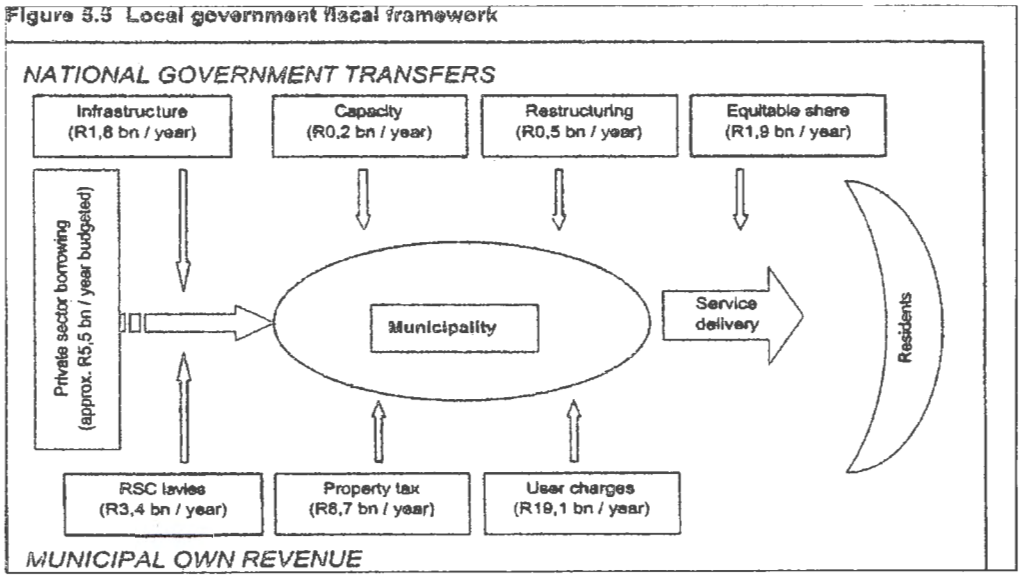
2.3.2.1 Municipal Budgeting

The local budget process as is known today had its genesis in the work of the New York Bureau of Municipal Research (one of the early voluntary organisations concerned with the applications of scientific principles of management to the conduct of local government affairs). In this early period, almost no city of any size in the United States operated under systematic budget procedures. From time to time, appropriations were made to individual departments and agencies, and revenues measures were enacted sporadically, with a view to finance most of the operating expenditures. This haphazard system developed as broad range of critics, interested not only in bringing some order out of the allocation processes, but also in causing offices, departments and agencies to develop plans for expenditure related to their assigned functions and goals (Moak & Hillhouse, 1978:65-66).

Currently, the budget is known as a proposed plan of expenditures and revenues,and the authorisation to spend is usually contained in a separate resolution of the council, generally called the Appropriation Ordinance. Even today, governing bodies of many municipalities still "adopt a budget" without a full understanding of which of the thousand lines in the

budget document constitute limitations upon what can be spent and which are only explanatory (Moak & Hillhouse, 1978:9.

Figure 2.1: Local government financial framework



Source: Intergovernmental Fiscal Review (2000:109)

According to Phillips (1960:441), a municipal budget is "a comprehensive plan, expressed in financial terms, by which an operating programme is effective for a given period of time." It includes estimates of: (a) services, activities and projects comprising the programme; (b) the resultant expenditure requirements; and (c) the resources usable for their support. More than any other document or instrument, a budget embraces policy proposals of the executive and policy decisions of a municipal council and sets forth the obligations of the executive branch of city government.

Similarly, Schaeffer (2000: 11) refers to local budgets as projections of future revenues and expenditures that are used to control financial transactions and serve as a management and planning tool to allocate services and goods to all citizens. Municipal budgeting therefore does not differ much from budgeting for the national or provincial governments in South Africa, because it is also used to allocate and redistribute municipal goods and services to the municipal residents.

Municipal budgets like budgets of most government agencies are divided into two categories. First, there is an operating budget which is financed by current revenues to

defray all costs that arise from the day-to-day operation of municipalities. An operating budget is responsible for disbursing all operating expenses which may include personnel remuneration, office supplies, and other current expenses (Schaeffer, 2000: 12-13).

Secondly, there is a capital budget which caters for the estimates and revenues for capital projects of a municipality. Every municipal budget, whether being a capital budget or an operational budget has the expenditure side and the revenue side. The following section discusses the revenue sources of local government. The expenditures of local governments are discussed in Chapter 3 under expenditure analysis: -

(i) Municipal Revenues

Like any other organisation, a municipality needs finances to execute its programmes for the delivery of basic good and services to residents. Local municipal governments have two primary types of revenue. Firstly, there are own-revenues that are collected locally and may include local taxes, service charges, fees and licenses, rental income from building and facilities, interest income on municipal investments, as well as income from sales of municipal assets. Secondly, the other major source of revenues includes intergovernmental transfers and grants, but these transfers are increasingly decreasing and as a result, it is essential for local municipal governments to review their level of self-sufficiency and to rely more on and accelerate the growth of their own sources of revenues (Schaeffer, 2000: 15).

The following are some of the sources of municipal revenues: -

(a) User charges

Perhaps the most obvious, and in many ways the most sensible recommendation that can be made with respect to revenue structures at any level of government is that appropriate user charges should be employed whenever possible. Local authorities may from an economic point of view, be viewed as firms delivering packages of local public services to residents. From this perspective, the first rule of municipal finance should therefore be: "Wherever possible, charge." While user charges are likely to be viewed by municipal officials as a potential source of revenue, their main economic value is to promote

economic efficiency by providing demand information to municipal suppliers and to ensure that what the municipalities deliver is valued at least at marginal cost by citizens. This efficiency objective is particularly important at the local level of government since the main rationale for localities in the first place is to improve efficiency. Whenever possible local public services should be charged at rates that are properly set, rather than being given away (World Bank Institute, 1999: 12).

There are at least three types of user charges: (1) service charges, (2) public prices and (3) specific benefit charges. Service fees include such items as licence fees, dog tax, business licences and other small charges levied by local governments for performing specific services, by either registering or providing copies for identifiable individuals or businesses. In effect, such fees constitute cost reimbursement from the private to the public sector (World Bank Institute, 1999: 11 - 12).

In contrast to services charges, public prices refer to the revenues received by local governments from the sale of private goods and services. All sales of locally-provided services to identifiable private agents, from public utility charges to admission charges to recreational facilities, fall under this category of revenues. In principle, such charges should be set at the competitive market prices, with no tax or subsidy element included unless doing so in the most efficient way of achieving public policy goals, like in South Africa, where households will be entitled to 6 kilolitres of free water per month. The last category of user charges is called specific benefit taxes. This type of revenues are distinct from service fees and public prices because they do not arise from the provision or sale of specific goods or services to an identifiable private agent, but are compulsory contributions like fuel taxes and taxes related to the provision of street-lighting and sewers (World Bank Institute, 1999: 13 – 14).

For efficiency reasons, user charges are levied on the direct recipients of municipal services. The appropriate policy is to charge the correct marginal rates for services used. According to Schaeffer (2000: 15 -16), these charges are levied on all municipal services that are used by residents and are not completely exhausted, but can be used continuously. The user

charges only cover the periodic infrastructure maintenance and operational costs. As mentioned above, they are charged according to the units consumed.

Similarly, Gildenhuys (1997: 98-99) defines user charges as amounts of money charged for the use of specific local government services. In this regard, it means that the services used in the process are not exhausted but remain available for use by other users on the payment of the prescribed user charge. In other words, the services do not disappear in the "using" process and, on condition that they are properly maintained, remain available to anybody who wishes to make use of them voluntarily. These services are used only to the point of satisfaction of each user. All in all user charges bears the following common elements as identified by Gildenhuys (1997: 98): -

1) The absence of compulsion – their payment is voluntary because the user has a choice in buying the services;

2) They are based on the benefit-received principle, which means that the user charge has to be paid on the direct benefit of the service to the user; and

3) The user charge is established according to the costs of delivering the service.

Objects of user charges may include all municipal quasi-collective services, which include fire, and protection services, health, educational and preventive health services.

(b) Consumer charges

Consumer charges are levied on all municipal services that are completely exhaustible and have to be replenished for their continual availability. The consumer of such charges usually pays the operating costs, capital costs, maintenance costs, administration costs and the interest if such a service is derived from a capital project financed from a loan. The primary objective of consumer tariffs is that they should yield adequate revenue to cover the costs of supplying such services to consumers (Gildenhuys, 1997: 100 – 101).

Consumer tariffs are increasingly charged for water, sewerage and electricity. Moreover, they are also commonly called public utility charges or trading service charges. Consumer charges or tariffs are levied on all particular services that are supposed to be self-financing and self-supporting. Consumer charges are in most instances levied on the volume or units of the service consumed and are collected directly from the consumers. Consumer tariffs bear the following characteristics: -

- There must be a possibility of excluding non-payers from consumption – particular services should be exclusive:

  - There must be a quantifiable benefit for the individual consumer, meaning that the benefit-received principle and the ***quid pro quo principle*** are encouraged for particular services (Gildenhuys, 1997:101).

In South Africa, the Municipal Systems Act, Act 32 of 2000 requires of municipalities to adopt and implement a tariff policy that reflect the following elements: -

- The amount individual users pay for services should generally be in proportion to their use of that service;

- Poor households must have access to at least basic services through: -
  - Tariffs that cover only operating and maintenance costs;
  - Special tariffs or life line tariffs for low level of use or consumption of services of for basic levels of service; or
  - Any other direct or indirect method of subsidisation of tariffs for poor households, Tariffs must also reflect the costs reasonably associated with rendering the service, including capital, operating, maintenance, administration and replacement costs.

(c) Property rates

According to Bell & Bowman (2002:25), property tax is the most lucrative source of municipal revenues that is currently under-exploited. Moak & Hillhouse (1978:126)

defined property rates as a group of taxes which are levied on the value of different kinds of property determined by the individual localities to be subject to taxation. These rates are usually levied on an ***ad valorem*** basis, that is, according to the capital value of immovable property. During the long history of property tax in municipal financing, the primary theoretical justification has been that, inasmuch as the ownership of the property constituted a fair index of wealth, it was appropriate to require contribution in support of public services in proportion to the accepted measures of wealth, that is, ownership of property.

In South Africa, Section 229 of the Constitution Act, 1996 (Act 108 of 1996) makes provisions for local government units with certain taxing powers. The section provides as follows:

> "... [A] Municipality may impose (a) rates (sic) on property and surcharges on fees for services provided by or on behalf of the municipality, and (b) if authorised by national legislation, other taxes, levies and duties appropriate to local governments into which that municipality falls, but no municipality may impose income tax, value-added tax (VAT), General Sales Tax (GST) or custom duties"

Section 10(G)(7)(a) of the Local Government Transitional Act Second Amendment Act, 1996 (Act 97 of 1996) contains similar provisions empowering local governments to "... . levy and recover property rates in respect of immovable property... " and " ... levy and recover levies, fees, taxes and tariffs in respect of any function or service of the municipality."

The tax base for real property tax is the capital value of such property. A proportional rate is levied on each rand value of the capital value of the property. It is assumed in municipal finance that the capital value of real property reflects the wealth of the owner as well as his or her ability to pay (Gildenhuys, 1997: 74 – 76 & Bell & Bowman, 2002:28).

According to Gildenhuys (1997:79-84), municipalities assess properties within their areas of jurisdictions differently. In South Africa, there are three predominantly used systems of property tax.

Such systems are:

i. The flat rating system
ii. The site rating system
iii. The differential/composite rating system

(i) The flat rating system

The flat system is used in areas where real property tax is assessed on the combined value of land and improvements and both are taxed at the same rate. In most instances, the total taxable property valuations tend to rise more steeply than that of land since new buildings are continually erected and old ones replaced by attractive and modern structures. In this regard, this system becomes very productive for the local estate market. According to Gildenhuys (1997:356), the advantage of flat rating is that as development proceeds, it brings more revenues, thus averting large increases in the rate levy. Its disadvantage is that it requires more administration and may discourage the improvement of property and owners of properties may erect inferior and less attractive types of buildings.

(ii) The site rating system

In the case of the site rating system, property tax is levied on the value of the site alone. This is a form of a land tax whose main aim is to encourage owners of vacant land to develop it to the greatest possible advantage. In the case of land that is not used, taxing land tends to provide a greater incentive to the owners of such a site to improve or add to their property. In other words, the site rating system reduces land speculation. In developing urban areas, under favourable economic conditions, taxing of land only may therefore lead to more industrial activity, provided that other factors influencing the industrial location (locational quotients) are also favourable. Taxing land only also has a market effect on the property (land) market since it causes unimproved land to change hands constantly. This system of property rating is counterproductive because it does not take into cognisance the costs undertaken by municipalities in sanitation and other related services. For individual municipalities, using this system makes them realise less revenues from property taxation (Gildenhuys, 1997: 82 & Craythorne, 1997: 355 – 356).

(iii) Differential rating

When land and improvements are differentially taxed, that is, when their values are taxed at different rates the system is called the differential rating system, the composite rating system or the semi-site rating system. This rating system is a combination of the other two forms of taxation. The amount levied on land is usually higher than that levied on improvements. Its major advantages is that it discourages the holding of land for speculative purposes, resources are not strained unduly by greater building activity and the resulting increased demand for services, since additional revenues are obtained from the tax imposed on the value of improvements. This would apply more particularly in cases where the tax rate on improvements approximates that of land (Gildenhuys, 1997:83).

Despite being a lucrative source of local revenues, property taxation has its own inherent advantages and disadvantages. According to Moak & Hillhouse (1978:130), the principal advantages claimed for the property tax are: -

- It provides a major portion of the locally derived tax revenue of local governments and cannot be easily replaced by any other form of taxation.

- The tax has a great degree of stability, especially in periods of economic adversity, where it continues to be a consistent producer of revenues.

- Many local government services are for the benefit of property and the occupants of property, so the property tax provides a manner in which contributions can be required of the owners and/or the occupants in some degree proportionate to the services being rendered, for example, police protection, fire protection, refuse collection and disposal.

- The property tax has a valuable social effect in that the owners of properties that are non-productive or of marginal value are encouraged to develop the properties or to sell them to others. Thus, a man and a wife or widow who occupies a house suitable for a large family may be encouraged to vacate the house that can then serve a broader social purpose through occupancy by a large family.

- ❖ The ownership of property is an index of a person's wealth, and therefore, property tax falls heavily upon wealthy families with large holdings than poor people who own property, or occupy small amounts of taxable property.

Against the above assets of property tax, there are several liabilities of the tax chief among which is that property tax is regressive in the sense that it tends to absorb (in the case of residential property) a greater proportion of income from the low-income earners than high income families. In this sense, it may counteract some of municipal programmes on poverty alleviation.

Even though property tax has its liabilities and assets, its adoption by municipal administrations for use in revenue generation reveals that its assets outweigh the liabilities and as such can be wisely manipulated to benefit even the poorest of the poor, by among others, exempting some kind of properties from taxation.

(d) Intergovernmental transfers

Intergovernmental transfers form but one element of local government financing. Municipalities have, in principle, sufficient revenue-raising powers to fund the bulk of their expenditure. They finance over 90 per cent of their recurrent expenditure out of their own revenues. In reality, the aggregate situation disguises many differences between municipalities, for example, rural municipalities are more reliant on intergovernmental transfers (as opposed to own revenues) than are urban ones. Even among urban local government, several would not be fully sustainable without significant transfers from the national government. Hence, the equitable-share-of-revenues arrangement has been designed in South Africa to take these differences into account when funding local governments. This section therefore outlines intergovernmental transfers to local governments in a South African context.

The apartheid systems of transfers were highly fragmented and inequitable, with the bulk of funds directed to formerly white municipalities. The Intergovernmental Fiscal Relations Act of 1997 requires that every year there had to be the enactment of the Division of Revenue Act to enhance transparency in the allocation of national resources to all spheres of government. While this is the case, the national government expects the other spheres

including municipalities to maximise the collection of their own revenue. It (the national government) only makes the following transfers to local governments: -

(1) Municipal Institution transfer (I)

This transfer flows to local governments that do not earn sufficient own revenue to support the institutions necessary to sustain democratic local government. (IDASA, 1998: 2 & Venter, 1998: 176).

(2) Spillover transfers (M)

According to the first draft of A Short Guide To The Equitable Share of Nationally Raised Revenues for Local Governments (1998:28), all projects that have spillover effects should be funded by charging services rendered, with individual municipalities charged according to use. Spillover transfers to Metropolitan and District Councils may however be justified on grounds of establishing a core staff capacity and financing capital projects proportionally to their use by the poor, from whom no cost recovery is appropriate. Generally, spillover effects refer to benefits that are derived by local authority A from projects of local authority B without any exchange of money (IDASA, 1998: 2 & A Short Guide To The Equitable Share of Nationally Raised Revenues for Local Governments, First Draft, 1998:31).

(3) Equalisation transfers (T)

Equalisation transfers are allocated to local authorities to compensate poorer metropolitan substructures for lower revenue capacity. Such compensation comes from richer substructures of the same metropolitan. The Intergovernmental Revenue Sharing Document envisages transfers within metropolitan councils, with no contribution from central government. This shows that municipalities differ according to their economic base and financial capacity to raise enough revenues for service delivery.

The essence of the above discussion is that intergovernmental grants and aid are a form of a mechanism to ease the financial strain off local governments with limited economic bases and revenue sources. They are also a form of mechanism to help local governments to provide goods and services to their residents.

Irrespective of which of the above sources of municipal revenues is used, the following are the internationally acclaimed guidelines of a successful revenue management regime.

2.3.2.2 Guiding principles of municipal revenue management

There are certain general principles that apply to all public revenue systems, whether federal, state, or local. Since no single revenue instrument embodies all the best attributes, a good revenue system uses a diverse group of revenue instruments in order to implement these principles. According to Ulbrich (2000:3-8), the most important properties of a good revenue system are efficiency, equity, stability, and relatively low compliance cost for taxpayers and administrative costs for the governing body.

(i) Efficiency

Efficiency refers to the effects of taxes (as well as fees and charges) on the decisions made by individuals and business firms. A tax is efficient if it does not create unintended distortions in private decisions, leading economic actors to make decisions about working, spending, investing, and relocating that would not have been made in the absence of a tax incentive or disincentive. Some taxes or fees are put in place with the intention of influencing behaviour. Taxes on effluents, for example, are intended to reduce pollution, and taxes on cigarettes and alcohol are intended at least partly to discourage consumption of these products. To the extent that they reduce pollution, smoking and drinking by the desired amount, these taxes would also be considered efficient (Ulbrich 2000: 3-4).

Ulbrich further argues that the only perfectly efficient tax is the poll tax, which is a flat tax per person regardless of income, wealth, consumption, or any other economic activity .The only way to avoid paying a national poll tax is to leave the country or die, so this tax is unlikely to distort many decisions. The poll tax has many other drawbacks that make it an unsuitable tax instrument, but it does provide a benchmark of efficiency.

All other taxes have effects on decisions that may be undesirable from an economic perspective. According to Ulbrich (2000:4) income taxes make leisure more attractive than working and encourage people to locate in the other local authorities that do not use this tax. Sales taxes discourage spending or encourage people to shift spending to non-taxed activities, such as services, or to non- taxed states or non-taxed transactions: Property taxes

discourage improvements. They also encourage residents to relocate to areas where the property tax rate is lower and to accumulate wealth in forms not subject to property tax, such as stocks, bonds and collectibles. In general, the broader the base of the tax, the lower the rate, and the more uniform the tax is across competing jurisdictions (cities and counties), the less the tax will distort private decisions.

The impact of taxes, especially local taxes, on locational decisions by households and business firms is a particularly important efficiency issue in designing a state and local tax system. For the County of South Carolina in the United States this issue has been particularly significant with respect to attracting and retaining industry. Local governments that want to attract quality industries must examine their tax structures from a competitive perspective. Tax burdens are not the only or even the primary consideration in industrial location decisions. But where two locations are similar in other relevant attributes, such as labour force quality, access to markets and transportation, or climate, tax differences can make the difference in site location (Ulbrich, 2000:4).

This issue of competitive efficiency is particularly significant in the case of the property tax. Because of the classified structure of the South Carolina property tax, industrial firms may find the property tax more burdensome here than in other states. This concern is reflected in the business tax incentives that are offered by South Carolina to new and expanding industrial firms. The goal of efficiency in taxation places some important constraints on tax design. For example, any proposed exemptions from the sales tax must be scrutinized not only because they will shift spending toward the exempt item and away from substitute items, but also because a higher rate will then be needed in order to raise the same amount of revenue. Offering tax advantages to some buyers, some classes of property owners, or some kinds of income means not only that other groups are disadvantaged but also that a higher tax rate must be applied to the diminished tax base to get the same revenue outcome (Ulbrich, 2000: 4)

(ii) Equity

The second broad principle of revenue system design is equity. Equity is the most challenging and in many ways the most important criterion. According to Ulbrich (2000: 4 -5) and Moak & Hillhouse (1978:54) it is part of the reason why tax systems become so complex. Equity means fairness in how the tax burden is distributed. There are two

primary criteria for equity. One is the benefit principle, which links contributions to the public treasury to value received in terms of consumption of public services. The other is the ability-to-pay, with the expectation that those with more income, wealth, consumption or other measure of ability to pay will contribute more than those with less will. Ability to pay is usually measured in terms of income, but wealth (assets, property) and spending are alternative measures. The three primary broad-based taxes used by most state and local governments-income, property, and sales-rely on these three measures of ability to pay as their foundation.

Clearly, these two criteria of benefit and ability to pay are often in conflict. It is those least able to pay, who are more likely to use many public services, while the wealthy may live in gated communities with privately-owned security systems and send their children to private schools. On the other hand, those who benefit from a service often live or work or spend outside the jurisdiction and cannot be compelled to contribute by the usual means of taxation. (Sales taxes are more effective than income and property taxes in reaching visitors and transients). Taxes and fees designed on the benefit criterion are more likely to extract a contribution from these people, who would otherwise be "free riders" on the provision of public goods (Ulbrich, 2000: 4 –5).

The benefit approach, whether expressed as a tax or a fee, lends itself more readily to certain kinds of public services than to others. While it is easy to determine who is getting shots at the local health department, who is generating the most solid waste, or who is making greatest use of the public park, how are the services of the city council allocated? Should the cost of the services of the fire and police department be charged only to those who make calls, or does everyone benefit from these services because they have access to them if needed? Do residents of a neighbourhood need to pay for their own, streetlights even if they offer significant benefit to others, including people from out-of-town trying to find their way around? It is inherent in the nature of the public sector that there are "shared" services that cannot easily be assigned to designated users or beneficiaries. Also there are services, like education, where there are primary beneficiaries (school children and their families) and secondary beneficiaries, that is, employers and the community as a whole, who benefit from a more educated and productive citizenry (Ulbrich, 2000:5).

For some revenue instruments, particularly service charges, the benefit approach is the dominant approach. For others, such as the income tax, ability to pay is the primary

criterion. Generally, these two criteria for how to allocate the tax burden are used in combination as part of balancing the revenue system among competing goals. Within an ability-to-pay/benefit framework, there are still a number of other ways of interpreting fairness. Two aspects of equity or fairness are particularly important for purposes:

- Horizontal equity, or treating people the same when they are in equal economic situations and/or make the same degree of use of public services;

- Vertical equity, or treating people with an appropriate degree of difference to reflect different economic situations and/or different degrees of use of public services.

Each of these two kinds of equity presents different challenges. Horizontal equity requires a careful definition of equal economic situations, whether it is occupying houses of equal value or having an equal ability to pay income taxes after allowing for costs of earning income, family size, medical expenses, or other relevant considerations. Vertical equity implies that people who have more (more income, more property, more consumption spending) should bear a larger share of the cost of government. However there are no clear guidelines as to whether "more" should be proportionally more or progressively more. The only generally accepted equity rule for vertical equity is that the tax system as a whole should not be regressive (taking a higher percentage of income from lower income households than from higher income households). Somewhere between proportional and progressive revenue systems lies a range of acceptable equity norms for revenue systems (Ulbrich, 2000: 5 – 6).

Finally, as Ulbrich argues, ensuring inter jurisdictional equity is a particular challenge to state governments, which collect revenue from both poor and wealthy cities and counties and distribute some of it back in the form of either state aid or state services to ensure that all citizens are treated equitably regardless of where they live. There is a significant conflict between the goal of local fiscal autonomy (which is part of home rule) and the goal of interjurisdictional equity.

(iii) Stability

Stability refers to a steady, reliable revenue stream. It is particularly important for local governments to have a stable, dependable revenue stream, because most of them have limited reserves to serve as a cushion against any sudden decline in revenues. One of the positive attributes of the property tax is that it offers a relatively stable revenue source. In contrast, a local government that depends on tourism-related revenue (such as accommodations and admission taxes or gaming taxes) would be more vulnerable to fluctuations in economic activity, because both tourism and business travel tend to be very sensitive to changes in the national economy (Ulbrich, 2000: 6).

As a matter of good policy, it is also desirable to have a stable revenue structure, and particularly a stable set of tax rules, rates and regulations. Frequent tinkering with the tax structure is frustrating to taxpayers and challenging to tax administrators. Private individuals and firms make decisions based on the current tax rules and may suffer unexpected losses if the rules change suddenly or frequently. Providing a stable tax framework in which individuals can make choices encourages long-range financial planning by providing a higher degree of certainty. Stability also allows tax administrators to have some breathing space in which to learn how to implement tax laws effectively and efficiently. The value of stability should not discourage legislators from making changes from time to time, but the gains from those changes must be weighed against the cost of implementation and the dislocations caused to taxpayers from constantly changing rules (Ulbrich, 2000: 6).

(iv) Collection and compliance cost

According to Ulbrich (2000:6), the fourth attribute of a good revenue system is low costs, including ease and convenience as well as explicit monetary outlay, for collection and compliance. Collection costs are those incurred by the state. A good revenue system does not use up too large a share of revenue in such "overhead expenses" as determining the amount taxpayers owe, processing tax returns, resolving disputes, or issuing regulations. The property tax is one of the most complex taxes to administer because of the challenge of assessing property. Compliance cost refers to the burden on the taxpayer of maintaining records, filling out forms, resolving disputes and paying for professional assistance in these processes.

Some taxes that appear to be inexpensive to administer have relatively high costs for the taxpayer, particularly the individual income tax. Other taxes place the compliance burden on a third party; sales taxes are nominally on the buyer, but it is the seller who has the obligation to collect the tax, maintain the records, file the returns, and incur other costs associated with this tax. Property tax places most of the cost on state and local government, with relatively low compliance cost for taxpayers.

There are three ways in which the administrative burden of local taxes and non-tax revenues can be reduced. One is to have greater uniformity among local governments in not only the kinds of taxes used but also in the bases, the rates, and other characteristics. A second way is to reduce the number of taxes collected locally. A third is to use a single collection agency for multiple users of a tax. Collection of local sales and property taxes are both ways in which collection and compliance costs are reduced. However, other undesirable effects sometimes offset such savings in administrative costs. Centralized collection and greater uniformity can reduce local autonomy and may make it less clear to taxpayers how much they are paying to each of several kinds of local governments. These factors must be balanced against other desirable attributes of the tax system in determining how important the collection and compliance burdens are for a particular tax or the system as a whole (Ulbrich, 2000: 7).

(v) Diversity

As the preceding discussion reveals, there is no perfect tax. Each of the major taxes, as well as minor taxes and non-tax revenue sources such as fees, licenses, and service charges, will score high on some qualities and low on others. The property tax generally gets high marks for stability and compliance cost, low rankings on efficiency and collection cost and mixed reviews in terms of equity. The sales tax (which includes the local option sales tax), gets a moderate to low rating on efficiency and equity (because it is mildly regressive) but scores fairly well on stability and collection cost, but imposes a substantial burden on vendors (especially small vendors) in terms of compliance cost. Fees and charges get high marks for efficiency because they ensure that those who use the service pay a large share of the cost, but they are criticised as inequitable (regressive) and are often quite expensive to administer. Income taxes provide revenue growth and can add some progressivity to the overall revenue system, but have high compliance cost for taxpayers. For these reasons,

economists argue that a revenue system with multiple sources at relatively low rates will probably be more equitable, efficient, stable, and cost-effective than a system that relies on just one or two revenue instruments (Ulbrich, 2000: 8).

2.3.2.3 Municipal Financial Accounting

The nature of local government financial accounting is such that it comprises two types of accounting: governmental accounting and commercial accounting. Government accounting caters for keeping records of transactions that are for the general governmental activities of the municipality – provision of basic services to the poor, while commercial accounting applies to all municipal enterprises that provide services to the residents on a business-like manner. Therefore, textbooks on municipal or local government accounting cover aspects of both governmental and commercial accounting (Moak & Hillhouse, 1978:329).

Government accounting is a form of non-profit accounting that was introduced by the **National Committee on Governmental Accounting**, which was later changed to **National Council on Governmental Accounting** in the United States of America. The bulk of municipal accounting falls under this accounting.

The nature of local accounting stems from the primary objective or purpose of local government, namely, to render those services that are demanded by citizens. The primary responsibility of local government accounting is to provide essential information and controls for assurance to the local legislative body and citizens/taxpayers that the local government has carried out executive and legislative intent for the improvement of their lives. In other words, the municipal accounting system should be able to facilitate financial accountability as well as legal compliance and all pertinent restrictions and limitations and positive mandates of municipalities (Moak & Hillhouse, 1978:330 – 331 & Atkinson & Reitzes, 2001:i).

The expenditures of local governments do not generate revenues. They provide services which normally have no price tag - they are dispensed without payment of a fee. Revenues are on the other hand, generated to finance expenditures and provide services. Local government accounting is therefore non-profit accounting. It is **fiscal accountability accounting, financial position accounting and budgetary accounting** to show that resources are expended in strict

compliance with legislative authorisations and that revenues and expenditures were brought to balance (Moak & Hillhouse, 1978:330 – 331 & Loebecke, 2000:11).

Broadly, financial accounting, whether in the public or private sector is the process of identifying, measuring and communicating economic information to permit informed judgements and decision-making by users of the information. (Berne & Schramm, 1986:12, Denhardt, 1991: 175 & Loebecke, 2000:11).

Schaeffer (2000: 4), defines municipal accounting as a process of recording, summarising, analysing and interpreting financial transactions. An accurate municipal accounting system should therefore be able to provide municipal officials with techniques to assemble, analyse and report financial data such that it may be used for planning, decision-making, cost and budget control. It should also be borne in mind that the main purpose of accounting in municipalities is to provide financial information that is accurate, complete and timely in a form that is understandable to users, so an accurate accounting system has to fulfil the latter.

An efficient municipal accounting system consists of an integrated structure of source documents, journals, ledgers and procedures used to determine the financial position of a municipality. The primary focus of this system is generally on cash flows and increasing transparency and accountability to the local constituency rather than on profit or loss reporting. There are various accounting systems used across the world, but the one that is used for municipalities is called fund accounting system.

1. Municipal Financial Accounting Structure

Local government accounting structure is built around a central pillar called the **Fund Accounting System.**

According to the Fund Accounting System, all government accounting systems including those of municipalities should be organized and operated on a fund basis. Schaeffer (2000: 1) defines a fund as a fiscal accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual

equities or balances, and changes therein, which are segregated for carrying specific activities.

Similarly, the Generally Accepted Accounting Principles define a fund as a set of interrelated accounts which record assets (revenues) and liabilities (expenditures/obligations) related to a specific purpose. There are three basic types of funds in municipal financial practices: (i) governmental funds, (ii) proprietary funds, and (iii) fiduciary funds (Denhardt, 1991: 175-176).

(i) Governmental funds

According to the World Bank (2000: 1 -6) and (Denhardt, 1991:175-176) local governmental funds are categorised as follows: -

a. The General Fund

The General Fund is used to record and account for financial resources except those required to be accounted for in another funds. It is used to account for general revenue sources, such as taxes, fines, and licenses. This is generally the largest fund of all municipal fund accounts.

b. Special Revenue Fund

The Special Revenue fund is used to record all resources that are restricted for special purposes, for example, transportation trust fund. It is also used for accounting for proceeds of specific revenue sources that are legally restricted to expenditure for specific purposes.

c. Capital Projects Funds

Capital Projects funds are those funds that account for financial resources to be used for the acquisition or construction of major capital facilities, such as dams, buildings, roads, bridges and water reticulation infrastructure.

d. Debt Service Funds

These funds are used to account for the accumulation of resources for the payment of general long-term debt principal and interests. It generally caters for the redemption of loans taken by the municipalities, especially for capital projects.

e. Special Assessment funds

These funds account for the financing of municipal infrastructure improvements deemed to benefit the properties against which special assessments are levied. In other words, it consists of receipts from special charges or fees levied on persons that benefit from a particular capital improvement project.

(ii) Proprietary funds

According to the World Bank (2000:2), the following are categories of proprietary funds: -

a. Enterprise funds

These funds account for operations that are financed and operated in a manner similar to private businesses -where the intent of the governing body is that the costs of providing goods and services to the public on a continual basis be financed or recovered primarily through user charges. Such goods and services may include self-supporting operations such as water and electricity charges.

b. Internal Service funds

Internal service funds account for the financing of goods or services provided by one department or agency to other municipal agencies or departments on a cost reimbursement basis.

(iii) Fiduciary fund

This fund accounts predominantly for trust and agency funds, meaning assets held by a municipality in a trustee capacity or as an agent for individuals, private organizations. Such other funds may include **Pension Trust funds.**

The previous section discussed the structure of a typical municipal accounting system and such a system is the same for all municipalities as prescribed by Generally Accepted Accounting Principles (**GAAP).** Municipalities are expected to establish and maintain their funds as required by GAAP and the law for sound financial administration.

Subsequent to setting up effective municipal accounting systems, municipalities are expected to adopt an appropriate basis of accounting. A basis of accounting is the approach adopted for identifying those points in the cycle of transactions at which accounts recognise the availability of resources, the commitment and use of funds, and the consumption or application of resources. On the inflow side, two bases have been adopted: cash accounting and the accrual accounting bases. On the outgo side, four bases are used: the cash, obligation, accrued expenditure and accrued cost.

Table 2.1 (on the following page) serves to clarify what "identifying points in cycles" means and to connect the corresponding bases:

Schaeffer (2000: 7) states that in the cash accounting basis the simplest of all accounting procedures is to record cash transaction: how much is received; how much was paid out, how much is on hand at the bank. On this basis of accounting, revenues and transfers are not recorded in accounts until cash is received, and expenditures or expenses transfers out are recorded only when cash is disbursed. GAAP does not really recommend cash accounting basis because it usually gives a misleading picture of municipal accounts, for example, cash received as a loan would be recorded as revenue and not as a liability (Schaeffer, 2000: 7 – 8).

Alternatively, municipalities may opt for accrual accounting in which the records of transaction are made according to the benefit period; for example, revenues that were due for the previous year should be recorded for the previous year, not the present period. In other words, the accrual system recognizes revenues when their charge is effective, not

when cash is received. Expenditures are recorded when the obligation is incurred, irrespective of when the disbursement was made (Schaeffer, 2000: 8).

Table 2.1 The Bases of Accounting, Source: Moak & Hillhouse, 1978

Transaction phase	Point in time when recorded	Recognised as (and basis)
In the inflow cycle (revenues)		
Receipt of tax or any other revenues without prior recording	When cash is received	A cash receipt (cash basis)
Tax or revenue due and definite amount known	When tax or revenue is earned, levied or billed	An accrued revenue (Accrued revenue system)
In the outgo cycle (expenditures)		
Placing an order for goods and services	When goods or services are ordered or contracted for	An obligation or commitment (Obligations basis)
Receipt of goods and services ordered	When goods are received, liability incurred or the invoice received	An accrued expenditure (accrued expenditure basis)

Each accounting basis has some weaknesses, although accounting becomes more refined as we move from the cash basis to the modified cash basis and modified expenditure cash basis. Most larger and middle-class local government now use a system under which transactions or obligations are recorded at the time incurred – expenditures are recorded as cash, when cash is paid, and as obligations when an order is generated. There is a tendency, within financial accounting, to refer to this as the "strict accrual basis", but careful attention to its operations reflects that it is modified cash accounting (Moak & Hillhouse, 1978:358-357).

2.3.2.4 Municipal Financial Auditing

The role of auditing in local government finance is becoming increasingly more important, not only because local government operations are expanding, but also because there is a growing need for developing new means for reviewing the end-results. The National Committee on Governmental Accounting (NCGA) in the United States of America (1974) defines auditing as:

> The process of examining documents, records, reports, systems of internal control, accounting and financial procedures and other evidence for one or more of the following purposes: -
>
> - To ascertain whether the statements prepared from the accounts present the financial position and results of financial operations fairly,
> - To ascertain whether the structure of the government accounting system complies with the Generally Accepted Accounting Principles (GAAP) norms,
> - To determine the propriety, legality and mathematical accuracy of local government's financial transactions and
> - To ascertain the stewardship of officials who handle and are responsible for financial resources of municipalities.

Similarly, Loebecke (2000:9-10) defines auditing as the accumulation of evidence about information to determine and report on the degree of correspondence between information and the criteria established.

According to Loebecke (2000: 8) historically, auditing local governments had been largely restricted to ascertain that the balance sheet represents a proper statement of the government's financial condition; a determination that money received has been properly recorded and deposited to government's accounts and that expenditures made are in accordance with local legislative authorisations. These continue to be very important

elements of the audit function, however, post audit controls are gradually expanding in to other areas. Some students of public finance believe that the audit function needs to be extended to embrace performance auditing, which would greatly expand the field. It would among others, include the use of management efficiency and effectiveness standards to measure the performance and achievements by each spending agency.

In South Africa and elsewhere in the world, the contemporary definition of auditing is:

> "The systematic process of verifying the reliability of financial reports and the appropriateness of the underlying financial activities, meaning that an audit is an examination of systems, procedures, programs and financial data."

The above definition does not differ with that of the **NCGA** and in trying to show the all-important position of auditing in local government finance, The Lima Declaration of Guidelines on Auditing Precepts, published by INTOSAI, opens with the following statement: -

> "The concept and establishment of audit is inherent in public financial administration as the management of public funds represents a trust. Audit is not an end in itself but an indispensable part of a regulatory system whose aim is to reveal deviations from accepted standards and violations of the principles of legality, efficiency, effectiveness and economy of financial management, early enough to make it possible to take corrective action in individual cases, to make those accountable accept responsibility, to obtain compensation or to take steps to prevent or at least render more difficult - such breaches " – (INTOSAI, 1999: 147).

Effective auditing can therefore contribute in several important ways to the management of a municipality's finances. It can:

- Detect irregularities involving the misuse of public funds and identify related weaknesses in management controls that may imperil the integrity of the municipality and the effective implementation of budgetary and other policy decisions;

- Determine the reliability of reports on budget execution and other financial data,

- Identify instances and patterns of waste and inefficiency that, if corrected, will permit more economical use of available budget resources,

- Provide reliable data about programme results as a basis for future adjustment in budget allocations.

Auditing is therefore a very critical element of municipal financial system and is regarded as a "watchdog" function. It can detect irregularities and recommend corrections and as such is used as a municipal finance-monitoring tool (OECD, 1999: 58).

It is against the above utilities of an auditing function that Section 53 of the Municipal Finance Management Bill requires of municipalities to be audited by the Auditor-General as per section 188 of the Constitution of South Africa, 1996 (Act 108 of 1996). The Act stipulates that the most important prerequisite for effective auditing programmes is the independence of the auditing authorities to assure that their work is not biased by any relationships they might have with the entity being audited. For internal auditing, the entity responsible for auditing should not be part of the finance or treasury function.

2.3.2.5 Municipal financial reporting

Traditional municipal reporting was previously aimed at showing compliance with the budget. While this function was met in local government with an adequate audit capacity, in others, improving compliance remained the priority challenge. Nevertheless, a need for more transparency and accountability called for a wider scope of reporting.

A local government reporting system should provide a means of assessing how well the government is doing. According to (Schaeffer, 2000: 9- 10) the municipal reporting system have the following three prominent objectives: -

According to Reny (1983:120) financial reporting should

- Assist in fulfilling the government's duty to be publicly accountable and should enable users to access that accountability. This means that municipal financial reporting practises should provide information to determine whether current year revenues are sufficient to pay for the current year's expenditure or financial services.

- Assist users in assessing the level of services that can be provided by the local municipality and its ability to meet obligations, as they are due. This means that financial reporting should provide information about the financial position and conditions of the local government, about the physical and non-financial resources that have useful lives that extend beyond the current fiscal year.

- Lastly, municipal reporting should assist users in evaluating the operating results of the government entity for the year. Municipal financial reporting should also provide information about the sources and uses of financial resources and about how the governmental entity financed its activities and met its cash requirements. Financial reporting should also provide information necessary to determine whether the jurisdiction's financial positions improved or deteriorated because of the current year's operations.

It is expected of municipalities to include a basic balance sheet and an expenditure and income statement to strengthen the usefulness of financial reporting. (World Bank Development Institute, 2000: 10).

2.3.2.6 Cash flow management

The main function of local government cash management is to ensure that the right amount of cash is available at the right time at the lowest cost to meet expired cash needs. Cash management systems need to consolidate a range of information relating to taxation receipts, loan repayments schedules, asset sales, transfer payments and individual municipal operating flows and capital requirements. In fact, cash management need to interface with

debt management to ensure that current interest and principal obligations can be met (PUMA: 1998:7).

Accurate forecasting of cash flows ensures that a municipality has sufficient cash to satisfy its obligations at any point in time (PUMA, 1998:7). Lovemore & Brummer (1993:2) refer to this "satisfaction of obligations at any point in time" as liquidity, which they continue to define as the ability to have sufficient cash to settle all short-term obligations as payments become due. Short-term obligations that form the main target of cash-flow management would include routine payments such as employee wages and salaries, creditors and suppliers. The main motives of this liquidity in local governments are transactional motives (the need to have cash ready to meet routine payments), precautionary motives (the need to have sufficient cash to accommodate emergencies) and the speculative motive (to temporarily invest idle cash in short-term securities in order to obtain interest.

Most local authorities have the constitutional authority to raise taxes, levy rates or where possible obtain funds through revenue-sharing or the allocation of grants. These non-reciprocal receipts are often the primary source of funding for local authorities, therefore, the efficient and prompt collection and investment of such receipts can generate amounts of additional receipts collected, lower processing costs and create additional interest revenue (PUMA, 1998:8).

Prudent cash management practices like the timely billing and collection of accounts are at the core of a well-managed financial system in municipalities, especially insofar as liquidity is concerned.

2.3.2.7 Municipal Borrowing and Debt Management

The demand for borrowed money at the local government level is high because local governments are the main suppliers of socio-economic infrastructure, such as roads, streets, water reticulation systems, electricity reticulation systems, sewerage systems, parks and open spaces, libraries, health clinics and many other infrastructure services. Without borrowed money, local governments would not be able to finance, the supply of the required infrastructure for the development of their residents' social and economic conditions, from their current revenues (Gildenhuys, 1997: 166).

Historically South Africa's municipalities have had a skewed access to private sector markets for borrowing purposes. White municipalities could borrow to build infrastructure, but black municipalities had little or no access at all to most forms of private sector borrowing. Today, the fundamental rules have changed because the amalgamated municipalities have been created and all the previously under-serviced have been integrated with the previously serviced to form single non-racial municipalities. Being subject to national legislation, local authorities have now been allocated statutory borrowing powers equally by provisions of Section 230(1) of the Constitution of Republic of South Africa Act, 1996 (Act 108 of 1996). latter gives all local governments the power to:

"... raise loans for capital or current expenditure in accordance with reasonable conditions determined by national legislation, but loans for current expenditure must be raised only when necessary and for finance bridging purposes only and must be repaid within twelve months."

In other words, the Constitution prevents the raising of municipal loans on a credit-revolving basis. Therefore, in future all the amalgamated South African municipalities must all be creditworthy (Glasser et al, 1998:7 & Gildenhuys, 1997:166).

As the legislative imperatives to local government borrowing had been identified and ratified, municipal borrowing is also showing signs of accelerated increase in view of the immense investment backlogs that local authorities face and the continuing decentralisation of service responsibilities. This as Peterson (1998:1) argues, gives municipalities even more pressure to remain creditworthy .Peterson (1998: 1-2) further defines a creditworthy municipality as the one which meet the credit risk standards of a lender. He continues by alluding to the point that the municipal credit risk is in most case determined by credit agencies. One such agency called Moody, define credit risk for municipal bonds as the probability that interest and principal will be paid in accordance with the terms of the bond issue, as well as the bondholder's likely return if the bond issue defaults. On the other hand, Standard and Poors uses the following municipal rating categories to reflect the creditworthiness of municipalities: -

- AAA – This credit rating reflects the capacity of the municipality to repay interest and principal to credit issuing institution. A municipality with this credit listing has

a strong chance of being given credit by various financial institutions for it has shown its competence in running its finances. The risks involved in giving municipal loans are very low and the bond itself can be cheaper .

- BBB – A municipality with this credit rating is the one that is perceived to be in adverse economic conditions or weakening circumstances that may consequently have a weakened capacity to repay debt (principal and interest). Giving loans or any other credit to such a municipality carries a very high risk for the issuing financial institution. It is therefore important for municipalities to keep check on their economies to sustain their credit rating at AAA rather than at BBB.

- B – At this level, the municipality may currently have a capacity to meet interest and principal repayments, but adverse business, financial and economic conditions may likely impair such a capacity or willingness to pay (Peterson, 1998:3)

Peterson (1998:10- 11) states that the ability of municipalities to repay debt is, therefore, sensitive to economic conditions and has a very extensive impact on the financial performance and condition of all municipalities. The precise economic risk depends upon a municipality's revenue and expenditure structure. Local authorities that raise most of their revenues from local taxes are especially vulnerable to local economic conditions and those that rely mostly on revenue-sharing from nationally levied taxes are less vulnerable to local economic conditions, but are more exposed to economic difficulties elsewhere in the whole country. Again, local authorities that are statutory expected to pay safety-net activities like unemployment compensation or hospital care for the poor out of locally generated revenues are more vulnerable to economic cycles than those that either do not provide these services or are compensated for them directly by transfers from either the provincial or central government.

Communities that have high concentrations of "old" economic activities, where employment is being slashed because of economic restructuring, face special difficulties in taking on debt obligation. Therefore, one important task of credit analysis and management is to identify economic events which would most impair a municipality's ability to repay debt and assess the risk of such economic events.

The acute infrastructure backlog compounded by chronic poverty in most of South African black areas makes the aspect of municipal borrowing even more imperative for the newly-established structures. There is a lot of demand for capital investment at the local level of government because it is the national policy that the bulk of services should be provided by local governments and that private investment, both equity and debt should be attracted to help meet these needs. The private investment community has been drawing back from the municipal sector, partly because of doubts about the financial viability of new municipalities, and partly because some previous debt has been repudiated by the borrowers. It is against this background that municipal borrowing is worth mentioning when it comes to municipal financial management (Glasser et al, 1998: 51 – 52).

Most of the policies that are employed in municipal borrowing emanate from the legal provisions of the Constitution of the Republic of South Africa Act, Act 108 of 1996, the Municipal Systems Bill, The Municipal Finance Management Bill and the White Paper on Local Government. Firstly, the legal imperatives of the former demand that municipalities to draft a clear municipal debt policy before venturing in any borrowing exercises.

Such a policy should be able to state the limits and types of debts to be undertaken. The policy should also be able to give a clear direction to municipal officials in the planning of debt management. Section 230 (1) (a) – (b) of the Republic of South Africa Constitution Act, Act 108 of 1996, as mentioned above, states that municipalities may only raise loans for capital or current expenditure in accordance with reasonable conditions determined by an Act of Parliament, but loans for current expenditures may be raised only when necessary for bridging purposes during a financial year and must be repaid within 12 calendar months. The Council should specifically approve each long-term capital debt. Developing an overall policy assures that relevant policy questions are considered from a broader perspective. Debt policies in general also give municipal policy-makers a clear latitude to integrate debt planning with other long-term planning and financial objectives (Glasser et al, 1998: 52).

A carefully crafted and consistently applied debt policy signals to lenders and rating agencies that a municipality is committed to control its borrowing. The following questions should be answered by a debt policy: -

- What are the acceptable levels of short and long-term debts?
- What are the acceptable purposes for which debt is issued?
- For what term will debt be issued?
- Will the municipality opt for general obligations or revenue debts?

The above questions lead to the discussion of purposes of issuing municipal debts.

According to (Berne & Schramm, 1986: 235 – 237) municipalities issue debt for different and several reasons most of which involve the financing of expenditures in the current period with revenues from future period. **Firstly**, the municipal debt is often issued to finance capital expenditures such as land, buildings and equipment acquisition which forms part of the municipal infrastructure for service delivery. In this sense, debt tends to link current benefits with future costs whereby the present benefits of service delivery are redeemed by future repayment of debt. The issuing of debt for capital projects is mostly from the fact that capital expenditures are too high to be financed from current revenues.

According to Phillips (1960:456) it is axiomatic that municipalities should not borrow to meet current expenses or to pay for certain types of equipment which are short-lived and have to be replaced with considerable regularity, for example, motorised equipments in many cities have to be replaced annually, biennially or at other intervals which may be predicted with reasonable accuracy. Therefore, these items should not be financed from loan funds.

Secondly, municipal debt may be issued to finance revenue-producing activities. Such activities may include water reticulation whereby the revenue streams of such an infrastructure will be used to repay the loan and interest.

Thirdly, municipal borrowing may be opted for to finance expenditures arising from emergencies, such as damage caused by natural disasters, like what happened in Mpumalanga and Kwazulu-Natal during the summer of 2000. Most of the capital infrastructure was damaged by floods for which the municipalities did not budget. So in order to repair and maintain most of such infrastructure, there was a need for capital injection from the private sector in a form of municipal bonds and loans. This type of debt

is encouraged either because current revenues cannot provide the funds needed for infrastructure or because disasters force municipalities to replace or partially upgrade their worn-out buildings and equipment. The use of emergency borrowing is not only restricted to natural emergencies but may include " man-made" emergencies, such as poor estimates of revenues or a sudden decline in the revenue base (Berne & Schramm, 1986:237 & Phillips, 1960:457).

Overall, municipal debt should be well-managed that lenders can be paid full amounts on time to keep municipality's finances in a liquid state. It does not matter for what reason or what kind of debt is being issued; the main issue in municipal borrowing is how municipalities manage their debts given their economies and the unmet expenditure pressures that arise from their community's needs (Berne & Schramm, 1986:125).

2.3.2.8 Municipal infrastructure finance

According to Fox (1994:7) the term infrastructure can be defined as capital investment from which services can be derived for household consumption. Defined in this manner, infrastructure comprises of those physical projects such as roads, mass transportation networks, water systems, sewer systems, solid waste management, drainage and flood protection, electric installations and telecommunications.

The above definition deserves careful attention because, firstly, the definition focuses mainly on the infrastructure's role in the production and consumption of services. A successful infrastructure programme is the one which is expected to churn-out or produce services sustainably to the public, but the role of infrastructure for residential consumption, particularly in low-income areas is integral to the benefits.

The World Bank's Urban and Local Government Strategy named **Cities in Transition** (2000: 47 –115) maintains that for prosperous rural and urban centres across the world, there is a need for more investment in capital infrastructure especially in the areas of maintaining basic services to the people. This Urban and Local Government Strategy is mainly based on a vision of sustainable cities, which was discussed above under sustainable cities. The outlines of such a strategy include liveability, competitiveness and bankability.

Liveability is brought about by the commitment of local governments to ensure that the poor achieve a healthy and dignified standard of living by providing systems for adequate housing, secure land tenure, credit, transportation, health care, education and other services for households that address environmental degradation, public safety and cultural heritage preservation for the benefit of all residents and to be liveable, cities must also become competitive.

Competitiveness refers to the provision of a supportive framework for productive firms to promote buoyant, broad-based growth of employment, incomes and investment. This implies that local governments must be well-governed and managed with representation and inclusion of all groups in the urban society, with accountability, integrity and transparency of government actions in pursuit of shared goals and with strong capacity of local government to fulfil public responsibilities based on knowledge, skills, resources and procedures that draw on partnerships.

Bankability is the financial soundness and at least for some cities, creditworthiness or financial health of municipalities requires the adoption of clear and internally consistent systems of local revenues and expenditure, transparent and predictable inter-governmental transfers, generally accepted financial accounting, asset management, and procurement practices, and prudent conditions for municipal borrowing.

To achieve these four interrelated objectives efficient municipal management and delivery of infrastructure-dependent services are vital. To ensure that municipal infrastructure contributes to the above, there is a need for all infrastructure projects to address the demand of the municipal communities for specific goods and services (Fox, 1994: 11 & World Bank, 2000: 47 – 112).

According to Fox (1994:11-12), there are different perspectives on why infrastructure investments are important, and motivation can be an important determinant of where such investments can be made. **Firstly**, investments may be intended to stimulate the economy. This objective is focussed on how infrastructure influences the economy through the supply side. Better water, sewer, roads, and other services are expected to expand overall economic potential by allowing firms to be more productive. Infrastructure development in

many instances serves as a potential rationale of why businesses should relocate to certain cities. In this regard, it is emphasised that infrastructure investments can be undertaken in response of the demand for economic growth by way of business investments.

Fox further argues that infrastructure investments are prudent to meet the demand for services. Demand arises from businesses in production, households and government. Meeting a demand for services should be the primary objective of most infrastructure projects and the primary determinant of why projects are chosen. Willingness to pay for services will be much greater and the resources will be used in ways that lead to increased satisfaction if infrastructure is built where there is sufficient demand for services. In addition, the full use of infrastructure capacity is more likely if infrastructure is built where demand exists (Fox, 1994:11).

The third perspective that Fox presents is that demand may emanate from a decision to provide services to people regardless of their willingness or ability to pay. Municipal policymakers may feel that access to services such as portable water is essential for maintaining a minimal standard of living and should be provided independent of the ability to pay. Demand in this regard is based on intent by policymakers to achieve equity and the demand must be articulated through the policymakers' views of the municipalities' equity goals. The term "merit good" is often used by economists to describe services deemed so meritorious that all should receive them regardless of the ability to pay.

There is also a tendency to identify demand in the context of an existing infrastructure system or a traditional preconceived notion of infrastructure delivery systems. Municipal policymakers with a demand orientation will discard prior notions of how services are delivered and begin with an understanding of what users want. Failure to meet demand may result in discontented users. Consumer dissatisfaction leads to low willingness to pay, underused services, and other problems. Inconsistency between the services demanded and those delivered may be most acute for low-income people. Although water connections, public buses, roads, and sewerage may be supplied, low-income residents may be most interested in services that require less and inexpensive infrastructure (Fox, 1994:14 - 15).

Demand also exists for six different aspects of infrastructure services: accessibility, capacity, diversity, quality, condition and time. Accessibility refers to the location of services relative to the population; for example, stand-post water has less accessibility than household connections. Access depends on a number of factors besides geographic location, including behaviour patterns and users' customs. Capacity refers to the maximum level of service that can be delivered. At the infrastructure system level, capacity may be the number of vehicles that a road can handle in an hour or the electric load. Diversity indicates the range of services offered, for example, intra-city subway and bus transportation are different forms of urban mass transit and may serve different groups. Quality includes reliability and other service attributes. Quality has two dimensions: the specific characteristics of infrastructure output, such as the biological traits of water when it leaves the treatment plant, the reliability of the system, such as the frequency of distribution breakdowns. Time is a dimension of each demand attribute, for example, water flow capacity is given per unit of time and accessibility refers to the time required to collect a certain amount of water (Fox, 1994: 15 - 16).

Besides the demand for services, there are other factors that necessitate infrastructure investments. According to Fox (1994:25 - 26), the construction of physical infrastructure may increase local incomes as workers may be hired and other inputs purchased locally. However, the benefits may be short-lived, being realised in the year that construction occurs. The longer-term benefits come through the supply-side use of infrastructure services to produce other goods. There is also evidence from various researches that higher income areas demand for more infrastructure services.

The basic character of the local economy will be an important determinant of the type of infrastructure needed. Areas moving from an agrarian to a goods-producing economy may find traditional infrastructure, such as roads and railways, most important and those moving from goods producing to services may find communications more important. Further, infrastructure can only have value in production to the extent that demand exists for the outputs produced using infrastructure services (Fox, 1994:10 – 15).

Fox further argues that development of infrastructure with the goal of relocating economic activity generally can be successful only within the narrow geographic ranges. Infrastructure

may be able to influence the location of development within a locality, because there is a tendency to locate where electricity and water services are available. The greatest effects will be on small firms and households, which are unable to deliver services for themselves. Providing infrastructure to growing, unserviced areas of a locality can be a successful strategy for meeting demands and increasing productivity. For example, benefits can be great if improved water is provided to an area formerly served by vended water, because of the potential for large cost savings.

After the demand of particular services or goods had been established and their impact on the economy had been determined, the most strenuous exercise is of determining the kind of financing which is appropriate for such a project or projects. The following section will therefore, concentrate on financing of municipal infrastructure, that is, on financing initial infrastructure and financing operations and maintenance.

Adequate financing is necessary for sustainable infrastructure systems. The role of finance is more than to ensure that sufficient funds are in place, because financing schemes can affect incentives and other goals, such as the equity motive of the infrastructure. This section examines topics in the financing of infrastructure and the discussion is separated into financing the initial capital investment and financing the operations and maintenance of infrastructure.

1. Financing initial infrastructure investments

Fox (994:41) states that local governments, donors and the private sector are the primary funding sources for infrastructure facilities, for example, in the Indonesian local governments, the Indonesian investments in roads, airports, mass transit, and seaports are financed through a combination of sources. User charges financed about 10 percent of investments, but the bulk of investments come from the private sector and the intergovernmental infrastructure-support transfers

(a) Government funding

A strong capacity to finance certain services through government revenues is essential. Own-source revenues and borrowed funds are the financing sources for local governments. The own-source revenues of local governments include taxes, charges for services, fees, net profits from local government enterprises and other miscellaneous sources such as the sale of assets and interest earnings. In South Africa, it has been very difficult for local governments alone to finance capital infrastructure programmes and the central government devised a programme called the **Consolidated Municipal Infrastructure Programme**. This programme had been designed to benefit areas where there is a need for the provision of bulk service supplies, like in the rural areas of South Africa, where there is no infrastructure for the provision of the basic services (Fox, 1994: 41 – 42).

(b) Borrowing

In this regard, a provision is usually made in a local government statute that allows local governments to borrow funds from the private financiers for municipal infrastructure. Such financing always comes about in a form of long-term loans. The Developmental Bank of Southern Africa (DBSA) is the prime financier of local government infrastructure in South Africa. In the North-West Province alone, the Christiana, Lichtenburg, Ipelegeng/Schweizer-Reneke and Ventersdorp/Tshing areas received millions of rands in form of loans to upgrade or construct municipal infrastructure projects ranging from water purification works, sewage treatment works and bulk water storage projects. In this case, the DBSA played a part of being a private financier for municipal projects (DBSA, 2000: 1 & Fox, 1994:42 – 43).

Infrastructure bank resources are loaned as a source of funds for the initial costs of infrastructure projects. The borrowing municipality must repay loans, usually from the finished project's revenue streams. The most important motivation that influences banks to borrow money to municipalities is the municipalities' creditworthiness. Limits on debt relative to municipal revenues is one guideline that constrains or sets a ceiling of how much municipality's can borrow in form of loans. If repayments fail, the borrower, in most cases attaches the collaterals, that is, the security behind the loans. Such securities may be

intergovernmental revenues, municipal non-critical assets and/or projects' revenue streams (Fox, 1994:43).

(c) Private equity financing

Private equity financing is the final source of funding. It could come from the resources of parastatals or private sector companies. This kind of infrastructure financing occurs when the private sector has ownership or partnership interest in the infrastructure. This can involve some form of **Build-Operate-Transfer** (BOT) arrangement, in which the private sector builds then operates the utility or facility for some period, after which the facility is transferred to the municipality. This requires a specified negotiated agreement between the private firm and the government. In South Africa, private equity financing is practised from the premise of Public-Private Partnerships (**PPP**), in which private sector companies have an option to operate certain governmental services on behalf of the government until the negotiated time elapses. In China, BOT agreements are encouraged as a form of foreign equity capital. As an example, Hopewell Holdings Ltd of Hong Kong is currently operating a power plant for the Guangdong and is starting a second one for the same locality(Fox, 1994: 44).

The other example of BOT arrangements as a form of private equity financing is in Cote d'Ivoire whereby the local councils and the private firm called Societe des Eaux Cote d'Ivoire (**SODECI**) are jointly delivering water services. **SODECI** operates and maintains the water systems for Abidjan, the capital, and 240 other cities and towns. Clearly, private equity financing offers another alternative with a number of advantages. Firstly, private financing offers access to resources that otherwise would be unavailable and this is the major impetus why most councils allow BOT projects for roads and electricity. Private equity financing can also have a stronger economic stimulus if it does not crowd out other investments. The disadvantages of private equity finance may occur in some cases in which the private sector rather than the public select projects. The extensive involvement of the private sector in selecting projects to be financed often causes the diversion of local government resources from more productive uses to less productive ones (Fox, 1994: 44 – 4).

2. Financing operations and maintenance

Operations and maintenance (O&M) are normally financed through user fees, general fund contributions from the local government, or intergovernmental transfers from the central to local government. Intergovernmental transfers are usually financed by the general fund of the central government. Local government are frequently promised revenue transfers from the central government but fail to receive the revenues when national tax revenues are tight. In other words, intergovernmental transfers are unpredictable. User fees are the preferred financing method whenever viable. Use fees can finance the full cost of infrastructure services that are private goods but probably cannot be the sole source for infrastructure services that have significant externalities. Water, roads, and telephones are private goods and can be fully financed with user charges. Sewerage, solid waste disposal and urban mass transit are partially financed with user fees but may need some contributions from the general fund (Fox, 1994:46 – 47).

According to Fox (1994:47) user fees are imposed in a variety of ways. Firstly, the traditional means is a price levied per unit of purchased services. A specific charge per cubic meter of water is an example, but household metering is necessary to levy effective charges for water. The fee should always be equal to the long-run marginal cost of delivery. Secondly, a fee may be charged or levied on a proxy for infrastructure consumption.

The above discussion on how municipal infrastructure is financed bears testimony to the important role played by municipal financial management and infrastructure management in service delivery, especially when it comes to the options of how to finance the provision of services to local communities. It is against this background that municipal infrastructure can be included as a component of municipal finance and the most important involvement of financial management in infrastructure management is whereby city officials have to choose between different options of financing such infrastructure. Each option is in most cases weighed according to its impact on the overall finances of such a given local authority.

2.4 Summary

This chapter presented the nature and scope of local government and local government financial management. It discussed the nature of local government institutions, their purposes and their financial management activities.

This following chapter discusses the financial analysis of local governments. The discussion starts with the basic nature of financial analysis and progresses with the analytical framework for financial analysis and its components and ends with the forecasting of local government finances.

CHAPTER THREE

LITERATURE REVIEW ON THE ANALYSIS OF LOCAL GOVERNMENT FINANCES

3.1 Introduction

This chapter presents literature on local government financial analysis and the models used in municipal financial analysis. First, the chapter presents a review on the nature and scope of local government financial analysis, then progresses with the nature and components of financial analysis.

3.2 Local government financial analysis

The World Bank's Training Manual in Local Government (1999:1) defines financial analysis as a set of tools and techniques, including fiscal indicators and forecasting, that allow municipal officers to measure the current fiscal condition of a municipality and predict trends in its future fiscal condition. In a nutshell, financial analysis helps municipalities to decide on how much they can afford to spend and how their new priorities will be funded.

The main purpose of analysing municipal finances is to determine how well municipalities have met their past financial obligations and how likely is it that they can meet their financial obligations now and in future. In other words, local government financial analysis is a management instrument used to determine and identify financial weaknesses and strengths of municipalities over specific periods (Pandey, 1997:61).

The level of this analysis is in most cases a municipality as a whole institution, not its constituent units, because data used in the analysis is usually aggregated institutional data, like municipal revenues, debts, expenditures or internal resources. Again, all the analysis is within a particular analytic framework within which the questions asked can be organised, datum is allocated and comparisons made.

According to Berne & Schramm (1986:7-8), the financial analysis framework should at all costs be able to pull together all different parts of the analysis and integrate them to assess

the financial condition of a municipality or a group of municipalities. For such a model to be relevant and successful in analysing such a financial condition, there is a need for complete, legitimate, useful and reliable data, but in most cases, audited municipal financial statements serve as sources of financial data. The most difficult data to collect is non-financial data, which include community needs and tastes, demographical data and other economic and social welfare data. Recently (in South Africa) Statistics South Africa is the prime provider of national, provincial and local statistics that can be used in this kind of analysis.

3.2.1 The analytic framework of local government financial analysis

In order to make sense of the financial and non-financial data of local governments, municipal financial analysis has to be performed with a particular framework that can provide a basis for understanding and reviewing existing measures of financial condition. The framework should also enable municipal officials to develop consistent set of measures that when taken together may result in a comprehensive view of local government financial condition (Berne & Schramm, 1986:67 & Gitman, 1997:110).

According to Carr (1984:43-49), and Berne & Schramm (1986:70-75), the framework for measuring local government financial condition starts with general considerations followed by the framework and its components and ends up with the basic assumptions taken from the framework.

3.2.2 General considerations of the analytic framework of financial analysis

The system of financial condition measurement presented in various studies is made up of several measures or formulae of financial condition. It is a framework for organising and interpreting a wide range of measures related to financial condition. Financial analysis is in this way viewed as a way to learn various dimensions of financial condition of a local government. In other words, the framework combines a set of measures that recognises the different dimensions of financial condition amid the wide range of factors that influence financial condition. According to Berne & Schramm (1986: 46), these factors may include the following:

(a) Non-financial and financial variables in financial analysis

Local governments operate within larger communities that both receive resources from and provide resources to the local government. Therefore, some of the measures of financial condition should incorporate characteristics of this larger community. These non-financial data may include community tastes and needs (poverty, education, unemployment and others) and the local conditions affecting production and distribution of public goods and services like population density (Berne and Schramm, 1986:81 -82 & Carr, 1984:46).

3.3 The framework and its components

According to Berne and Schramm (1986:75) for the analytic framework for financial analysis to be used gainfully, there is a need to relate the basic components to different financial data presented. The ingredients of financial condition can be analysed in the following separate components: -

Firstly, available external revenues are examined through ***revenue analysis*** to determine the local government's ability to raise additional revenues from external source. Revenue analysis examines the basic economic strength of a local government, the resources to be tapped, the capacity of the local government to generate revenues and actual revenues raised. Revenue analysis as a component of financial analysis is the most important subject of the present research.

Secondly, available internal resources are studied through ***internal resource analysis*** to determine the local government's ability to draw on its internal financial resources to meet financial obligations. The analysis compares existing, levels of liquidity of internal resources with estimates of the government's need for internal resources and liquidity.

Thirdly, current expenditure pressures are studied through ***expenditure analysis*** where it is determined of the pressures of the local government for additional expenditures. Expenditure analysis in reality examines the need or demand for more services and goods

by the local government's community and the prices of physical resources needed for provision of services against the actual expenses of a local government.

Lastly, debts and pensions determine the analysis of the amount of available resources that are to defray debts when they become due and the motivation for local governments to incur additional debts. ***Debt and pension analysis*** examines the effect of borrowing, repayment, cash flows and pension funding on the overall financial condition of local governments. Both pension and debt analyses are used to project to what extent will expected resources carry debt and meet pension payments.

From the above discussion, it can be seen that the financial analysis of local government involves a number of factors, which are hereby categorised as the components of the analytic framework. It has also been realised that at the very heart of the framework there is a concept of financial condition. Financial condition of a local government is referred to as the probability that such a local government will meet its financial obligations (Berne & Schramm, 1986:70- 73), but different authors had their own views on financial condition. It is therefore important to look at the other meanings of financial conditions before continuing using the term in a vague perspective.

3.3.1 Financial condition of local governments

Evaluating a municipality's financial condition means sorting through a variety of financial and other data (for example, data on the local economy, population levels and composition, local business climate, character of local finances, changes in the local population) and identifying both positive and negative trends.

Therefore, the term "financial condition" assumes many meanings. In a narrow accounting sense, it refers to a government's capacity to generate enough cash or liquidity to pay its bills. This is referred to as "cash solvency". Financial condition can also refer to "budgetary" solvency - a city's ability to generate sufficient revenues to meet its expenditure needs over its normal budgetary period and not incur deficit (Groves & Godsey, 1981:6 & Carr, 1984:43).

In a broader sense, financial condition refers to the long-term ability of a government to pay all the costs of doing business, including expenditure obligations that normally appear in annual budgets. Finally, financial condition refers to whether a government can provide quality services required for the general health and welfare of communities. This is referred to as "service level solvency". A lack of such solvency would been seen in the case of municipalities that happen to be in sound financial condition, but are not able to support an adequate level of provision of municipal basic services. In a nutshell, financial condition refers to:-

- **A municipality's ability to maintain services and capital services** - The most important questions that are to be asked are: Can the municipality continue to afford to pay for services it currently provides, maintain its capital facilities, such as streets and buildings and continue to provide services at the level of quality required for the health, safety and welfare of the community and provide services desired by residents.
- **A municipality's ability to handle unexpected events** - In this regard, it is implied whether the municipality has the financial ability to handle emergencies, withstand local and regional economic disruptions, or adjust for an eroding revenue base due to rapid inflation.

Berne and Schramm (1986:69) modified the above definition of financial condition to include that it is a probability that a given government can meet its financial obligations to consumers, employees, taxpayers, suppliers and any group, as these obligations become due. Therefore, this long-run balance between revenues and costs warrants special attention. A local government that is in a good financial condition can sustain the existing delivery of services to the public, withstand economic slumps and meet the demands of the changing service needs. A local government's on-going revenues should be sufficient to meet short-term expenditure commitments as well as finance major capital expenditures and long-term costs (Carr, 1984:43- 45).

Evaluating the above variables of a local government's financial condition is a very difficult task. It is a process of sorting through a large number of pieces - the local economy,

population trends and the internal finances of the city itself. Not only are these factors too large to evaluate, but also many of them are difficult to isolate and quantify. No single piece can be used to tell the whole story about the financial condition of a municipality, but municipalities are able to gather substantial data that can be used to approximate the financial condition of its institutions and agencies. The following section will therefore look at the in-depth analysis of municipal finances. The section will start with the framework for financial analysis and progresses with the components and forecasting of municipal finances.

3.4. The financial analysis framework and its components

The following section presents the framework of financial analysis with its components and how each component affects local government financial ability to sustain liquidity and delivery of services to the residents. The section starts with revenue analysis followed by expenditure analysis, debt analysis and internal resource analysis.

3.4.1 Revenue Analysis

The purpose of revenue analysis is to determine the current level, growth potential and stability of revenues available to a municipality, the amount of current revenues compared to their theoretical maximum and, if possible, the extent to which revenues have been raised effectively and efficiently (Berne & Schramm, 1986: 98). Revenue analysis proceeds in four steps as discussed below.

Revenue analysis begins with an analysis of the **economic base** of a municipal community. In this regard, the main question is about the resource or economic base from which the municipality draws its revenues, in other words, the main concern is on the level of economic resources and their fluctuations over time. The analysis then progresses with the analysis of the **revenue base**, which is defined as actual methods that municipalities can use to tap revenues from the economic base. The third step is the examination of **actual revenues** of municipalities, the levels and changes of different tax and non-tax revenues

that finance local government activities. The sources of data in this instance are governmental financial statements (Berne & Schramm, 1986: 98).

Finally, the analysis emphasizes on **revenue capacity** and **reserves**. In terms of revenue capacity, we examine the institutional, legislative and financial capacities of municipalities to tap resources from their base. These capacities may range from revenue laws to revenue collection efficiency of a municipality. The difference between this capacity and actual revenues amounts to **revenue reserves**. In other words if actual revenues are greater than the revenue capacity, then reserves will be negative. The following is therefore a comprehensive outline of the revenue analysis of local government.

3.4.1.1 Economic base

The economic base of a local government is in most cases dependent upon the economic conditions of the individuals, organizations that make up the municipal community or clientele group that ultimately provide revenues used by the local government concerned. This community is for the most part identified as living within a particular geographical area, meaning that the economic base of municipalities is mostly proportional to the economic conditions within its own boundaries; for example, property revenues are only levied on properties that are with municipal boundaries.

While this economic base can be described in a variety of ways, for this study it is appropriate to look primarily at the economic performance of the area, the economic structure and the locational characteristics that underlie the local economy's performance.

(i) Economic performance

The economic performance of a local area is reflected by the size and value of goods and services produced, the level and distribution of returns to capital, labour and other factors of production and the extent to which the production function utilises local resources. Local economies that import labour and other resources that are locally available are inefficient economies which export revenues to external areas at the detriment of the local

economy. For municipalities' financial conditions to be sound, there is a need for the use or employment of local resources (capital, human and financial). This economic performance can be measured by:-

- Industrial capacity versus unemployment rate - The comparison between the unemployed labour force and the size of the unused industrial capacity. A local area whose economy employs less people with a huge unexploited industrial capacity is said to be operating at an inefficient level.
- Productivity analysis – Local governments routinely measure their region's economic productivity as a key indicator of economic performance. Over the long run, standards of living cannot be improved without productivity increases, so local economies have to be very productive if they are to support higher standards of living. In this case, the term "productivity" is usually defined in terms of value of output relative to unit cost of labour, and returns to capital. Increasing productivity will reflect increased investment in effective human resource development, learning by the labour force, effective allocation of capital, and most importantly effective deployment of technology, for example, computers and the Internet (Webster & Muller, 2000:21).

(ii) Economic structure

The economic structure of a local area has a very influential impact on the economic performance of the area and consequently on the amount of revenues that can be exploited from that economic base. The term "economic structure" is used to communicate the import-export and the supply-demand imperatives of the local economy's products and services.

Most studies approach the economic structure of local areas from a perspective of whether the local industries are for local consumption only or for both local and export markets, that is, production by local businesses is classified as export-oriented when it is for sale outside the area and thus bringing revenues into the area. The essence of the foregoing statement is the export-import/demand-supply approach looks directly at how the outputs

of each type of industry are divided between export and local consumption and in most cases, exports are seen as a driving force for local economies, because exports import revenues into the area. In such a way, the local economy will be able to expand, thus creating more job opportunities and availing enough revenues to the local council in a form of payment of local taxes and rates.

Webster & Muller (2000: 20) argues that in the economic base analysis, export activity (export from the city region) is termed "basic" and is assumed to be the driver of the urban region's economy. On the other hand "Non-basic" activities which refer to city-serving activities (activities for local consumption) are also important to local areas, especially large urban areas like Shanghai in India, which contain approximately 60 million people. In this case, economic activities will be recommended to sustain the delivery of services and goods to the local people, but all in all, export-based economies are inherently superior to import-based economies.

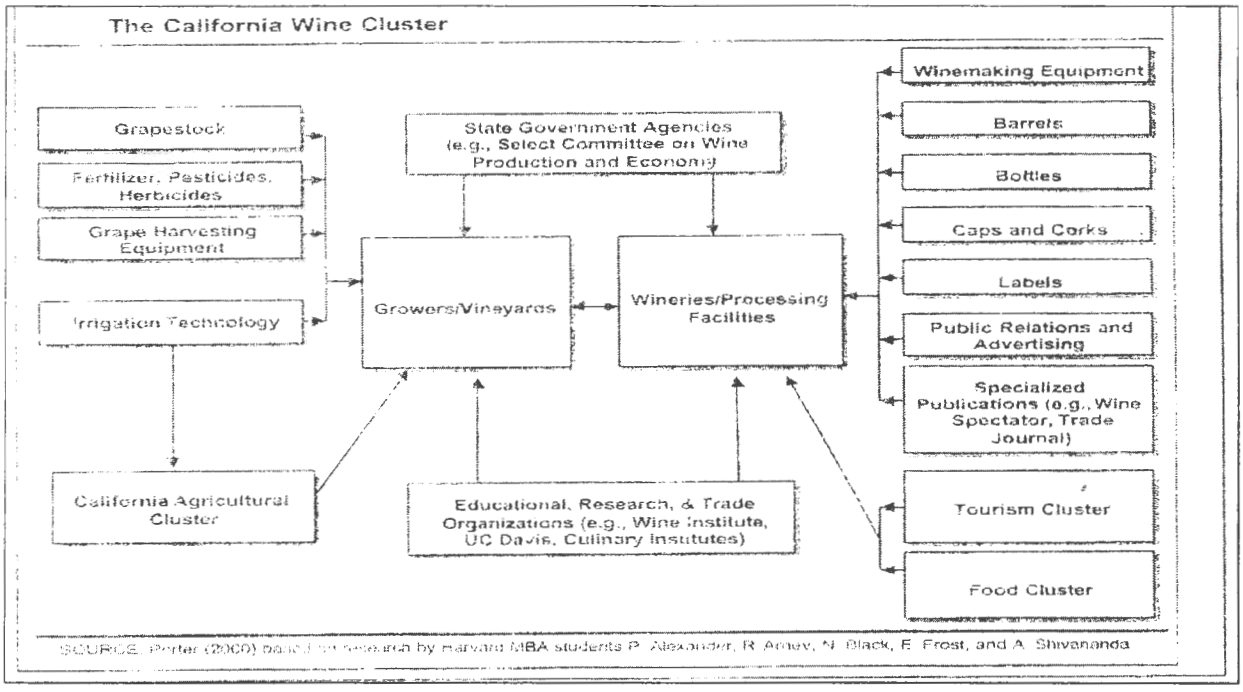
Besides looking at the export-import characteristics of a local economy, it is also of utmost importance to determine the extent to which the overall industrial structure is diversified. Economic diversification measures the industrial concentration of particular industries in certain towns, for example, in South Africa, Kimberley's economy specialised in diamond-mining and all economic activities were either mining-related or were supplementing the mining industry. The danger of specialised economies is that when the demand of their production goes down, the locality's economy stands to suffer the consequences of such a fall. Therefore, an economy that produces many different goods and services with smaller diversified industries may in the short-term not be as efficient as a "single industry" town, but it may be better to respond to the changes that have turned most "specialised economies" into disaster areas. Furthermore, industrial diversification may offer advantages to new industries that need to be close to the supply of certain goods and services.

Presently, diversification has afforded most municipalities a chance to transform their economies from industrial centres to become more oriented to service activity particularly in finance, business, production, tourism and personal services. The best example is of Silicon Valley in the United States of America which was known for its manufacturing of computers, today its economy has diversified from computer manufacturing to the

production of semi-conductors, and has outgrown its technological prowess to include businesses such as textiles, footwear, apparel production and electronic assembling (Webster & Muller, 2000: 3).

According to Webster & Muller (2000: 12 - 15), local governments can also opt for industrial cluster strategies to diversify their economies around a single industry. Figure 3.1 depicts a wine industrial cluster in Davis, California. It shows a cluster of a group of firms in related industrial activities that are spatially concentrated and internally networked. As the diagram demonstrates, the cluster is not simply the agglomeration of core activities, that is, wine growers and processing facilities, but also includes the presence of and linkages to related institutions and activities.

Figure 3.1: California Wine Industry Cluster, Source (Porter, 2000)



Research institutes such as the Wine Institute and the University of California at Davis, relevant government agencies and committees, marketing agencies and wine publications are as much a part of the Davis (California) Wine Industry Cluster as bottle and cork makers and the producers and sellers of grape harvesting and wine-making equipment. Linkages to related industries distinguish the cluster from the traditional growth centre

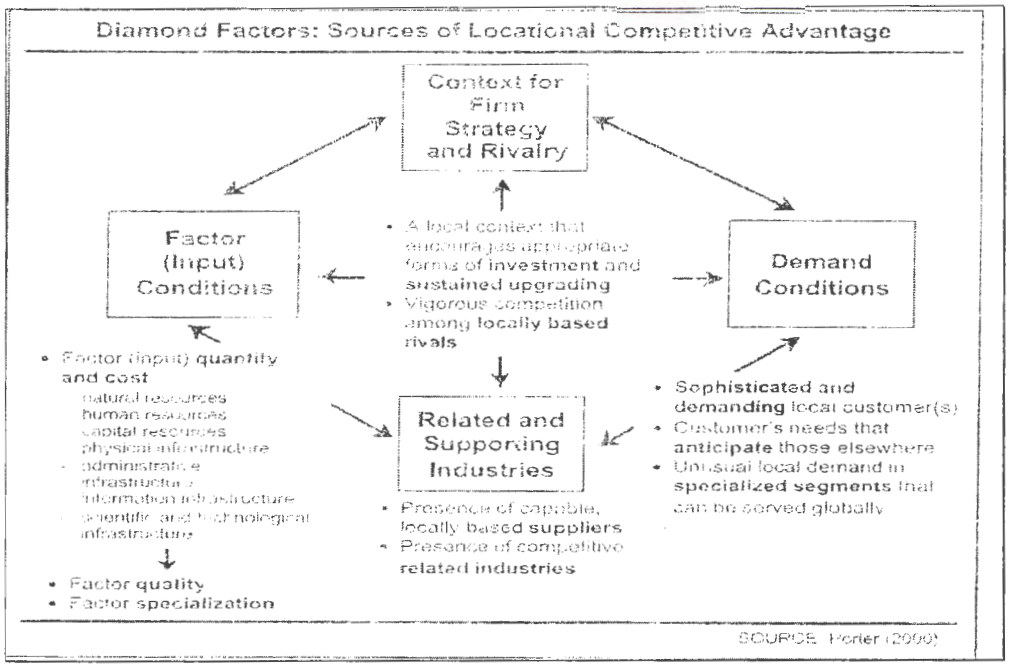
concept, which focusses on supply chain linkages and indirect multipliers. There is increasing evidence that industrial clustering as depicted by the California Wine Cluster can help boost the local economies of most local governments, especially in developing countries. These clusters are found to be especially effective in infant industries (Webster & Muller, 2000: 14 – 15).

Financially, economic diversification in its pure form or in a form of clustering, affords municipalities a diversity of economic activities from which they can tap their revenues. In other words, economic diversity may well result in revenue diversity for most local councils. It is therefore encouraged that cities and other rural local government be able to encourage economic diversification so as to survive economic booms and busts (shocks) and also to create a broader tax base from which they can tap their revenue. For revenue analysis, knowledge and data of the structure of the local economy forms the most important base from which to plan for revenue collection and estimation, especially during budget formulation.

The other important element of the economic base is the supply of the skilled labour force and the locational characteristics of an area. In this regard, the economy of a local area is believed to thrive well when there is an adequate supply of skilled and educated labour force, especially in the areas of technological manufacturing and fabrication. Locational characteristics may refer to facilities that provide transportation access to and from the area. This would include airports, seaports, rail terminals and networks and road networks (particularly controlled access highways). The capacities and capabilities of these facilities should also be benchmarked against the best in the country. Most local economies collapse due to the difficulty with which investors have to transport their wares from the production point to the delivery point. Therefore, in financial analysis there is a need for local governments to inventorise their facilities to plan for their economies in a correct way (Webster & Muller, 2000:26).

To create locational competitive advantage, Webster & Muller propose that the following factors as illustrated in the Fig 3.2 to be taken into consideration: Context for firms; strategy and rivalry, factor (Input) conditions, demand conditions and related or supporting industries.

Figure 3.2: Sources of Local Competitive Advantage



Source: Porter, 2000

In order for local economies to prosper well, municipal officials are encouraged to create what is termed locational competitive advantage. As Figure 3.2 depicts, for the local economic development to be successful, there is a need to meet certain conditions, and such conditions are termed by Porter (2000) in Webster & Muller (2000: 14 -15) as supporting conditions, which he refers to as "the diamond factors". As reflected in Figure 3.2, such factors include quality factor inputs (labour, resources, infrastructure, science and technology), related supporting industries (clustering of supplier and producer industries) and a conducive context for industrial growth, like issuance of incentives and subsidies.

When designing locational competitiveness strategies, municipalities should always consider the impact of such strategies on their economies and consequently on their revenues. If these strategies inhibit economic prosperity, they will also have a negative impact on the revenues of municipalities.

The municipality under the present investigation is the capital city of the North-West Province. It would therefore be necessary to integrate the literature on the economies of capital cities into this study to illuminate the structure and performance of the local Mafikeng area

(iii) The economic nature of capital cities

The capital is by definition a seat of power and a place of decision-making processes that affect the lives and the future of the nation ruled and that may influence trends and events beyond its borders. Capitals differ from other cities: the capital function secures strong and lasting centrality; it calls for a special hosting environment to provide what is required for the safe and efficient performance of the functions of government and decision-making characteristics of the place." (Gottmann & Harper, 1990:63).

Antoniou (1994:24) states that for the economist, a capital is the location of a disproportionate share of public sector employment and for the architect and it is the lucrative site of representative buildings, monuments and parks. If the consequence of being a capital was limited to housing a disproportionately large concentration of government employees, then one would be tempted to see a capital city as simply a typical city with a lot of public sector administration buildings. A capital would therefore be no more different from a manufacturing city as the latter is different from a commercial city, and so on. However, this specific function of capital cities not only leads to a distinctive labour market, but also to dramatically different municipal structures, land use patterns, local economic base, architectures, tourism, local cultures and political identities.

Capital cities are usually larger, more subsidized, or more bombastic than the rest of the nation's cities. National and regional governments treat capital cities differently, wanting the capital to look and act differently than other cities in the nation. Under the old German Reich for example, residential hallways were to be at least 1.1 metres wide in the capital city, but need only be 1 metre wide in the rest of the nation. One sees this distinction in the rebuilding of Rome as the new capital of a unified Italy during the rapid industrialization-urbanization period of the 1870s, in which heavy industry was kept away from the city (Antoniou 1994:24). The new capital, apparently, was not to be just another Italian industrial city. German urbanists therefore have

traditionally distinguished between the sleepy, elegantly built city that held the royal residence (**die Residenzstadt**) and the more culturally dynamic, class-struggling industrial city (**die Industriestadt**).

Drewe (1993:344) states that the unique role of a capital city is not absolute. Just as New York City is termed a "global city" even though not the entire city functions are on a global scale, so too are the activities of "capital cities" clearly not limited to governmental functions. Despite their large public sectors, capital cities still must struggle within the national economy, and thus "there is every reason to first study the functioning of capital cities as cities, even if they are viewed as cities **sui generis**, because their future also depends on their functioning regularly. Capital cities are both ordinary and unique; doubly bound to be good physical environments where real people live out ordinary lives, as well as symbolically rich cities that capture the qualities a state wishes to portray to the larger world (Milroy, 1993:86).

Several factors determine the relative importance of the political versus the administrative roles of the capital city: **the size of government employment vs. private sector employment, the amount of city land devoted to government buildings**, its level of centralization, the economic-regulatory links between the public and private sectors, and the years that the city has hosted the national or regional government. Differences in these factors lead to very different public-private roles of capital cities (Milroy, 1993:86).

The significance of the capital city thus extends far beyond the large presence of government employees. Nations especially federal states often have large centres of regional and national government employees outside the capital city. The United States has located federal courts, military offices and bases, mints, and many agency offices in various cities throughout the nation. This is increasingly the case in Germany as well. This decentralized pattern creates local dependencies in these towns on national government employment and contracts, especially in the defense sector (Markusen et al, 1991). When the local share of national government-dependent employment is high enough, one might call these centres, such as Los Angeles and Colorado Springs, "**government cities**." Yet a government city is to a capital city what a branch plant is to a corporate headquarters: the result of the spatial division of labour, with the primary decision-making in a single, central location, and the implementation/production in many locations. The capital city, despite decentralization of economic activity, remains the centre of government affairs.

Overall, a capital city is a specific form of an "information city": not just in its late 20th century incarnation as a high-tech, financial and media centre (Castells, 1990), but also in its older role as a centre of governmental and military information processing, of political decision-making, of power-brokering, of census and tax gathering.

> "A capital is a transactional crossroads catering to the problems and needs of vast areas from where transients come to the capital, in more or less regular and recurrent fashion, to transact diversified business or gather information" (Gottmann & Harper, 1990: 81).

Capital cities have, therefore become huge processing centres of the modern bureaucratic state with high-profile, front-office leaders and low-paid back-office government clerical workers analogous to the insurance, financial and legal processing found in the private sector of contemporary "information cities." As the boundaries between the public and private sector increasing blur, the data of this public information city extends far beyond the traditional documents of diplomatic treaties, military strategy and tax records to be remarkably similar to private-sector information used by the insurance, financial and legal businesses (such as the processing of medical, unemployment and retirement payments, loans, interest rates and repayment schedules (Castells, 1990:48 & Gottman & Harper, 1990: 81 - 86).

> "...The economic centre does not necessarily also have to be the political centre. Based on economics Lyon in France had a better chance than Paris to develop into a future metropolis. Capital cities are economically often parasitic. All attempts to attract manufacturing had only marginal success. The capital city economy serves above all, the consumption and support of the administrative and political presence. Only London, as the trading centre of a growing empire, did not burden..." (Beyme in Campbell (2000:5).

Capital cities have a double existence: they are unique creatures of the national or regional government with a **guaranteed public-sector economic base**, seemingly outside the normal economic network of a nation's cities. Yet at the same time they are local economies subject to

the vicissitudes of economic restructuring, global competition and fiscal constraints like all other cities. Overall, capital cities have seemingly contradictory economic development histories. Some capital cities have developed a powerful public-private economic dynamism from this dual identity, while others have suffered under the burdens of hosting the regional government (Chinitz, 1961:14).

The most obvious economic presence in a modern capital is the high concentration of government employees, along with the generated indirect employment that follows. In many cases, the government also directly contributes to the local municipal budget. Construction of government offices, monuments, museums, embassies, theaters and other facilities brings in additional economic activity. These facilities in turn attract outsiders for both business and tourism. Firms seek proximity and access to government offices and bring in more jobs, construction, and tax revenues. Other firms set up in the capital to serve government offices with legal, financial, communication, and administrative services (Clark & Lepetit 1996:1).

Lobbyists for corporations, trade unions, non-profits and other interest groups cluster in the capital. The communication and transportation infrastructure built to service government activity also attracts users from the private sector. The cumulative result is that the most successful capitals act as powerful growth poles. And this urbanizing force of capital cities is not new: one third of the total increase in urban population in Europe during the 16th and 17th centuries took place in nine capital cities (Clark & Lepetit 1996:1).

Given their political construction, capital cities have not had to rely nearly as much on "natural" locational advantages (access to raw materials, natural harbors, etc.) to achieve a comparative advantage in urban development. Athens is an example of a capital whose growth and wealth was not merely due to the city's geographic location or industrial base, but rather due to political will, being "artificially recreated in 1835 by a foreigner-king, eager to establish his prestige and authority on a historic site, Athens is a Brasilia that has succeeded" (Gottmann & Harper, 1990: 78).

The most powerful capital cities (for example, London, Paris, or prewar Berlin) were locations where the public and the private sectors synergistically combined: the government attracted economic activity, which in turn strengthened the government sector, and vice versa. Sometimes these political and economic forces are so effectively intertwined that their boundaries blur.

> "[C] apital cities tend to combine, especially in their physical forms, the power that accompanies administrative functions with the power linked to the bourgeoisie and capital. This duality makes it very difficult to distinguish local and national forces affecting urban form" (Sutcliffe, 1993: 196).

The resulting two-dimensional synergy between the public and private sectors, and between local and national forces is typically the most successful in areas where the capital city and the nation grew up together. In these long-standing capitals, the government seat often emerged as the centre of industrialization, trade and financial capital. Fishman (1987) believes that even if Manchester was an early national centre of manufacturing in England, London assertively combined its imperial and industrial strengths to emerge as the dominant economic city. These "early" capitals, continuously serving as the centre of early nation-states, were generally able to both act as catalysts to the nation's industrialization and use the newly-found wealth to reinforce their dominance among the nation's cities. Taylor argues that the 19th Century was an era where capital cities could use their political power to gain advantage over "purely industrial cities," creating a structure where "the importance of a world city was measured by the power of its state" (Taylor, 1995: 55). Drewe (1993:368) captures the notion of the synergy in this way:

> "...The future of capital cities ... depends at least as much on their functioning regularly as cities as on their being capitals"

Hosting the capital city is therefore no guarantee of a successful, dynamic local economy. Though somewhat protected, a capital city is not wholly immune to the vagaries and dangers of the marketplace. In the eyes of the government, its priority in the capital city is to run an effective administration, not to build the foundation of a healthy local economy. As such, the number of government jobs in a capital is driven essentially by government demand and fiscal constraints, not by the local labour supply. This local reliance on government payroll and subsidies leads to an unequal relationship of dependence between capital and nation. If the local economy is not adequately diversified, a capital city can resemble a company town, where a single industry dominates the labour, capital and property markets and in turn retards the healthy diversification of entrepreneurship, labour skills and capital availability in other sectors (Chinitz, 1961). The government does not have a direct incentive to promote the economic diversification of its host (capital city). In extreme cases, the loss of the capital city due to relocation (for example, Rio de

Janeiro, the former West Berlin, Petersburg, and now Bonn) bluntly reveals the downside of this dependence on the government sector, just as plant closure or plant relocation reveals the vulnerable economic foundations of a company town (Goodall, 1978:20 & Hirsch, 1984: 51 – 55).

In larger capitals such as Berlin, there is not the same danger of the monopolistic company town dependency as in smaller capitals such as Bonn or Brasilia. However, this in turn means that the government sector alone cannot be the engine of growth. Current prognoses of Berlin's economic future reflect this inability of being a capital city to necessarily overcome deeper structural problems in the local economy. For instance, despite the arrival of the capital in the year 1999, total employment in the city is predicted to decline by over 30,000 jobs between 1995 and 2010, including not only a loss of 60,000 manufacturing jobs, but also a loss over 30,000 government jobs due to downsizing and decentralization (Eickelpasch & Pfeiffer 1996). The contrast to the 19th century is telling: after Berlin became the capital of a unified Germany in 1871, the municipality's population soared from 826,000 in 1871 to over 2,000,000 by 1910. The powerful synergy of urbanization, industrialization, and nation-state building that led to Berlin's phenomenal growth a century ago simply is no longer present.

For some cities, being capital leads to a healthy, though modest economy in the shadow of larger economic cities in the region (for example, Ottawa, Bern, Bonn, Canberra). Yet in some cases being a capital city can actively undermine the economic development of a city. High investments in non-direct income-producing costly public works, such as large public spaces, parks, monuments and palace grounds, can drain local coffers (Eldredge 1975: 510-511). The symbolic capital city often lacking a healthy industrial or the commercial base does not generate enough taxes to cover the substantial costs of operating the real city.

Capital cities often produce inert, non-competitive local economies that are dependent on subsidies. A persistent complaint heard in West Berlin during the cold war was that the huge subsidies from Bonn created a "**subsidy mentality**" that undermined the development of a local economy that could successfully compete in the national and international economies on its own feet. In addition, these subsidies can often distort the structure of the local economy, inflating antiquated sectors while neglecting the emerging ones (Eldredge, 1975: 528 – 537).

Squires (1989) notes another symptom of this inertia is the lack of a viable public-private growth coalitions in Washington D.C. and other capitals, coalitions that in other cities strategically promote the interests of urban development, housing construction, job generation, local

philanthropy and urban renewal. This lack of a powerful growth coalition is likely due to the subordination of the local private sector to the interests of the government. What emerges is a reversal of a common unequal partnership in which the private sector benefits more than the public in the capital, national public interests gain more than local private interests. The result is a public-sector failure analogous to the traditional market failure. This sentiment is shared by Jane Jacobs, who sees the work of capitals as transactions of decline, and that behind the "'busyness at ruling, a capital city of a nation or an empire, vivacious to the last, at length reveals itself as being surprisingly inert, backward and a pitiable place'" (Paquet 1993: 280).

This ability of government's presence to both promote and undermine the local economic development of a capital city leads to two conclusions: First, there is no uniform economic relationship between a government and its capital city. Second, this relationship can alternate between cooperation and conflict, not only across capital cities, but also over time for the same capital city. One cannot simply conclude that the presence of government is good or bad for a city's economy, for the government has simultaneously created and distorted the city's economy.

This echoes the sometimes co-operative and sometimes conflicting relationship between local powers in the capital. The capital city's special administrative status within the nation can be both an advantage and a barrier to economic development. When the city benefits, it is because of the symbiotic, mutually beneficial relationship between the public and private sector. Public activity in turn attracts private enterprise and each feeds off the other. When the city economy suffers, it is because the government's activities crowd out private activities. The government takes the best real estate, crowding out room in the downtown for private development while removing the land from local property tax roles (Taylor, 1995:68-72).

The government takes the best-skilled people for government jobs, crowding out the private sector in the labour market. The basic question is, which is more powerful in a capital city, the synergy or crowding out? The answer is, to a great extend, dependent on various factors: the timing of the capital's establishment relative to the nation-state's formation and industrialization; the political structure of government; the institutional and spatial links between the public and private sectors; the pro- or anti-urban political culture; and commitment to politically construct the capital as the undisputed center of the nation (Drewe,1993:411–413).

One might judge the success of a capital city based on its economic size and wealth. However, if the primary function of a capital city is to government, then the primary criterion for a capital's success is how well it facilitates this role, and not how large the city itself becomes. For the nation

as a whole, the economy of the capital city is therefore primarily important to the extent that it assists or hinders the administrative functions (even if it in the process the local residents of the capital suffer.) Perhaps in the earlier period of nation-state building the size of the imperial capital was a good proxy of the size of the nation as a whole, since the royal seat was typically the centre of wealth, commerce, military power and education. This big capital-big nation link may also have applied to the early stages of industrialisation in developing nations, where a high concentration of people, wealth, industry and capital in the primate capital city has been seen as an unfortunate but necessary stage of spatial-industrial development, which will eventually evolve into a more equal, decentralized national industrial geography as adequate transportation and communication networks spread throughout the country or region (Campbell, 2000:38-60).

In most advanced industrial nations, there is no intrinsic link between the size of the capital city and the size of the national economy. There is still a curious pride involved in demonstrating wealth and economic strength in capital cities, and this pride fueled some of the resistance to keeping the capital of a world economic powerhouse. In France, the economic success of the country is no more tied to its maintenance of a dominant capital city in Paris than West Germany's success was tied to its selection of an intentionally modest capital city in Bonn.

This is not to say that the relative size of the capital city is random or that the nature of the capital city has no influence on the functioning of the national government. It also does not reject the possibility that a nation still needs a large, powerful city (but not necessarily a capital) to compete in the global markets: it is certainly not coincidental that the three leading global cities, London, New York and Tokyo, are located in three leading economic nations. It is to say, however, that nations with both dominant capital cities (France, United Kingdom, Japan) and modest capital cities (United States, Canada, Australia, West Germany) have been able to be economically successful in the postwar era (Campbell, 2000:38-64).

Campbell (2000, 38) believes that on balance, capital cities are more complex, heterogeneous and hopefully relevant than their general reputation in urban literature suggests. Capital cities are politically constructed places, and yet are subject to many of the same economic and fiscal pressures of all other cities. They are simultaneously a municipality representing local interests, a capital representing political power, and a host of international gatherings. They are home to both the symbolic "imagined community" of the bureaucratic apparatus of governmental offices. Capital cities also lie at the intersection of political and economic interests in the nation. Though all cities experience the interaction both cooperative and conflicting of government and private

interests, nowhere do these interests intersect with such power as in a capital: the government-market interactions are more complicated in a capital, and the national government has greater influence over the local economy, labor markets, and land markets. This creates a distinctive political economy of capitals.

3.4.1.2 Revenue base

The economic wealth of a community affects the financial condition of its local council. The financial condition is directly affected by how local councils tap revenues from the community's wealth and income. This section is therefore various methods that are employed by municipalities to tap revenues from their economic bases. These methods are for the purpose of this study termed "revenue base". This revenue base consists of legally defined basis for levying certain kinds of taxes and rates (Berne & Schramm, 1986:116).

A necessary initial step in determining the revenue base of municipalities is to identify the classification of the major methods used by local governments to raise revenues and the source of these payments. Knowledge of the methods used arms the analyst with a comparison tool with which to test and measure the efficiency and effectiveness of each revenue collection method. In this section, it is imperative to discuss revenue collection for "own revenues" and then examine revenues transferred from other spheres of governments to municipalities.

(i) Tax revenues

Virtually all governments have taxing powers or receive funding from others levels of government that have extensive taxing powers. Taxation methods consists of the application of a ***tax rate*** that is levied on some measurable ***tax base*** with the product of the two yielding tax revenues from that particular method and source. Tax bases for local governments include various forms of wealth, that is, property and estate taxes and other miscellaneous taxes (Berne & Schramm, 1986:118-119).

For local governments, property tax is a major source of revenues, especially when intergovernmental revenues are excluded. This tax as discussed in Chapter 2 is applied to the assessed value of non-exempted properties and land. Its rate may be fixed or vary with the kind of the property concerned or the location of the property in the city. The value of the tax is assessed on the capital value of the property, where the fraction of assessment should not or exceed 100 per cent. Properties of governments together with those of charitable, educational, religious and sometimes those of older or low-income residents are exempted from payment of the tax (Berne & Schramm, 1986:119).

Property tax revenues to a significant extent depend on the value of all taxable property within the governmental jurisdiction. Property values, in turn, depend on the type of property involved and the economic activity and condition of the jurisdiction. Housing and commercial values reflect the size and income of the population relative to the supply of housing and the number of commercial establishments; industrial property market values also depend on the strength of both local and outside markets and the resulting profitability of the industrial establishment. Thus, the size of the property tax base and the economic activity and viability of local governments are closely linked (Berne & Schramm, 1986:120 – 121).

(ii) Current charges and special assessments

Current charges or user charges as they are sometimes called, are an important source of revenues for local governments. In principle, current charges can be made for those services or commodities provided by a local government that are like private goods: where those receiving the service can be clearly defined and charged for the service without major benefit accruing to those who do not pay, the so-called "free-riders". Thus, those who use water in their homes, swim in the public pools can be identified and may be charged for the good or service received (Berne & Schramm, 1986:121).

Current charges are used in a variety of areas that lend themselves to this method of collection. Topping the list is electricity and water charges followed by sewerage and sanitation. On the other hand, special assessments or taxes to pay for specific projects like sidewalk constructions are compulsory, yet they may vary from one jurisdiction to the

other, but the most important thing about user charges is that they are always based on the amount of goods or services consumed or sometimes there may be a flat rate for users, regardless of their level of consumption. In the case of flat rates, user charges serves the role of a price for that service, thus a water fee based on a metered water usage charges more on those who use heavy water masses than those with light consumption. This may discourage excessive use of water.

Finally, organisations or individuals that are subject to user charges are always identified by the type of service or commodity they receive or by their geographical location and the main importance of user charges is to give the concerned local government authority a capacity to provide a service or good on a on-going basis at improved quality and delivery levels (Berne & Schramm, 1986: 122).

3.4.1.3 Revenue capacity

The average financing system is a method that is frequently used in estimating revenue capacity of localities. In this approach, a separate estimate is made for each of the revenue-raising devices employed by local governments and these estimates are based on the experiences of localities, for example, the estimated revenue capacity of property taxes is based on the market values of taxable properties; sales tax capacity on income levels; and so on. Revenue capacity for each instrument is estimated by multiplying the available base by an average tax rate (Gardner, 1973:299).

According to the above-mentioned system, the revenue capacity of a local government is a package concept, that is, the capabilities of many specific revenue instruments are added together to reveal the total capacity. In an absolute sense, revenue capacity is limited only by the total income and total wealth (including the borrowing power) located in the area or owned by the residents of the area and by the willingness of these people to permit this income and wealth to be taken by government. However, on a measurement sense, revenue capacity is a more fundamental concept that requires quantification after which an index effort can be established on how to exploit such a capacity (Gardner, 1973: 297 – 303).

Berne & Schramm (1986:134) define revenue capacity in the context of the political, legal and economic realities that constrain local governments to exploit their economic base. The authors define revenue capacity as the extent to which the economic base can be tapped by a local government within the above-mentioned constraints. The difference between the capacity and actual revenue then creates **reserves.**

When one looks at the definitions of Berne & Schramm (1986) and Gardner (1973), one finds that both definitions are correct and support each other, that is, revenue capacity is the extend to which local governments exploit their economic bases given some economic, political and social constraints (the what part of the definition), but it is determined by multiplying the estimated base by the approved tax rate (the how part of the definition). Therefore, these authors agree with what revenue capacity is and therefore, the main effort should be based on: what is the impact of this revenue capacity on the revenues of local governments. The following discussion focuses on such impacts (Gardner, 1973: 297 – 303 & Berne & Schramm, 1986:134).

Berne & Schramm, (1986:144 – 145) revenue capacity is an important factor in financial analysis for several reasons. Firstly, the relationship between revenue capacity and the economic base is the best indicator of the extent to which various municipalities have the ability to raise revenues. Secondly, the relationship between actual revenues collected to the revenue capacity creates revenue reserves which serves as an indicator of financial condition. This means that the extent to which actual revenues fall above or below the revenue capacity is an important measure of the financial pressures faced by such a municipality.

3.4.1.4 Revenue reserves

The primary reason for estimating revenue capacity, as discussed above, is to assess the extent to which local governments' actual revenues are over or above their revenue capacities. Revenue capacity is in a sense, a revenue benchmark that allows local governments and other organisations to be evaluated in their relative "using up" or "drawing down" of their revenue bases. If the revenue capacity is greater than actual revenues, then the difference represents the revenue reserves; and if the capacity is less

than actual revenues, then this shows an overextended exploitation of the revenue base by local governments (Berne & Schramm, 1986: 144).

It is mostly helpful to analyse revenue reserves by comparing them against the unmet expenditure requirements of local governments. This implies that a local government facing clientele groups with very real and apparent need for more services may find its large revenue reserves inadequate, but a similar local government with less demand for services may be financially secure with smaller reserves. In brief, it does not matter how much revenue reserves a particular municipality have, the main thing is how is such a reserve contributing to the financial condition of a municipality (Berne & Schramm, 1986: 145).

Each step in local government revenue analysis is very important because it gives municipalities to make realistic revenue budgets. It is against such a complete analysis that municipal officials are able to make correct and realistic decisions that will not endanger the financial condition of their municipalities. Revenue analysis is therefore a necessary beginning in any annual municipal financial planning and budgeting. The analysis of the financial condition of local governments cannot stop with the examination of the revenues. To add to the understanding of local government financial analysis, there is a need to study how these revenues are used. The following section is on expenditure analysis as a component of financial analysis.

3.4.2 Expenditure Analysis

The main aim of expenditure analysis is to determine the expenditure pressures of local governments for additional expenditures. Expenditure analysis disaggregates expenditure items and sees how each item contributes to the expenditure function of the municipality and how the item contributes to the delivery of services to the residents. It is therefore prudent to look at the basic nature of expenditure analysis.

3.4.2.1 The nature of expenditure analysis

Traditionally, the economic analysis of public expenditures focuses on the **efficiency** and **equity** of resource use: Have local government expenditures maximised public benefits for the costs of the resources used? Has the resulting distribution of benefits and costs been equitably based on the economic need (ability to pay). In financial analysis, there is more emphasis of the connection efficiency and equity to the financial health of municipalities, because inefficiencies and inequities, besides being undesirable for their own sake, may increase the expenditure pressures on localities and can adversely affect their financial condition (Berne & Schramm, 1986:165).

(a) Local government expenditures and the satisfaction of community needs

The pressure of how much local governments must spend their revenues depends mostly on how well municipal communities' needs are met. Firstly, local governments spend money on personnel, materials and supplies and so forth (as factors of production) to conduct their daily statutory and general obligations. Secondly, the conversion of the physical resources into goods and services also depends on how the local governments are making money available for the production function; for example, a local government institution can use money to buy heavy-duty lorries for refuse collection, but it has to spend more money again in carrying the actual duty or function of refuse removal. At the end of the above two types of expenditure, the public outputs emerging from the above process are aimed at meeting community needs for refuse collection. The expenditure pressures on local governments are therefore a result of what the community needs and the prices of the factors of production, to produce services and goods that may satisfy such community needs (Berne & Schramm, 1986:165).

(b) Municipal expenditures by character

One major classification of expenditure used in most countries and especially in the United States of America is based upon the character of municipal government expenditures. This classification shows how much financial and other resources are exhausted for current operations, capital outlays, and interest on outstanding debts. In other words, when assessing municipal expenditures by character, it is intended to identify the class of expenditure that predominantly eats up the revenues and to see whether such expenditure fulfils the unmet needs of the community. If more revenues are disbursed for capital outlays in order to deliver electricity reticulation, water reticulation, sewerage and halls, then it is money well-spend. The same hold if the municipality spend money on personnel which offers the community basic needs like health, security and daily administrative work. (Phillips, 1960: 439 – 440).

Phillips further argues that the ratios of operating expenditures, capital outlays and interest payment may be valuable to decision-makers (municipal councillors) to study capital outlays problems in their constituencies with greater care and to determine the extent to which such outlays are invested in self-liquidating projects and the economic returns to the community that benefit people more than expenditures can be justified. For example, capital expenditures like water reticulation projects can be self-liquidating, thus removing further expenditure pressures from municipalities and outlays for better streets and highways may shrink distances, eliminate bottlenecks and speed up the traffic flow in a community, thus providing substantial economic benefits for business and industry in that community. Other outlays, of course are for "luxury" projects, such as golf courses, swimming pools, parkways all of which may be desirable but some of which the community may ill afford.

(c) Municipal expenditures by purpose and function

Another classification of municipal government expenditures that Phillips cites is the one which explicitly indicates municipal expenditures by purpose and function. General purpose expenditures include outlays on metropolitan policing, fire, ambulance and emergency services, sanitation, public welfare (housing and health) and education; whereas

utility operations outlays may include expenditures on water supply, electricity supply, gas reticulation, metropolitan transit and other sewerage activities. The most important aspect of this classification is its ability to show the contribution of each item of expenditure to the total welfare of the community and its share of expenditure. If a certain item consumes more resources than it can contribute to the welfare of the people, then such an expenditure item should be revisited and be carefully diagnosed for its "terminal effect" on municipal finances (Phillips, 1960: 441).

Therefore, according to Phillips (1960:441) the most important aspect of expenditure analysis is the ability of the analyst to analyse the contribution of various expenditure items to the total expenditure of the municipality against the contribution of such items' contribution towards meeting the daily social welfare needs of the community. Expenditure analysis can also be assessed against the revenue capacity of municipalities to examine the impact of the revenue and expenditure ratios towards the financial health of a municipality.

3.5 Models for financial analysis of local governments

The discussion of local government financial analysis without any mention of methods or models for analysis will be an incomplete exercise in determining the financial condition of municipalities. The following discussion section therefore deals with such methods or models.

The analysis of finances in local government employs a series of models that had been designed to portray the financial condition of municipalities over some time. In the present study, the researcher will use the Financial Trend Monitoring System and other trend and ratio models to analyze the finances of local authorities.

3.5.1 The Financial Trend Monitoring System

According to Carr (1984:46-47) the Financial Trend Monitoring System **(FTMS)** was developed during the early sixties by the International County/City Management Association **(ICMA)** for uniform municipal reporting in the US local government. Presently, it is the most commonly used financial analysis model in the United States of America and had been extrapolated to other countries of the world. Basically the FTMS provides tolls that a city can use to: -

- ❖ Gain a better understanding of a local government's financial condition,
- ❖ Monitor changes in the financial condition so as to identify emergency problems before they reach serious and crisis proportions, and
- ❖ Obtain a clear picture of the city's financial strengths and weaknesses.
- ❖ Develop remedial action to deal with the financial problems and weaknesses of a municipality.
- ❖ Project future financial needs (Groves, Godsey &Shulman, 1981:6).

The FTMS identifies and organizes all factors that affect the financial condition of municipalities in such a way that they can be easily analyzed and, to an extent measured. It is a management tool that pulls together pertinent information from the municipalities' financial reports and statements, mixes it with appropriate economic and demographic data and creates a series of indicators that when plotted over a period of time can be used to monitor changes in the financial condition of local authorities (Carr, 1984:46-47 & Alachua County Report, 1998:1).

The system is built on three main factors, as depicted in Figure 3.3, namely environmental , organisational and financial factors.

The **environmental factors** affect the city in two ways. Firstly, they create a demand, for example, an increase in population may force the city to add more houses and other complementary services. The demand for such services then places an extra need on the local authority concerned to expend more financial resources. This has a direct effect on the financial condition of municipalities (Carr, 1984:48-49).

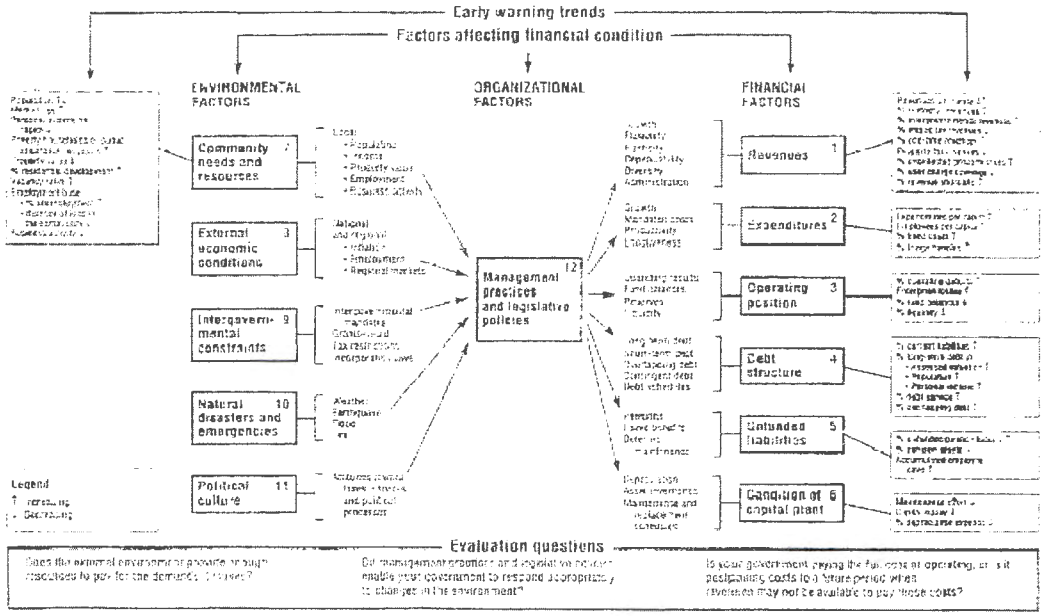
Secondly, an increase in population may also increase community wealth and tax revenues and in this instance will trigger the local authority concerned to either increase its service provision or improve the quality of their services. Underlying the analysis of the effects of environmental factors on municipal financial condition is the question: Do environmental factors provide enough resources to pay for the demands they make. The results of the analysis must always be able to answer this question (Carr, 1984:48-49)

The organisational factors are a city government's response to changes in the environmental factors. The FTMS hereby assumes that any government can remain in a healthy financial condition if it makes proper adjustments to adverse conditions by increasing efficiency, raising taxes or by taking some other appropriate action.

In this regard, the management practices and policies that respond to a change in the environmental factors may impact upon municipal financial condition, for example, if there is a tendency of non-payment for services by municipal residents due to external economic factors, the policies adopted and the management practices adopted should always safeguard the financial condition of such a municipality. Underlying the effects of organizational factors on the financial condition of municipalities is the question: Do the council policies and management practices provide opportunities for appropriate responses to changes in the financial condition of a city (Carr, 1984:48).

Figure 3.3 is a graphical representation of the Financial Trend Monitoring System.

Figure 3.3 The Financial Trend Monitoring System



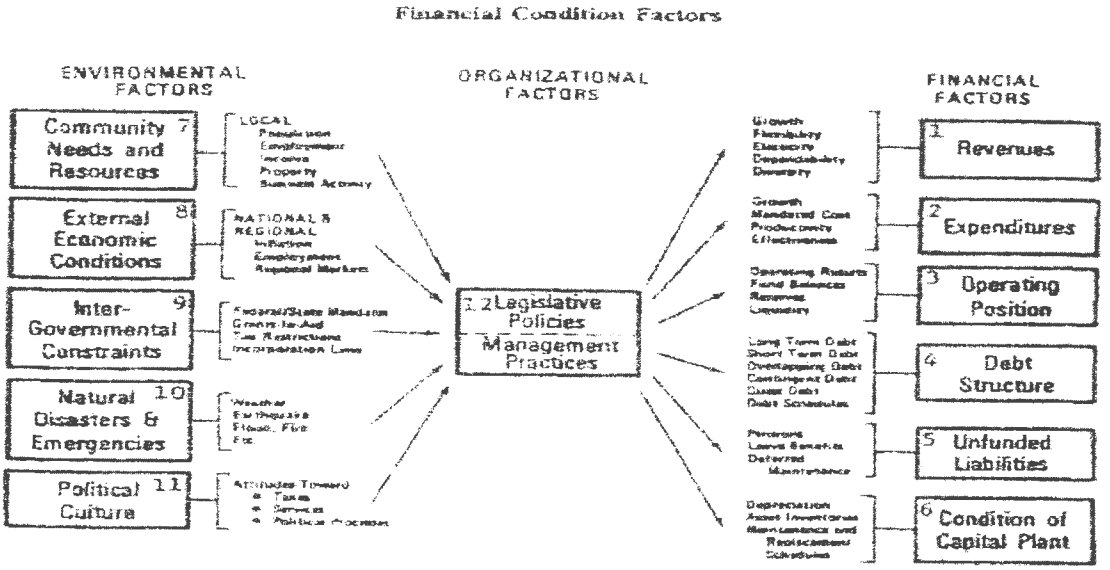
Source: Groves, Godsey & Shulman (1981:6) (refer to Annexure 8 for a clear FTMS representation)

Lastly, the financial factors reflect the condition of the city government's internal finances. In some respects, they are a result of the organizational and environmental factors, that is, if the environment makes a greater demand than revenues provided and if the organization is not effective in making balancing responses, then the financial factors would eventually show signs of cash and budgetary insolvency. In this regard, the underlying question is: Is the government paying full costs of operations without postponing costs when revenues might not be available to pay these costs (Carr, 1984:49).

The Financial Trend Monitoring System consists of 6 financial factors which are clearly reflected in Annexure 8 and Figure 3.4.

Figure 3.4: Financial condition factors

Source: Valente (1983: 8) & City of Clearwater Financial Report (2000:1).



3.5.1.1 Revenue indicators

According to the FTMS it is very important to study and analyze revenues because, without revenue, local authorities cannot provide services.

Analyzing revenues will help to identify the following problems: -

- ❖ Deterioration of the revenue base
- ❖ Poor estimation and forecasting techniques
- ❖ Poor collection procedures
- ❖ An unfair tax burden on one segment of the population, for example, property owners
- ❖ Over-dependence on external sources of funding, especially intergovernmental grants and transfers

In this regard the analysis of all net operating revenues, restricted revenues, intergovernmental revenues, tax revenues property tax revenues, uncollected property revenues, user charges revenues should be analyzed thoroughly and be compared with relative levels in previous years.

3.5.1.2 Expenditure Indicators

Expenditure indicators refer to the amount of money spent on capital projects relative to the needs of the community and the money spent on defraying interest on loans and operating costs. If a given municipality expends more money on operational costs, with the community having many unmet needs, then the financial condition of such a municipality is said to be deteriorating on unhealthy. If a municipality uses most of its expenditures on capital projects to finance the unmet needs of the community, in the long it can be said that such a municipality is in a healthy financial condition (given that all other factors are kept constant).

3.5.1.3 Operating position (liquidity)

Liquidity is a good measure of a local authority's short-term financial condition and its cash position. Cash position, which includes cash and short-term investments, determines a locality's ability to pay its short-term obligation. In this study and the FTMS, liquidity is measured by the ratio of current municipal assets to current municipal liabilities. The internationally accepted ratio in this regard should always be at least 2:1, so that municipalities will be able to use their current

assets to defray some of their current liabilities (City of Harrisonburg Financial Trend Report, 2000:40 & Project Viability, 2000:9).

3.5.1.4 Population

Rapid changes in population size of municipalities can have significant effects on their short-term and long-term financial health. For example, a rapid increase in the population of the city can cause the city to invest heavily in roads and schools or to hire additional employees. If the previous trend can reverse due to economic shocks, a given municipality may be left with too large an asset base for its population. Again, if the population is increasing because largely young families inhabit the area with children, the municipality can expect its expenditures to increase rapidly for the foreseeable future. Conversely, if the expansion is due to the influx of professionals, it is likely that revenues will increase at a higher rate than expenditures (City of Harrisonburg Financial Trend Report, 2000:59).

3.5.1.5 Business Activity

Growth in business activity is generally a sign of a healthy local economy. There are several measures of business activity, and in this study the researcher has chosen to look at the number and the growth rate of local retail business, manufacturing concerns (with a lot of fabrication activities) and service businesses. Growth in the above sectors of the economy is sure to boost the business activity of a municipality (City of Harrisonburg Final Trend Report, 2000: 69).

External economic conditions may include trends in inflation, employment, economic wealth and business activity. Most of these factors are really beyond the control of local government, which means that anticipation and preparation are the best means to adjust to changes in the external economic conditions. In the long run, this requires building a local economic base that is protected from sudden downturns in the business cycle and to build such a base, municipalities should invest in the development and maintenance of capital plant and provide a level of service that will encourage businesses to stay and expand. It must also have stable revenue producing commercial and industrial sectors whose markets will not diminish during national recessions. An adequate skilled labour force also need to be available together with the availability of adequate industrial infrastructure and transportation networks (City of Harrisonburg Financial Trend Report, 2000:72).

No exact indicators have been developed within the FTMS to help evaluate how well a municipality can adapt to changes in external conditions, but the following questions can serve as a guideline for such an evaluation:

- **What is the composition of the tax base? How sensitive is it to changes in the national economy?**

The answer to the above question in evaluating the financial condition has to show whether the economy is diversified or whether there is an over-concentration or specialization of such an area on a single industry like mining. In terms of diversification, the local economy is unlikely to fall prey to the external economic shocks because of its diversified source of revenues, but for a specializing economy, like a mining economy, if the demand of the mineral concerned goes down, the demand goes down with the local economy. In South Africa, the city of Stilfontein bears this testimony when the closure of the gold mining activities around the city also made the city 's economy to quickly spiral down.

3.5.1.6 Debt indicators

The factors developed under this indicator are intended to help any city in monitoring changes in debt structure. The overriding concern is to ensure that the city's outstanding debt does not exceed its ability to repay in worst-case scenarios. Municipal debt are both short and long term – current liabilities or short-term debts are the sums of all liabilities due at the end of the fiscal year and principal on long-term debt is due the following year or in future. This indicator is really concerned with identifying whether increasing levels of short-term borrowing are being used to finance deficit and/or mask liquidity problems. The warning trend identified by the FTMS is one of an increasing ratio of current liabilities to net operating revenues (City of Harrisonburg, 2000:43).

3.5.1.7 Intergovernmental transfers

Analyzing intergovernmental revenues as a percentage of total operating revenues is important because while intergovernmental revenues will always be a major component of total revenues, localities do not need to rely too heavily on external support. Over-reliance on intergovernmental revenues is very dangerous since they are an unreliable source of revenues due to their susceptibility to national budgetary constraints. In other words revenues from this source may

increase and decrease without any explanation from the higher tiers of government (City of Harrisonburg, 2000:8).

3.5.2 Testing the Financial Trend Monitoring System

According to Groves, Godsey & Shulman (1981:15) the FTMS was developed with the assistance of 50 city managers and finance directors across the United States of America. After the system was developed, draft handbooks and worksheets were developed for collecting data and calculating the indicators. The system was tested in 24 US cities of differing size, geographical location, economic strength, and rural-urban characteristics. The cities were selected in a manner to provide a cross section of the foregoing features. Each city was asked to develop trends for a ten-year period, to analyse the data and then provide the International City Management Association with the results.

3.5.2.1 Successes of the FTMS

The results of the tests were positive - the cities found the FTMS to be a useful management tool, especially for finance directors, for they stated that it gave them "hard numbers" to substantiate what they knew intuitively, but which they had difficulty in demonstrating. In addition, they felt that it provided a broad perspective of their cities's financial condition, which is readily explainable to individuals such as municipal council members who do not have a background in municipal finance and economics (Groves, Godsey & Shulman, 1981:15 - 16).

One test city, before using the system believed that it was in a good financial condition although not without problems. However, after analysing a number of factors through the FTMS, the city found that its problems were much more serious than previously believed - increasing operating deficits, decreasing fund balances, decreasing liquidity, a negative real dollar growth in property revenues. Besides being a tool for measuring the financial health of the municipality, other test cities used the FTMS to orientate council members on issues of financial management. Other used the results from the FTMS to convince financial institutions that they were creditworthy and could afford to issue bonds for financing long-term capital infrastructure and also to convince council members if there was a need to raise property taxes (Groves, Godsey & Shulman, 1981:16).

3.5.2.2 Liabilities of the FTMS

The FTMS is therefore a tested model that revealed itself to be of more use in terms of managing the finances of local government institutions, but still it was not without liabilities. According to Groves, Godsey & Shulman,(1981:16-17) its liabilities included:-

- **Technical problems**

  The most common technical problem is related to the availability of data, especially data going back for more than five years. Although most cities that tested the model adhered to Generally Accepted Accounting Standards (GAAP) and independent audits, many found that such data did not exist in a form that was needed, and that they had to do a considerable amount of disaggregation of data. Again, many of the smaller communities discovered that economic and demographic data were difficult to locate. The recommendation to prevent this technical glitch was that all data collected for the municipalities should be stored in a manner that would be user-friendly when doing financial analysis through the FTMS.

3.6 Time Series Analysis Technique

The time series technique of financial analysis originates from private sector financial analysis, but it is presently used by both the private and public sector. In the private sector time series analysis techniques are applied when a financial analyst have to choose investment options –Financial analysts often evaluate the financial performance of various market indices by looking at the trends of such indices over some time in order to make informed investment decision-making. It employs the comparison of current to past performances using ratio analysis and this allowed financial brokers to determine whether the index has a history of non-performance of profitability. Developing trends therefore helps municipalities in planning for their future operations. Time series, therefore, employ the following year-to-year techniques to evaluate the financial position or condition of municipalities (Berne & Schramm, 1986:86-90 and Gitman, 1997:118).

The most commonly used time series analysis techniques in Public Financial Management are:

3.6.1 Percentage change method

The percentage change technique measures the percentage change in growth in the general or individual finances of local governments between two financial periods. It only reflects the growth rate of finances without mentioning any concomitant impact of such changes. The example of how the percentage method functions, is best illustrated in the following calculation derived from the figures of 1998/1999 appropriations of funds to different expenditure items of Madison Borough Government as reflected in Annexure 1: -

The percentage change for salaries and wages appropriation is –

Percentage Change = ($6,527,581 - $6,338,420)/$6,338,420

= 3%

In other words, the allocation of finances has grown by 3% between 1998 and 1999. In analysing the financial condition of municipalities, this percentage increase can be mixed with pertinent economic and demographic data to examine the causes and impact of this growth on the general financial health of the municipality. This method is usually used for short-term financial analysis of municipalities, for example, between two financial periods.

3.6.2 The Index method

This is the analysis tool, which is commonly used in the world stock exchanges to examine the performance of different indices within various sectors of the stock exchanges. The method takes the base (starting period) of the analysis as 100 and any percentage decrease in the growth of the financial variable is added to 100 . The main aim of this method is to examine the performance of any financial variable from a certain period over some longer period, for example 10 to 20 years. The index method when used with the above example implies that the index number of the allocation to the salaries and wages budget vote was 100 added to 3, which is 103. The trends in the growth away from 100 as a base and towards 100 are easily recognised and can be presented on graphs to depict a clear performance of a financial variable.

3.6.3 Common size method

The common size method is used to examine the importance of each revenue sources towards the municipalities or the expenditure item that "eats" most of the municipalities' revenues over a single financial period. Calculations of the common size percentage of salaries and wages towards total expenditures of Madison Borough are as follows:-

Common size = $6,527,581/$21,890,317

= 29.8 %

This figure implies that salaries and wages constituted 29.8% of the total allocation of funds to the Madison Borough Municipality in 1999. This percentage can then be compared to other expenditure items upon which decisions can be made in the following financial periods.

3.7 Summary

This chapter presented the literature on the financial analysis of local governments. The FTMS as a model for financial analysis with its successes and liabilities was extensively discussed

CHAPTER FOUR
RESEARCH DESIGN AND METHODOLOGY

4.1 Introduction

This chapter presents the research design and methodology, which were used to carry out the study. It starts by presenting the research design; progresses with data collection methods used and ends up with data analysis techniques. The rationale of this chapter is, therefore, to outline the research design, administration procedures and different methods used in collecting and analysing data

4.2 Research design and case study as a research methodology

Research design provides the glue that holds the research project together. A design is used to structure the research, to show how all of the major parts of the research project - the samples or groups, measures, treatments or programmes, and methods of assignment - work together to try to address the central research questions (Trochim, 1999:3-4).

This study on the financial analysis of the Mafikeng Local Municipality is essentially a case study. The researcher wanted to examine the financial trends and patterns of the municipality from 1998 to 2001. Babbie in Berg (1998: 214) defines a case study as a representation of a comprehensive description and explanation of many components of a social situation, event, organization, community or nation. The author states that case studies use a triangulation of varied techniques to assemble a range of data about a single case, that is, on individuals, groups or organizations.

Similarly, Sjoberg et al (1991:29-79) view a case study as an ideal methodology when an in-depth investigation is needed. According to Yin (1984:23) case study research excels in bringing people to an understanding of complex issues or objects and can extend experience or add strength to what is already known through previous research. Case studies emphasize detailed contextual analysis of a limited number of events or conditions and their relationships. Yin (1984:23) further defined case study research as an empirical enquiry that investigates a contemporary phenomenon within its real-life context. For this reason, case study research is very appropriate and relevant for this study on the financial analysis of the Mafikeng Local Municipality, because

the researcher was investigating a contemporary phenomenon within its real-life context, and sought to do an in-depth study on the municipality's finances.

Sjoberg et al (1991:34) also define a case study as a triangulated research strategy, meaning that it involves different kinds of methodologies in data collection. Stake (1995:78) defines triangulation as a series of protocols that are used to ensure accuracy and alternative explanations, and that it arises from the ethical need to confirm the validity of the processes taken. In case studies, this achieved by using multiple sources of data. Seaman (1987:171) cites that data collected for case studies relate not only to the subject's present state but also to its past experiences, situational and environmental factors that are relevant to the problem being examined.

Hamel et al's (1993:56) assertions supplements the above discussion on triangulation by stating that case study methods essentially involve systematically gathering enough information from various sources about a particular person, social setting, event or group to permit the researcher to effectively understand how it operates or functions. Case study research is not necessarily a data-gathering technique on itself, but a methodological approach that incorporates a number of data-gathering measures, which will be discussed as this chapter progresses.

According to Yin (1984:27) and Hagan (1993:30) the approach of case studies varies significantly from other general field studies, for case studies can incorporate and employ a number of data technologies such as life histories, documents, oral histories, in-depth interviews and participative observation. Yin (1984:107) further cites that in reality, the main problem of case studies is to establish meaning rather than location, and in a way triangulation increases the reliability of the data and the processes of gathering it. In this context triangulation also serves to corroborate data that is gathered from other sources. In other words, case studies attach meaning to various data collected.

Similarly, Taylor (1967:38) views case studies as complex because they use various modalities for data collection and that they may produce large amounts of data for analysis.

Researchers from many various disciplines use case study method to build upon their theories, to produce new theories, to dispute or challenge theories, to explain a situation, to provide a basis to apply solutions to situations, to explore or to describe an object or phenomenon.

4.2.1 Demarcating case studies

The other important aspect of case studies is the need to define and demarcate the case very carefully, meaning that boundaries for investigation have to be determined. In this case, case study research comes in two ways; firstly as a **community case study** (Huysamen, 1994:169).

Berg (1998:219 – 220) refers to a community as a geographically delineated unit within a larger society. Such a community is small enough to permit considerable cultural homogeneity and diffuse interactions and relationships between members. Case studies on communities can be defined as the systematic gathering of enough information on a particular community to provide the investigator with understanding and awareness of what things go on in that community; why and how these things occur as well as who among the community members frequent such behaviours and activities.

Secondly, there are **organisational case studies**. Organisational case studies are defined as the systematic gathering of enough information about a particular organization to allow the investigator to gain insight into the life of that organisation. This type of case studies might be fairly general in its scope, offering approximately equal weight to every aspect of the organisation, for example, the human resources, structure, finances, functioning and controlling, or they might be specific by placing a particular emphasis on a specific area or situation occurring in the organisation. The versatility of organisational case study research therefore, presents the opportunity for a researcher to either widen or narrow his or her focus of research. The present study, on the examination of the finances of the Mafikeng Local Municipality, lends itself more to be a restricted organisational case study.

4.2.2 Functions, merits and demerits of case studies

As a research methodology, case studies play a particular part in the whole exercise of research and the following are some of the functions that they can fulfill.

4.2.2.1 Functions of case studies in research

Firstly, case studies are a useful tool to explore the phenomena that have not been rigorously researched and the information obtained can be extremely useful in the production of hypotheses

and that such hypotheses can be tested more rigorously in subsequent research (Polit et al, 1991:208).

Secondly, Polit et al (1991:208) argues that case studies sometimes can be used in conjunction with large-scale researches to serve in an illustrative capacity. Research reports that are filled with extensive statistical information often fail to convey some of the richness of the real-life subject matter, so it may be perfectly reasonable to predict future behaviour of the research subject of the case study based on the events or relationships experienced by the subject in the past .

4.2.2.2 Limitations, mitigating factors and counter-arguments on the use of case study as a research methodology

Unquestionably, the greatest advantage of case studies is the depth that is possible when a limited number of institutions or groups is being investigated. Case studies provide the researcher with the opportunity to have an intimate knowledge of the subject's condition, feeling, action (past and present), intentions and environment. On the other hand, the same strength is a potential weakness because the familiarity of the researcher with the subject may make **objectivity** very difficult. This is true in instances where the researcher may infer what she or he knows about the organisation or object as the prevailing situation or whereby data are collected by observational techniques, for which the researcher is the main and only observer (Berg, 1998:217 & Polit et al, 1991:210).

Perhaps, the most serious demerit of the case study method is its lack of **generalisability**. When research is undertaken, the main aim is not only to explore a single entity but also to seek solutions for other situations and entities. In most case studies, it is generally difficult to argue that the same relationships found in the present study would manifest themselves in other subjects of the same nature (Baldridge, 1989:32). According to this author, researchers always hope to find results that can be applied to many situations not just to the one they are studying. Therefore, there is a challenge that case studies should be well undertaken so that they cannot only fit the specific individual, group or event studied, but generally provide understanding about similar individuals, groups or events (Bogdan & Biklen, 1992:66).

The counter-argument is that generalisation of case study findings is a legitimate outcome, based on an understanding of the nature of that generalisation. It is Yin's view that generalising from case studies is not a matter of statistical generalization (generalizing from a sample to a universe)

but a matter of analytic generalisation (using single or multiple cases to illustrate, represent, or generalise to a theory). Therefore, case studies involve only analytic generalizations (Yin, 1998: 39 - 41).

Similarly, Stake (1978) describes the generalisability of case studies as "naturalistic," that is, context-specific and in harmony with a reader's experience and thus "a natural basis for generalization." This means that case study findings often resonate experientially or phenomenologically with a broad cross section of readers and thus facilitate greater understanding of the phenomenon in question (Snow and Anderson, 1991: 87). It is therefore, considered legitimate to generalise based on the degree to which a case is representative of some larger population. It is not merely a question of how many units but rather what kind of unit is under study; it is the nature of the phenomenon that is the true gauge of the population to which one seeks to generalize. (Feagin, et al, 1991: 63).

Related to the generalisability issue is the concern that case studies can oversimplify or exaggerate a situation, leading the reader to distorted or erroneous conclusions about the actual state of affairs, as distinct from the report itself (Guba and Lincoln, 1981: 32). Skillful data collection, analysis, and reporting can reduce the possibility of this outcome, although it is characteristic of the case study that interpretation goes beyond the mind of the researcher to that of the reader. Researchers should not attempt to use case studies to address enumerative questions that qualitative data are poorly equipped to answer, such as how often, how many, or how do most people respond. Qualitative researchers must be careful not to use quantitative descriptions in their non-random samples, to include the use of percentages to describe the sample's behaviors, because this lends a false impression of generalisability to the larger population (Williams, 1991:3-8).

The other merit of case study approach is that case studies provide an opportunity to look at the issues in depth. This is particularly important where the subject matter is complex. Case studies are also flexible because they are able to investigate many cases or single cases. The case study approach is particularly useful in that it allows a greater diversity of research methods.

Lastly, case studies as single cases allow for in-depth investigation of one organisation event or setting. The present study is a single case study and it afforded the researcher numerous opportunities to investigate the finances of the Mafikeng Local Municipality in depth.

4.3 Data collection methods

For every research initiative, the data collection stage forms a very delicate process or stage of the whole process. The following are data collection methods used in this study.

4.3.1 Documentary methods

Documents have always been used as a source of information in social and business research, either as the only method or in conjunction with other methods. They are employed in the context of many diverse studies, such as quantitative studies, qualitative studies and case-study research. It is most unusual that any research study can be carried out without employing some form of documentary methods, for example library search (Sarantakos, 1997:274).

In document study, researchers **primarily** use documents for data collection. Kiecolt & Nathan (1985:10) define documents as written materials that contain information. Documents are rarely developed with research in mind, yet they are potential rich sources of social, economic and political data. Most document studies are often qualitative but they may employ quantitative content analysis techniques. The main aim of document analysis is to transform non-quantitative data into quantitative data, thus quantifying the content of narrative communication in a systematic and objective fashion where the data can be presented in graphical form or in tables. In this context, documents are usually referred to as **secondary material** and their analysis is therefore called **secondary analysis** (Patron & Sawicki 1993:111 & Sarantakos, 1997:274).

Sources of data for document study are diverse and may include public archives, actuarial records and official documentary reports.

4.3.1.1 Public archives

As Denzin (1978:219) remarks, archival records can be divided into public and private records. Public archival records are predominantly prepared to be accessible to the general public unless they contain classified information, for example, law enforcement records and credit histories. The term public archive brings to mind some form of library. Although libraries are indeed archives, so too are graveyard tombstones, hospital admittance records, computer-accessed bulletin boards, motor vehicle registers, newspaper morgues, arrest records and even credit

companies' billing records. Any "running" record is therefore an archive (Webb et al, 1981 in Berg, 1998:179).

In addition to providing large quantities of inexpensive data, archival material is virtually non-reactive to the presence of investigators. Many researchers find archival data attractive because public archives utilise more or less standard formats and filing systems, which makes locating pieces of data and creating research-filing systems for analysis earlier. For this study, evidentiary data was sourced from the archives of the Mafikeng Local Municipality.

4.3.1.2 Official Documentary reports

Schools, social agencies, hospitals, retail establishments and other organisations have a habit of creating an abundance of written records, files and communications (Bogdan & Biklen, 1992:182). Many researchers regard the "mountain" of paper or electronic records as something other than official records. In essence, such records which may include official court transcripts, police reports, census information, financial reports, political speech transcripts, are very valuable official documents that can help in most case study researches and in other research types. These records may even include less obvious and sometimes less openly available forms of communication like inter-office memoranda, printed e-mail messages, minutes of meetings and organisational newsletters. These materials convey important and useful information that a researcher can effectively use as data (Berg, 1998:182).

4.3.1.3 Advantages and limitations of documentary methods

Documentary methods demonstrate a number of strengths and weaknesses. They are therefore used only if and when the strengths outweigh the weaknesses. A brief summary of advantages and limitations of documentary methods is provided below:

<u>Advantages</u>

- **Retrospectivity** - Documentary methods enable researchers to study past events and issues.

- **Quick and easy access** – This applies at least to many documents, more so since the introduction of electronic media and the spread of personal computers. The availability of data banks and sophisticated computer programs have made this method an invaluable

tool of research for many researchers. The availability of documents through the Internet strengthens this point.

- **Spontaneity** – in most cases, the writers produce documents without being requested to do so by researchers. This reduces researcher bias significantly.

- **Low cost** – Documentary research is more economical than most other types of research.

Limitations

Despite the advantages, documentary methods demonstrate some limitations of which the researcher must be aware. The most common limitations are: -

- Some documents are not complete or up to date and thus an incomplete analysis of a phenomenon may be construed as an existing phenomenon.

- Some documents may have some methodological problems, for example, coding and presentation methods.

- Sometimes, documents are biased, presenting only the views of their authors.

For the present study on the Mafikeng Local Municipality, the advantages of using secondary materials outweighed the limitations, and therefore documentary methods were predominantly used. Archive materials and official documents were used to gather data for the study. Documents that were of importance and interest for the researcher were the latest demographic reports (to assess the trend and changes in the demographics of the Mafikeng area), financial documents, especially audited financial statement for the research period 1998 to 2001. In this regard, it is very clear that this study used document for data collection and therefore can be categorised as a document study.

4.3.2 Content analysis

As a method of research, content analysis is a documentary method that aims at a qualitative and/or quantitative analysis of the content of texts, pictures, films and other forms of verbal, visual or written communication. As a qualitative technique, content analysis may be directed

towards more subjective information, such as motives, attitudes and values. As a quantitative method, it may be employed when determining the time, frequency or duration of an event (Eckhart & Ermann in Sarantakos, 1997:280).

Categorical analysis is a form of quantitative analysis in content analysis whereby the analysis involves the study of documents by means of set categories, producing nominal as well as ordinal and interval data, which are then processed statistically. This method is discussed more under content analysis under data analysis in 4.4.1.

4.3.3 Interviews

According to Merton (1990:67), one of the most important sources of case study information is the interview. Such a conclusion may be surprising, because of the usual association between interviews and the survey method. However, interviews are also essential sources of case study information. The interviews may take several forms. Most commonly, case study interviews are of an **open-ended nature**, in which a researcher asks key respondents for the facts of a matter as well as for the respondents' opinions about events. In some situations, one may even ask the respondent to propose his or her own insights into certain occurrences and may use such propositions as the basis for further inquiry.

A second type of interview is a *focused* interview in which a respondent is interviewed for a short period of time -an hour, for example. In such cases, the interviews may still remain open-ended and assume a conversational manner, but one is more likely to be following a certain set of questions derived from the case study protocol, for example, a major purpose of such an interview might be simply to corroborate certain facts that one already think have been established (but not to ask about other topics of a broader, open-ended nature). In this situation, the specific questions must be carefully worded, so that one appears genuinely naive about the topic and allow the respondent to provide a fresh commentary about it. On contrast, if the researcher asks leading questions, the corroboratory purpose of the interview will not have been served.

Even so, the researcher needs to exercise caution when interviewees appear to be echoing the same thoughts- corroborating each other but in a conspiratorial way. Further probing is needed. One way is similar to that used by good journalists, who will typically establish the sequence of events by deliberately checking with persons known to hold different perspectives. If one of the

interviewees fails to comment, even though the others tend to corroborate one another's versions of what took place, the good journalist will even indicate this result by citing the fact that a participant was asked but declined to comment (Merton, 1990; 74).

A third type of interview entails more structured questions, along the lines of a formal *survey*. Such a survey could be designed as part of a case study. This situation would be relevant, for instance, if the researcher is doing a case study of a neighbourhood and surveyed the residents or shopkeepers as part of the case study. This type of survey would involve both the sampling procedures and the instruments used in regular surveys, and it would subsequently be analysed in a similar manner. The difference would be the survey's role in relation to other sources of evidence; for example, the residents' perceptions of neighbourhood decline or improvement would not necessarily be taken as a measure of actual decline or improvement but would be considered only one component of the overall assessment of the neighbourhood (Merton, 1990; 74).

Overall, interviews are an essential source of case study evidence because most case studies are about human affairs. These human affairs should be reported and interpreted through the eyes of specific interviewees, and well-informed respondents can provide important insights into a situation. They also can provide shortcuts to the prior history of the situation, helping you to identify other relevant sources of evidence. However, the interviews should always be considered *verbal reports* only. As such, they are subject to the common problems of bias, poor recall, and poor or inaccurate articulation. Again, a reasonable approach is to corroborate interview data with information from other sources (Merton , 1990; 74).

For the present study, the researcher did not plan to carry out an interview, but a visit to collect documentary data from Mafikeng Local Municipality's Deputy-Treasurer ended up in an open-ended type of interview. During the interview, the researcher probed, from the Deputy-Treasurer's perspective, the state of the economic base of the Mafikeng Local Municipality and its impact on the municipality's revenues and expenditures. The results of the interview are reported in Chapter 5.

4.3.4 Administration procedures and category for data collection

The validity of content analysis as a form of documentary method and as adopted in this study can be better enhanced by a precise explanation of procedures followed and the categories developed.

To collect data on the finances of the Mafikeng Local Municipality, the researcher wrote a letter of permission to access the municipal financial records from 1998 to 2001. The Deputy Municipal Treasurer allowed the researcher access to the Balance Sheets, Consolidated Cash flow Statements and Income and Expenditure Statements of the municipality for the period mentioned above. The letter is exhibited in Annexure 2 and the financial statements are exhibited in Annexure 3 (1-15).

In collecting data on the economy of the Mafikeng area, various documents were used. These included the Mafikeng Local Municipality's Integrated Development Plan, which was availed through the University of North-West Library's Short Loan Section. Other statistics, especially demographical data about the Mafikeng Local Municipality, were collected from the Municipal Demarcation Board's website at http://www.demarcation.org.za.

Population statistics for the Mafikeng area were used to analyse the population size, income levels, education, employment/unemployment and other population dynamics in the area. The main aim of this analysis was to find out the impact of the existing demographics on the municipality's economic base.

4.3.4.1 Construction of data categories

The collection of data through documentary methods, especially through content analysis becomes possible through the construction of categories associated with the study. A category is a set of criteria, which are integrated around the theme of the research. Categories are selected to make classification of data variables and must be accurate, one-dimensional, exhaustive and mutually exclusive.

In this present study on financial analysis of local government institutions, only one category has been determined: **financial indicators**. This category is further subdivided into other financial

variables for the purpose of data analysis. Three subcategories of financial indicators, which are employed are:

- Revenue indicators
- Expenditure indicators
- Financial condition

4.4 Data analysis

The present study predominantly used secondary data analysis and specifically content analysis in analyzing the Integrated Development Plan of the Mafikeng Local Municipality, 2000.

4.4.1 Content analysis

In content analysis, researchers examine artefacts of social communication as mentioned above in secondary analysis. Typically, these are written documents or transcriptions of recorded verbal communications. Broadly defined, content analysis " is any technique for making inferences by systematically and objectively identifying special characteristics of messages" (Holsti, 1968: 608).

One of the current leading debates among users of content analysis is whether to use qualitative or quantitative methods. Berelson (1952) in Berg (1998:224) suggests that content analysis is "objective, systematic and quantitative." Similarly, Silverman (1993:59) dismisses content analysis from his discussion of qualitative data analysis "because it is a quantitative method". However, Sellsiz et al (1959:336) state that concerns over quantification in content analysis tend to over-emphasize "the procedure of analysis" rather than " the character of the available data". Sellsiz et al continue by stating that heavy quantification of content analysis results in a somewhat arbitrary limitation in the field by excluding all accounts of communication not in the form of numbers and those that may lose meaning if reduced to numeric form.

Other proponents of content analysis, notably Smith (1975:218) suggests that researchers should blend qualitative analysis and quantitative analysis, because the former deals with the forms of antecedent-consequent patterns of form, while quantitative analysis deals with duration and frequency of form. Abrahamson (1983; 286) also argues, " content analysis can be fruitfully employed to examine virtually any type of communication and as a consequence, content analysis may focus either on quantitative or qualitative aspects of communication methods".

In the present study, the researcher followed the paths of Smith and Abrahamson by employing content analysis for both qualitative and quantitative analysis of data, that is, analyzing narrative and numerical communication by employing content analysis techniques. This emphasises that case studies in most cases need triangulated research efforts.

4.4.1.1 Category development in content analysis

As mentioned above, data analysis in content analysis requires of researchers to construct a set of mutually and exhaustive categories in selecting the type of data to be collected. Category development is therefore a very important administration procedure in any research employing content analysis. There are typically three approaches to category development: inductive approach, deductive approach and the combination of both (Abrahamson, 1983:286). In the inductive approach, the researchers begin with "immersing" themselves in the documents in order to identify the dimensions that are meaningful to their problem.

In a deductive approach, researchers use some categorical scheme suggested by a theoretical perspective and the documents to provide a means of providing data for the problem (Abrahamson, 1983:286). In brief, when performing content analysis, there should be a development of a category system for classifying units of analysis, and after devising such a system; there should be the identification of units of analysis and a system of enumeration (Johnson & Joslyn, 1991: 221 – 223).

In the present study, the researcher used a deductionist approach to content analysis whereby data that were collected were categorized according the theoretical perspectives of the Financial Trend Monitoring System (FTMS) as postulated by the International City/County Management Association (ICMA).

4.5 Secondary data analysis

Content analyses often employ secondary data for data analysis. Analysis of secondary data, therefore, involves the utilization of existing data (either qualitative or quantitative), collected for the purposes of prior study or a different course, to pursue a research interest which is distinct from that of the original data (Hinds et al, 1997:38 – 39).

Secondary research forms the basis of any evidence-based profession, be it health care, information management, or any other. By reanalyzing previously collected data from original (primary) studies, it is possible to summarize large volumes of information in a succinct manner. This not only increases the precision of the overall result, but also assists in the decision-making process. By conducting secondary research, it is possible to establish generalisability of findings, as well as examine conflicting results. It also provides an opportunity to identify gaps in the current knowledge base, and hence suggest future primary research areas.

Traditionally, social scientists have been encouraged to collect and analyse their own data, regardless of the method used. Unfortunately, independent researchers are presently finding it difficult to collect their own data, so they mostly analyse data that was collected by other people for other reasons rather than research. Constraints of the current economic climate and the least financial support awarded to research initiatives have then made researchers to rely on precollected data (Kiecolt & Nathan, 1985:9).

Similarly, Glaser (1962:74-75) argues that more attention to secondary analysis by independent researchers is because of their motivation to satisfy their intellectual curiosity and a wish to contribute to the accumulation of scientific knowledge. Faced with dearth of capital to carry out their researches, that is, limited financial resources, time and manpower, they opt for precollected data, which is obtainable form various sources, like archives.

As is the case with all research methodologies, secondary data analysis has its own advantages and limitatons. Its advantages as mentioned above are time efficiency and resource savings, because it is cheaper to reanalyse existing data than to collect and analyse new data. The most frequently encountered limitations of secondary data analysis are the location of data to be analysed. In spite of many thousand studies in data archives, it is sometimes difficult to find archives with relevant variables for present studies, but with careful analysis of archives and perseverance, this element of liability can be easily overcome (Chadwick et al, 1984:265).

For this study, the researcher used the quantitative methods to analyse data on the finances of the Mafikeng Local Municipality. The percentage change method, the index method and the common size method were used to analyse the finances of the municipality ranging from 1998 to 2001. The usage of these ratio methods was done within the framework of the **Financial Trend Monitoring System** as developed by the **International County/City Management**

Association as discussed in Chapter 3. The data analysed was gleaned from the financial statements of the municipality spanning from 1998 to 2001. In this case, the data analysis took a form of a trend analysis study. The trend series was then plotted on the pie and bar charts to explicitly reflect the trend of the finances of the Mafikeng Local Municipality.

In conclusion, this study is of a case study nature and therefore integrates various methods of data collection (triangulation) and also employs both the quantitative and qualitative methods to analyse secondary data that were collected from various documentary archives of the Mafikeng Local Municipality.

4.6 Summary

This chapter presented the methodologies used in collecting and analysing data. As mentioned in the discussion this case study research used various methods, both quantitative and qualitative, to collect and analyze data for the study. following chapter is on the presentation of data collected during the study

CHAPTER FIVE

DATA PRESENTATION ON THE FINANCES OF MAFIKENG LOCAL MUNICIPALITY

5.1 Introduction

This chapter presents the finances of the Mafikeng Local Municipality from 1998 to 2001 as reflected on the official documents (financial statements) collected from the archives of the municipality. It starts by presenting the background of Mafikeng Local Municipality and continues by presenting its finances.

5.2 Background of the Mafikeng Local Municipality

The Mafikeng Local Municipality is a category B South African municipality situated in the north-western part of the country. It hosts the capital of the North-West Province and consists of two major towns: Mafikeng and Mmabatho. Mafikeng is a historical South African town, whereas Mmabatho was the capital of the former Bophuthatswana homeland government. The municipality hosts two Central Business Districts (CBDs), an ultra-modern university campus, provincial headquarters of most ministries of the North-West Provincial Government (NWPG) and the provincial legislature complex. The municipality falls within the boundaries of the Central District Council (Category C municipality) in the North-West Province.

The infrastructure inventory of the municipality includes, **inter alia**, a multi-purpose sports stadium, a world-class airport, and a relatively new and advanced drainage and sewerage systems. The Mmabatho part of the municipality is a newer town as compared to the Mafikeng town, which exhibits old colonial tradition, especially on its buildings and infrastructure.

The municipality has a new stock of housing units in Mmabatho and a relatively older stock in Mafikeng except the Riviera Park Suburb. As such, the Mafikeng Local Municipality manages its finances and uses the existing infrastructure to deliver economic and social services to its residents for quality standard of living. The section below therefore presents the finances of the Mafikeng Local Municipality from 1998 to 2001.

5.3 The finances of the Mafikeng Local Municipality

The nature of the finances of Mafikeng Local Municipality reflects the constitutional mandate of the local sphere of government to provide quality services to municipal citizens. The municipality is also a form of a business entity with commitments to its suppliers, personnel and financial institutions (clients) and a receiver of revenues from its residents (clients).

The finances of the Mafikeng Local Municipality are, therefore, composed of the following components (as reflected on the financial documents collected from the municipality's Treasury Department): -

- Revenues
- Expenditures
- Creditors (Accounts Payable)
- Debtors (Accounts Receivable)
- Fund Balances
- Revenues reserves
- Municipal Investments.
- Bank overdrafts

5.3.1 Revenues

The Mafikeng Local Municipality derives its revenues from a variety of sources. In the Income and Expenditure statements, revenues are subdivided into two main categories, namely, **Intergovernmental transfers** and **Operating revenues**. Intergovernmental transfers are further divided into provincial and central grants. The main purpose of the intergovernmental transfers is to augment the locally-collected revenues. Operating revenues are on the other hand realized through the sale of water, property assessment and charges from various municipal services (Refer to Annexure 3 (1-11).

Table 5.1 Revenues of the Mafikeng Local Municipality, 1998 to 2001

Revenue Item	1998	1999	2000	2001
		GOVERNMENT TRANSFERS		
Provincial	R7, 006,827	R7, 448,154	R2, 547,810	R6, 281,014
Central	0	R2, 680, 118	R1, 659, 560	R2, 004, 361
		OPERATING REVENUES		
Sale of water	R20, 926, 841	R28, 452, 576	R24, 794, 861	R28, 078, 423
Property rates	R35, 144, 596	R33, 316, 497	R37, 802, 461	R38, 325, 771
Other charges	R19, 249, 911	R18, 545, 382	R25, 214, 804	R28, 086, 182
TOTAL	**R82, 328, 174**	**R90, 442, 727**	**R92, 019 496**	**R102, 775, 751**

Source: Mafikeng Local Municipality, Financial Statements: 1998 to 2001

5.3.2 Expenditures

The Mafikeng Local Municipality incurs expenses in the payment of municipal salaries, wages and allowances; purchase of bulk water; repair and maintenance, capital charges and contributions to the reserve fund and accumulation of fixed assets (Refer to Annexure 3(1-19).

Table 5.2 shows the expenditures of the Mafikeng Local Municipality between 1998 and 2001.

Table 5.2: Expenditures of the Mafikeng Local Municipality (Refer to annexure 3(9-19)

Expenditure Item	Sub-Items	1998	1999	2000	2001
Repairs		R7, 041, 615	R7, 575, 906	R6, 245, 930	R6, 937, 411
Salaries		R40, 515, 943	R43, 563, 088	R46, 535, 180	R49, 514,593
General Expenses	Other expenses	R35, 070, 384	R35, 147, 975	R35, 535, 407	R39, 119, 898
	Water purchases	R11, 153, 688	R15, 276, 046	R14, 990, 424	R18, 863, 293
Contributions to Fixed Assets		R184, 057	R46, 504	R5, 426	R64, 061
Contribution to the reserve fund		R3, 187, 956	R2, 846, 680	R1, 763, 715	R2, 254, 820
Capital charges		R12, 780, 195	R12, 292, 688	R12, 005, 793	R12, 412, 165
TOTAL		**R109, 933, 838**	**R116, 748, 887**	**R117, 081, 875**	**R129, 166, 241**

Source: Mafikeng Local Municipality, Financial Statements: 1998 to 2001

5.3.3 Operational surplus and/or deficits

Operational surplus is positive balance on the Mafikeng Local Municipality's financial books at the end of each year whereas the deficits reflect expenditure levels that surpassed the amount of revenues collected. Table 5.3 shows that the Mafikeng Local Municipality experienced operational deficits through the research period, that is, from 1998 to 2001.

Table 5.3 Operational surplus and/or deficits of the Mafikeng Local Municipality, 1998 - 2001

Year	Revenues	Expenditures	Surplus (Deficit)
1998	R82, 328,174	R109, 933,838	(R27, 605, 664)
1999	R90, 442, 727	R116, 748, 887	(R26, 306, 160)
2000	R92, 019, 496	R117, 081, 875	(R25, 062, 379)
2001	R102, 775, 751	R129, 166, 241	(R26, 390, 490)

5.3.4 Creditors (Accounts payable)

Like all institutions involved in service provision, the Mafikeng Local Municipality incurs debts or liabilities in the process of providing services to its residents. Liabilities are financial commitments made by the municipality to pay for service already delivered in future periods. The liabilities of the Mafikeng Local Municipality are divided into short-term and long-term liabilities with the former incurred in financing revenue short-falls in a single financial year, and the latter incurred in financing high-cost municipal capital infrastructure like dams, roads and bridges.

Table 5.4 presents the liabilities of the Mafikeng Local Municipality between 1998 and 2001 financial years

Table 5.4: Liabilities of the Mafikeng Local Municipality, 1998 to 2001 (Refer to Annexure 3(4-6))

Debt item	1998	1999	2000	2001
Long-term debt	R27, 446, 308	R26, 196, 428	R25, 479, 085	R24, 880, 528
Current debt	R10, 845, 879	R11, 791, 341	R9, 603, 236	R9, 851, 169
Bank overdraft	R6, 848, 080	R10, 704, 008	R8, 571, 006	R17, 414, 509
Provisions	R2, 840, 426	R5, 002,397	R5, 717, 234	R4, 974, 659

Source: The Mafikeng Local Municipality, Financial Statements: 1998 to 2001

5.3.5 Debtors (Accounts receivable)

The Mafikeng Local Municipality provides public goods and services to its local clientele and such organizations and private persons have to pay user, consumer and special charges for services provided. Generally, not all of the clients pay their accounts on time, so the unpaid accounts are hereby referred to as accounts receivable. Table 5.4 presents accounts receivable for Mafikeng Local Municipality.

Table 5.5: Mafikeng Local Municipality's debtors, 1998 to 2001(Refer to Annexure 3(4-6))

Type of debtors	1998	1999	2000	2001
Long-term debtors	R2, 904, 493	R1, 698, 351	R1, 522, 405	R2, 340, 435
Current debtors/Short-term	R65, 551, 276	R83, 515, 087	R98, 647, 718	R116, 247, 091

Source: Mafikeng Local Municipality, Financial Statements: 1998 to 2001

5.3.6 Fund Balances

The fund balances represent the cumulative net income or loss generated by the Mafikeng Local Municipality at the end of a financial year. Alternatively, the fund balance is defined as the amount of cash currently in the municipal fund (or in the account maintained by the municipal treasurer for the fund), minus any outstanding commitments for reimbursement under the fund. Under this definition, the fund balance would exclude as-yet unprocessed claims against the fund or any recognition of future claims likely to be submitted for known releases (United States Environment Protection Agency, 1993) at http://www.epa.gov/swerust1/directiv/aa965014.htm)

Fund Balance = Cash in Fund - Claims Processed

Table 5.6 Fund Balances (refer to Annexure 3(1-15)

Fund Balances	1998	1999	2000	2001
	R79, 028, 696	R85, 926, 780	R97, 238, 829	R110, 478, 059

Source: Mafikeng Local Municipality, Financial Statements: 1998 to 2001

The table above therefore depicts all monies in the funds of the Mafikeng Local Municipality minus all commitments to be made from the fund at the end of each financial year from 1998 to 2001.

5.3.7 Revenue reserves

Each and every financial year, the Mafikeng Local Municipality sets aside a percentage of its locally-collected revenues to contribute to the municipal reserve fund. This fund is designed to help the municipality in times of both financial and natural disasters. The revenue reserves of the Mafikeng Local Municipality are shown in Table 5.7

Table 5.7: Contributions to the reserve fund (Refer to Annexure 3(4-6))

RESERVES	1998	1999	2000	2001
Reserves	R16, 925, 731	R20, 856, 407	R24, 640, 875	R25, 900, 039

Source: Mafikeng Local Municipality, Financial Statements: 1998 to 2001

5.3.8 Investments

It is a prudent practice in municipal cash-flow management that municipal unused revenues be invested in various short and long-term portfolios to earn extra income in a form of interest. The Mafikeng Local Municipality also invested portions of its unused revenues in different investment "envelopes". Table 5.8 presents monies invested by the Mafikeng Local Municipality between 1998 and 2001.

Table 5.8: Investments, 1998 - 2001(Refer to Annexure 3(4-6))

INVESTMENT	1998	1999	2000	2001
Long-term investments	R12, 000, 000	R14, 852, 238	R7, 000, 000	R4, 531, 233
Short-term investment	R2, 030, 960	R1, 738, 684	R4, 456, 796	R8, 562, 280

Source: Mafikeng Local Municipality, Financial Statements: 1998 to 2001

The above finances of the Mafikeng Local Municipality were collected through the perusal of the financial archives of the municipality with the help of the Treasury Department and they are audited figures.

5.3.9 Bank overdrafts

Bank overdrafts as reflected in Annexure 3 (1-15) and Table 5.8 below reflect the amount of revenues borrowed from the Municipality's Account at the bank to defray operational expenditures in a given financial year. They are a form of a short-term loan.

Table 5.9 Bank overdrafts (refer to Annexure 3(1-15)

Bank overdraft	1998	1999	2000	2001
	R 6,484,080	R 10,704,008	R 8,571,006	R 17,414,509

Source: Mafikeng Local Municipality, Financial Statements: 1998 to 2001

5.4 Summary

This chapter presented the finances of the Mafikeng Local Municipality as contained in the balance sheets, Income and Expenditure statements and the Consolidated cashflow statements of the municipality from 1998 to 2001. The chapter mainly presented the finances of the Mafikeng Local Municipality based on revenues, expenditures, operational surpluses/deficits, investments, fund balances, overdrafts, creditors and debtors. The following chapter analysis the finances of the Mafikeng Local Municipality based on the working of the Financial Trend Monitoring System (FTMS) as discussed in Chapter 3.

CHAPTER SIX: DATA ANALYSIS

FINANCIAL ANALYSIS OF MAFIKENG LOCAL MUNICIPALITY

6.1 Introduction

This chapter presents the analysis and interpretation of the data on the financial analysis of the Mafikeng Local Municipality. Quantitative and qualitative data collected during the investigation are summarised and discussed.

6.2 The financial analysis of the Mafikeng Local Municipality

The provision of accurate estimates regarding household, population and economic figures always remains a controversial and challenging aspect in any type of investigation. In this study, changes in boundaries brought about by the new Local Government dispensation, the provision of statistics at different levels of spatial aggregation (for example, magisterial, pre-December 2000 Local Government and post-December 2000 Local Government boundaries) imply a wide range of a number of different population statistics. In terms of the Mafikeng Local Municipality, the approach followed to arrive at a realistic estimate was to make distinction among three areas within the existing municipality, namely: -

- The formal areas of Mafikeng and Mmabatho
- The "peri-urban areas
- Rural villages

The peri-urban areas and the villages are legally part of the Mafikeng Local Municipality, but did not from part of the research since they were only integrated into the municipality in 2001. In other words, all the statistical estimates in the following analysis are based on the data on the formal Mmabatho-Mafikeng magisterial areas. **All the figures of percentage change had been rounded-off.**

The financial analysis of the Mafikeng Local Municipality, therefore, proceeds in the following steps: -

- **Revenue analysis which includes analysis of the economic base, especially the following**
  - Analysis of revenues per source

- **Expenditures analysis which includes**
  - Expenditures of the municipality per expenditure item

- **Analysis of other financial variables of Mafikeng Local Municipality**
  - Creditors
  - Debtors
  - Fund Balance
  - Revenue reserves
  - Municipal Investments
  - Bank overdrafts

Actual revenues, expenditures as well as other financial variables as discussed in Chapter 5 were gleaned from annual financial statements of the Mafikeng Local Municipality from 1998 to 2001 (Annexure 3(1-15).

6.2.1 Revenue analysis of Mafikeng Local Municipality

The following analysis of revenues of the Mafikeng Local Municipality was done according to the revenues per source. As a matter of information, the Mafikeng Local Municipality exploits its revenues from the following sources: -

- **Intergovernmental revenues**
  - Provincial government grants/transfers
  - Central government grants/transfers
- **Water sales**
- **Assessment rates/Property taxation**
- **Other charges**

As mentioned in Chapter 3, the research used the financial indicators as developed by the International County Management Association (ICMA) in the Financial Trend Monitoring System (FTMS). The time series techniques of the percentage change; index method and the

common size methods were used to detect the growth trend of the finances. The percentage change method was used to determine the percentage contribution of each financial item to the overall finances of the municipality each financial year. The Index method was used to determine the growth pattern from the base year (100) in 1998 through 1999, 2000 and 2001.

6.2.1.1 Intergovernmental revenues

Intergovernmental fiscal relations in South Africa are mainly co-ordinated by the Financial and Fiscal Commission, and they are in such a manner that municipalities are recipients of both unconditional and conditional financial transfers. These transfers are made to match the devolution of responsibilities from the higher spheres of government to local governments with monetary resources for sustained municipal service delivery.

(a) Provincial government grants/transfers

For the purpose of this study, the analysis of the intergovernmental transfers to the Mafikeng Local Municipality is based on the financial statistics in Table 5.1.

Table 6.1 Provincial government transfers/grants

Year	Amount	Percentage Change	Common size
1998	R7, 006, 827	-	8.51%
1999	R7, 448, 154	6.30%	8.24%
2000	R2, 547, 810	-65.79%	2.77%
2001	R6, 281, 014	146.53%	6.11%

Cf. Table 5.1

In 1998, the Mafikeng Local Municipality received a grant of R7, 006, 827 from the North-West Provincial Government. Between 1998 and 1999, the provincial grant grew by 6.30%, declined by 65.79% between 1999 and 2000, and showed an improvement of 146.53% between 2000 and 2001.

In terms of common statements, in 1998, provincial grants formed 8.51% of total municipal revenues in 1998. In 1999, the contribution declined slightly to 8.24% and thereafter took a

nosedive to 2.77% of total municipal revenues in 2000. It improved a little bit in 2001 by contributing 6.11% towards total municipal revenues.

(b) Central government grants/transfers

Table 6.2 below reflects the size of central government grants transferred to the Mafikeng Local Municipality from 1998 to 2001. In 1998, the Mafikeng Local Municipality did not get any grant(s) or transfer(s) from the central government. In 1999, the grant came in a form of R2, 680, 118. This showed an increase of 100% between 1998 and 1999. The grant declined by 38.08% between 1999 and 2000. Between 2000 and 2001, this grant increased by 20.78% to approximately R2 million in 2001.

Table 6.2 Central government grants/transfers

Year	Amount	Percentage Change	Common size
1998	R0	-	0.00%
1999	R2, 680, 118	100%	2.96%
2000	R1, 659, 560	-38.08%	1.80%
2001	R2, 004,361	20.78%	1.95%

Cf. Table 5.1

The common statements for this grant shows that in 1998, there were no revenues realised, but in 1999, a grant from the central government formed 2.96% of municipal revenues and in 2000 they formed only 1.80% of total municipal revenues and further improved to 1.95% in 2001.

Local government finance practitioners and scholars encourage municipalities to rely more on own-revenue rather than on intergovernmental transfers, because, as shown above, such transfers are an unreliable source of municipal revenues. In addition, although these transfers may be insignificant to the local fiscus, they are very important in alleviating the financial pressure from municipalities in providing basic services, especially to the poorer sectors of local communities.

6.2.1.2 Water sales

Mafikeng treats water provision as a particular service and therefore provides it as a commodity or trading service. This means that water provision should provide surpluses in order to cover

operational costs of the provision exercise and be able to service loans that are usually made to erect water infrastructure. As such, Table 6.3 and Figure 6.1 show that in 1998, and the other subsequent years, water revenues were second to only property tax in contributing enough revenues to the municipality.

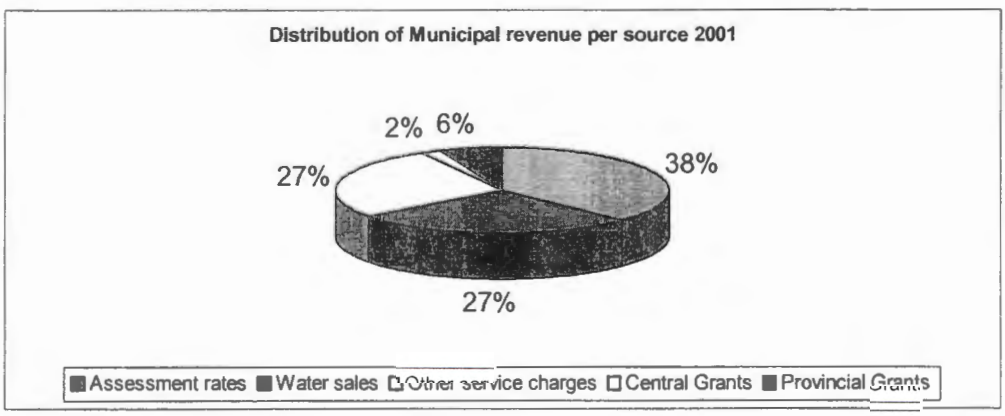
Table 6.3 Water sales

Year	Amount	Percentage Change	Common size
1998	R20, 926,841	-	25.4%
1999	R28, 452, 576	35.96%	31.46%
2000	R24, 794, 861	-12.86	26.95%
2001	R28, 078, 423	13.27%	27.32%

Cf. Table 5.1

Between 1998, water revenues formed 25.4% of the total municipal revenues and as Table 6.3 shows, between 1998 and 1999, the contribution escalated by 35.96% to 31.46% of overall municipal revenues in 1999. Between 1999 and 2000, water sales declined by 12.86% and formed 26.95% of total revenues of the municipality. Between the later part of the research period, that is, between 2000 and 2001, water sales revenues showed a positive growth of 13.27% which yielded a total common size of 27.32% of the total municipal revenues.

Figure 6.1 Distribution of locally collected revenue, Mafikeng Local Municipality, 1998



Source: Mafikeng Local Municipality; Income & Expenditure Statements, 1998 – 2001

When comparing water sales revenues against expenses in purchasing bulk water for the municipal area, it can be seen in Table 6.4 that water sales realised surpluses in straight years from

1998 to 2001. This means that even for the Mafikeng Local Municipality water services satisfy the criterion to be a trading service

Table 6.4 The profitability of water service provision.

FY	Water revenues	Water expenses	Deficit (-)/Surplus (+)
1998	R 20,926,841	R 11,153,688	+ R 9,773,153
1999	R 28,452,576	R 15,276,046	+ R 13,176,530
2000	R 24,794,861	R 14,990,424	+ R 9,804,437
2001	R 28,078,423	R 18,863,293	+ R 9,215,130

Cf. Tables 51 and 5.2

In 1998, the municipality realised a surplus of approximately R9 million, which increased to R13 million in 1999 and declined to the region of R9 million during 2000 and 2001. Although the sluggish economic conditions in Mafikeng (observed during the study) are to bear on the profitability of water provision, the present profitability margin reflects the importance of water sale revenues towards maintaining a healthy financial condition of the Mafikeng Local Municipality.

6.2.1.3 Assessment rates/Property taxation

The literature on local government finance in Chapter 2 singled out property tax as an important and lucrative source of revenue for municipalities. For the Mafikeng Local Municipality, property taxes also formed an important source of revenues.

Table 6.5 Assessment rates/ Property taxation

Year	Amount	Percentage Change	Common size
1998	R35, 144, 595	-	42, 69%
1999	R33, 316, 497	-5.12%	36.84%
2000	R37, 802, 461	13.46%	41.08%
2001	R38, 325, 771	1.38%	37.29%

Cf. Table 5.1

According to Table 6.5, in 1998, property tax revenues amounted to 42.69% of the total municipal revenues. Due to the sluggish economic growth that resulted in businesses and residents relocating to other areas outside Mafikeng, the contribution margin declined by 5.12%

between 1998 and 1999 to 36.84% in 1999, then improved to 41.08 % in 2000 and further declined to 37.29% in 2001.

Despite the upward and downward swings of the property revenues in the period 1998 to 2001, they remained the main portion of revenues for the Mafikeng Local Municipality. Although additional data on the property tax base of the Mafikeng area was not available, this trend agrees with the literature on property taxes that property tax is the main source of municipal revenues and change proportionately to changes in the local economic base, especially the real property market (cf. Figure 6.1)

In the absence of data on the delinquent property revenues and the total revenue base of Mafikeng, it is very difficult to decide whether the present trend of property revenues contribute towards the healthy financial condition of the municipality or not. According to the Financial Trend Monitoring System (FTMS), falling revenues from property tax portray a **warning sign** for something amiss in the economic base and growing revenues show a **favourable** health of the locality's financial condition. The decelerated increase in revenues exploited from the property tax base in the Mmabatho-Mafikeng magisterial area is a warning sign to the municipality that there is something amiss in its economic base.

6.2.1.4 Other charges

Like all municipalities, the Mafikeng Local Municipality offers the following services as basic for the social and economic well-being of the local community of the Mafikeng area:

- Cemetery
- Ambulance and fire emergency services
- Health services (Clinic)
- Libraries

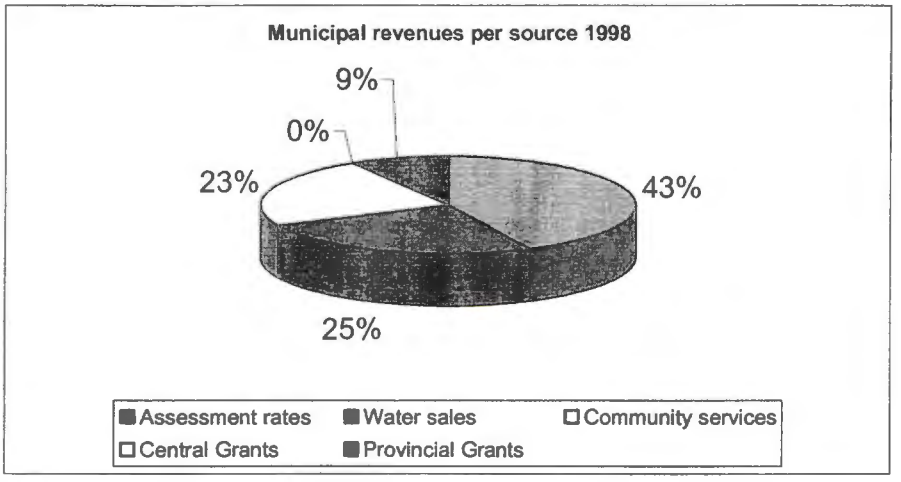
For this study, revenues realised from the provision of these services are categorised as other charges. According to Figure 6.2 and Table 6.6, in 1998 revenues realised from the provision of community services formed 23.38% of the total revenues of the municipality.

Table 6.6 Other charges

Year	Amount	Percentage Change	Common size
1998	R19, 249, 911	-	23.38%
1999	R18, 545, 382	-3.66%	20.51%
2000	R25, 214, 804	35%	27.40%
2001	R28, 086, 182	11.39%	27.33%

Cf. Table 5.2

Figure 6.2 Distribution of municipal revenues, 1998



Source: Mafikeng Local Municipality; Income & Expenditure Statements, 1998 - 2001

Between 1998 and 1999, revenues from other charges declined by 3.66% and formed 20.51% of total municipal revenues in 1999. Between 1999 and 2000, this source of revenues contributed 27.40% of total revenues. This showed an increase of 35%. In 2001, as reflected in Table 6.6, revenues from community services formed 27.33% of the total municipal revenues. Inasmuch as revenues from this source are not expected to yield profits/surpluses for Mafikeng Local Municipality, they are an integral part of the municipality's revenue system because residents are expected to supplement the municipality in rendering community services.

With all factors intact, the size of revenues from community services is an indication of the local populace's commitment to support the municipality to deliver services to them, regardless of the present pressing economic conditions in the area.

6.2.2 Expenditure analysis of the Mafikeng Local Municipality

Chapter 2 defined local governments as agencies of service delivery to the local people. In delivering the said services, municipalities have to procure some equipment, pay personnel and pay for bulk supply of services from suppliers. The latter involves financial transactions whereby the municipality collects revenues from the residents and expends them to satisfy the demands of the local population.

The Mafikeng Local Municipality expends its revenues on the following expenditure items, repairs and maintenance, salaries and wages, general expenses and others.

6.2.2.1 Repair and maintenance

The Mafikeng Local Municipality is continually faced with challenges to satisfy the demands of their communities. Most of the services that it has to provide are infrastructure service. Such services include streets, urban lighting, water, electricity supply, drainage works and traffic lights and others. The Mafikeng Local Municipality therefore has a huge inventory of infrastructure assets that need to be repaired and maintained to sustain service delivery. In order to extent the useful life of all the inventorised infrastructure assets, the Mafikeng Local Municipality expended a portion of its revenues on repair and maintenance of infrastructure. For the financial year 1998, the municipality spent 6.41% of its revenues (R7, 041, 615) on infrastructure repairs and maintenance.

Table 6.7 Repairs and maintenance

Year	Amount	Percentage Change	Common size
1998	R7, 041, 615	-	6.41%
1999	R7, 575, 906	7.59%	6.49%
2000	R6, 245, 930	-17.56%	5.33%
2001	R6, 937, 411	11.07%	5.37%

Cf. Table 5.2

Between 1998 and 1999, expenditures on repairs increased by 7.59% to form 6.49% of total municipal expenditures in 1999. Between 1999 and 2000, this expenditure declined by 17.56% to form 5.33% of total expenditures. In 2001, the expenditure on repairs and maintenance totalled

5.37% of total municipal expenditures. The periodic maintenance of infrastructure has a positive impact on future capital plant expenditures, because frequently maintained infrastructure needs minimal expenditures from one financial year to the other, and can lengthen the useful life of capital plants.

6.2.2.2 Salaries and wages

In order to implement its service delivery and development programmes successfully, the Mafikeng Local Municipality needs a team of skilled IT, financial, and human resources practitioners and other support personnel with relevant administrative skills for effective execution of municipal service delivery programmes. In addition, in order to get a good crop of personnel, the municipality must be prepared to reward its personnel handsomely, especially those that are high in demand and short in supply.

Table 6.8 Salaries and wages

Year	Amount	Percentage Change	Common size
1998	R40, 515, 943	-	36.85%
1999	R43, 563, 088	7.52%	37.31%
2000	R46, 535, 180	6.82%	39.75%
2001	R49, 514, 593	6.40%	38.33%

Cf. Table 5.2

The examination of the expenditures on salaries and wages incurred by the Mafikeng Local Municipality reveals that in 1998, 36.85% of the municipal revenues were spent to defray personnel costs. As Table 6.8 shows, personnel costs rose by 7.52% between 1998 and 1999 and later by 6.82% and 6.40% between 1999 and 2000 and 2000 and 2001 respectively. In 1999 salaries and wages contributed only 37.31% of total expenditures, which increased to 39.75% in 2000. In 2001, salaries and wages formed 38.33% of municipal expenditures.

6.2.2.3 General expenses

General expenses as they appear on the financial statements of the Mafikeng Local Municipality as reflected in Annexure 3 (1-15) are subdivided into other expenses and purchase of water.

(a) Other expenses

Other expenses reflect the amount of revenues expended on services other than water services. Such services are called community services; community services are all those services that are basic for the social and economic health and growth of a city or rural area. In terms of the Mafikeng Local Municipality, in 1998, the size of expenditure on community services formed 31.90% of the overall expenditure of the municipality.

Table 6.9 Other expenses

Year	Amount	Percentage Change	Common size
1998	R35, 070, 384	-	31.90%
1999	R35, 147, 975	0.22%	30.11%
2000	R35, 535, 407	1.10%	30.35%
2001	R39, 119, 898	10.09%	30.29%

Cf. Table 5.2

The size of the expenditure increased by 0.22% between 1998 and 1999 and formed 30.11% of total municipal expenditures in 1999. Expenditures on community services grew by 1.10% between 1999 and 2000 and by 10.09% between 2000 and 2001. The growth in expenditures between 2000 and 2001 reflects a need that faced the municipality to broaden its provision of community needs, and may have had an impact on its finances.

(c) Water purchases

Water is basic for the health of the residents of the Mafikeng Local Municipality, so the provision of water is central to the levels of liveability in the area, especially to the poor sectors of the Mmabatho-Mafikeng community. The Mafikeng Local Municipality as a vehicle of local service delivery is expected to deliver quality water services to its citizens in a sustainable and affordable manner.

The examination of expenditures on water provision in the Mafikeng Local Municipality reveals that, in 1998, expenditures incurred in the provision of water services amounted to 10.15% of all municipal expenditures. Expenses on purchasing bulk water for municipal residents grew by 36.96% and formed 13.08% of total municipal expenditures in 1999. By 2000, this expenditure

item accounted for 12.80% of total expenditures which reflects a decrease of 1.87% between 1999 and 2000. In the later years of the research period, that is, between 2000 and 2001, expenditures of water purchases grew by 25.84%.

Table 6.10 Water expenses

Year	Amount	Percentage Change	Common size
1998	R11, 153, 688	-	10.15%
1999	R15, 276, 046	36.96%	13.08%
2000	R14, 990, 424	-1.87%	12.80%
2001	R18, 863, 293	25.84%	14.60%

Cf. Table 5.2

Given the importance of water provision to the social welfare of Mafikeng residents, the size of this expenditure is by international standards satisfactory, only if water is accessible to all who live within the municipal boundaries of the Mafikeng Local Municipality, especially the poor.

6.2.2.4 Contributions to creation of fixed assets and reserves

As a practice of prudent municipal financial management, the Mafikeng Local Municipality is often required to set aside some of its annually collected revenues towards the creation of fixed assets and the accumulation of reserves. Fixed assets are equipments that support the delivery of services like trash collection vehicles, traffic control vehicles, rubbish bins, buildings, computers, printers and others.

(a) Contributions towards creation of fixed assets

Expenditures or transfers for future procurement of fixed assets declined by 74.73% between 1998 and 1999 and formed 0.17% of total expenditures in 1998. As the common size statements and the percentage change figure reflects in Table 6.11 that contribution to fixed assets is the smallest expenditure item of the Mafikeng Local Municipality.

Table 6.11 Contributions towards the creation of fixed assets

Year	Amount	Percentage Change	Common size
1998	R184, 057	-	0.17%
1999	R46, 504	-74.73%	0.04%
2000	R5, 426	-88.33%	0.0001%
2001	R64, 061	1080.63%	0.05%

Cf. Table 5.2

Table 6.11 above shows that between 1998 and 2000, the Mafikeng Local Municipality cut its transfers to the creation of fixed assets. This trend correlates well with the value of fixed assets in Table 5.2, which shows that the value of fixed assets continued to decline from 1998 to 1999. There was a sudden rise in money earmarked for fixed assets, that is, a growth of 1080.63% between 2000 and 2001.

(b) Contribution to reserves

Table 6.12 Contributions to reserves

Year	Amount	Percentage Change	Common size
1998	R3, 187, 956	-	2.90
1999	R2, 846, 680	-10.71%	2.44%
2000	R1, 763, 715	-38.04%	1.51%
2001	R2, 254, 820	27.84%	1.75%

Cf. Table 5.2

Table 6.12 shows that the contribution of revenues towards reserves decreased by 10.71% between 1998 and 1999 and formed only 2.90% of total expenditures in 1998. The contribution declined even more, that is, by 38.04% between 1999 and 2000 and formed 2.44% of total expenditures in 1999. In 2000 and 2001, revenues contributed towards reserves amounted to 1.51% and 1.75% of the total municipal expenditures and transfers, respectively. This shows that from 1998 to 2000, there has been a decline in expenditures dedicated to the creation of reserves. An increase of 27.84% was realised between 2000 and 2001.

6.2.2.5 Capital charges

Mafikeng Local Municipality, like any municipality, has no financial capacity to undertake huge projects that cost billions of rands. In order to invest on capital infrastructure for providing infrastructure services, the municipality depends on private sector loans. These capital loans are used to create municipal waterways, bridges, dams, halls, streets and roads. Capital charges, as they appear on the Income and Expenditure statements of the municipality from 1998 to 2001, are payments made in paying back the loans and the rate of return on initial investment (normally called interests).

In 1998, the portion of expenditures that was dedicated towards paying the long-term loans was only 11.63% of municipal expenditures.

Table 6.13 Capital charges

Year	Amount	Percentage Change	Common size
1998	R12, 780, 195	-	11.63%
1999	R12, 292, 688	-3.8%	10.53%
2000	R12, 005, 793	-2.33%	10.25%
2001	R12, 412, 165	3.38%	9.61%

Cf. Table 5.2

In 1999, the portion declined to 10.53% and further to 10.25% in 1999 and 2000 respectively. In 2001, 9.61% of total municipal expenditures were used to service outstanding loans and interest. This reflected a decrease of 3.8% and 2.33% between 1998 and 1999, and 1999 and 2000 respectively. Between 2000 and 2001, expenditures on capital charges grew by 3.38%. This may be explained by the escalating bank overdrafts (Table 5.8) taken up by the municipality between 2000 and 2001. By international financial standards, the level of debt and debt servicing as carried and executed by the Mafikeng Local Municipality reflects a creditworthy entity *(œteris paribus)*.

6.2.3 The analysis of other financial variables of the Mafikeng Local Municipality

The above analysis of revenues and expenditure trends of the Mafikeng Local Municipality does not give a total picture of the state of finances of the Mafikeng Local Municipality. The following

analysis of other financial variables is an attempt to establish a full view of the finances of the Mafikeng Local Municipality between 1998 and 2001.

6.2.3.1 Operational surpluses and/or deficits

From the perspective of the definition of financial condition in Chapter 3 as the ability of municipalities to raise enough revenues to cover expenditure obligations of the past, present and the future, the deficits incurred by the Mafikeng Local Municipality (as reflected in Table 6. 14) suggest that the municipality failed to maintain a healthy financial condition from 1998 to 2001

Between 1998 and 1999, total municipal expenditures increased by 6% whereas revenues increased by 10%. Between 1999 and 2000, revenues increased by 2% with a 0.4% increase in revenues and lastly, between 2000 and 2001, overall revenues grew by 12% and expenditures by 10%. These figures suggest that the revenues of the Mafikeng Local Municipality grew at a faster rate than expenditures, especially between 1998 and 2000, but between 2000 and 2001, the revenues show a slower growth whereas expenditures were growing faster. All in all, the Mafikeng Local Municipality's operational deficits decreased by 5% between 1998 and 2000, only to increase by 5% between 2000 and 2001.

Table 6.14 Operational surplus and/or deficits of Mafikeng Local Municipality, 1998 - 2001

Year	Revenues	% Change	Expenditures	% Change	Surplus (Deficit)	% Change
1998	R82, 328,174		R109, 933,838		(R27, 605, 664)	
1999	R90, 442, 727	10%	R116, 748, 887	6%	(R26, 306, 160)	-5%
2000	R92, 019, 496	2%	R117, 081, 875	0.4%	(R25, 062, 379)	-5%
2001	R102, 775, 751	12%	R129, 166, 241	10%	(R26, 390, 490)	5%

Cf. Tables 5.1 and 5.2

In other words, the Mafikeng Local Municipality expended more than it exploits from its economic base. These deficits compounded by huge bank overdrafts displayed in Table 5.8 also shows that the municipality is also using bank overdraft facilities to compensate for revenue shortfalls. In 1998, the municipality made an overdraft facility of approximately R6 million, which

increased to R10, 704, 008 in 1999 and escalated to R17, 414, 509 in 2001. This projects an entity in financial distress, especially in the short and medium terms.

6.2.3.2 Creditors

For the purposes of this study, the creditors for the Mafikeng Local Municipality have been divided into three categories, namely: -

i. Long-term creditors
ii. Current creditors
iii. Bank overdrafts

(i) Long-term creditors

Table 6.15 shows that the level of long-term debt borrowed from financial institutions for the creation of capital projects that rendered services to residents of the Mafikeng Local Municipality. The table shows that due to expenditures made on capital charges (cf. Table 6.13), the Mafikeng Local Municipality was able to decrease its long-term debt by 4.55% between 1998 and 1999. Between 1999 and 2000, long-term debt continued to decline by 2.74% and by a further 2.35% between 2000 and 2001.

Table 6.15 Long-term debt

FY	Amount	% Change
1998	R 27,446,308.00	-
1999	R 26,196,428.00	-4.55%
2000	R 25,479,085.00	-2.74%
2001	R 24,880,528.00	-2.35%

Cf. Table 5.3

This shows that the Mafikeng Local Municipality is prepared to keep itself in a creditworthy position as far as the municipal bond market is concerned, and thereby try to maintain a healthy financial condition.

(ii) Short-term/Current creditors

Table 6.16 below shows that the Mafikeng Local Municipality is giving current debt the same attention given to long-term debt except that there was an increase of 8.72% of current debts between 1998 and 1999.

Table 6.15, Short-term/Current debt

FY	Amount	% Change
1998	R 10,845,879.00	-
1999	R 11,791,341.00	8.72%
2000	R 9,603,236.00	-18.56%
2001	R 9,851,169.00	2.58%

Cf. Table 5.3

Between 1999 and 2000, current debt decreased by 18.56% and increased by a small margin of 2.58% between 2000 and 2001. Frequent episodes of weakened liquidity positions may be the reason behind the increases in current debt between 1998 and 1999; and between 2000 and 2001.

(iii) Bank overdrafts

Bank overdrafts are in this study considered as a form of debt because it is monies given to the Mafikeng Local Municipality to meet its immediate cash needs with a promise and commitment to liquidate the cash loaned in future, when enough cash becomes available. With regard to municipalities in South Africa, they are only permitted to undertake operational overdrafts within a single financial year and not take it on a credit-revolving fashion.

Table 6.17 Bank overdrafts

FY	Amount	% Change
1998	R 6,848,080.00	
1999	R 10,704,008.00	65.08%
2000	R 8,571,006.00	-19.93%
2001	R 17,414,509.00	103.18%

Cf. Table 5.3

Table 6.17 paints a negative picture on the finances of the Mafikeng Local Municipality. According to this table, the level of overdrafts as a form of short-term operational loans

increased by 65.08% between 1998 and 1999. It decreased by an index of 19.93 between 1999 and 2000, and then skyrocketed by a massive 103.18% between 2000 and 2001.

The latter increase in bank overdrafts can be explained by that the Mafikeng Local Municipality is expected to liquidate its immediate cash with less or no corresponding revenues coming from its clients (businesses and residents consuming municipal revenues in form of manufactured services). In the long-term, these huge increases may impair the creditworthiness of the municipality and therefore jeopardise its participation in the local municipal bond market.

6.2.3.3 Debtors

Debtors of the Mafikeng Local Municipality are also divided into two categories, namely, long-term and short-term debtors.

(a) Long-term debtors

Long-term debts due to the Mafikeng Local Municipality decreased by 41.53% between 1998 and 1999. It can be inferred from this decrease in debt, that municipal clients who committed themselves to long-term debt paid the municipality huge sums of money between 1998 and 1999. Between 1999 and 2000, long-term debts continued to decrease by 10.36% and further increased by 53.73% between 2000 and 2001.

Table 6.18 Long-term debtors

FY	Amount	% Change
1998	R 2,904,493.00	-
1999	R 1,698,331.00	-41.53%
2000	R 1,522,405.00	-10.36%
2001	R 2,340,435.00	53.73%

Cf. Table 5.4

It can be argued from this increase that there was some unwillingness by long-term debtors to liquidate their debts between 2000 and 2001. This unwillingness to pay for municipal services often renders the municipality insolvent and subsequently unable to provide quality services without unnecessary operational disruptions.

(b) Short-term debtors

The level of short-term debtors is of utmost concern to the researcher. In 1998, as Table 6.19 reflects, over R65 million were owed to the municipality, the figure increased astronomically to R116 million in 2001. The size of short-term account receivables then increased by 18.12% between 1999 and 2000, and by 17.84% between 2000 and 2001. The age of the debts owed to the municipality are as reflected in Annexure 5, most of which are more than 3 months old (90+ days).

Table 6.19 Current/ short-term debtors

FY	Amount	% Change
1998	R 65,551,276	-
1999	R 83,515,087	27.40
2000	R 98,647,718	18.12%
2001	R 116,247,091	17.84%

Cf. Table 5.4

Accordingly, it can be argued that the huge deficits and overdrafts experienced by the Mafikeng Local Municipality are due to the huge number of municipal residents who cannot or are unwilling to pay for their municipal services. The Municipality Finance Department tried to encourage residents to pay, by using incentive programmes as shown in Annexure 6. The incentive programme also failed to make an impact. The Mafikeng Local Municipality is in this regard left with no other option but to revoke the legislative procedures available to it and coerce local residents to pay for their services. If this is not done within a short space of time (short-term), the municipality will find itself in a deep financial crisis or both monetary and service insolvency.

6.2.3.4 Fund Balances

Despite the ailing economy and mounting current debtors, the Mafikeng Local Municipality was able to maintain a sizeable portion of money in its funds between 1998 and 2001.

Table 6.20 Fund Balances

FY	Amount	% Change
1998	R79, 028, 696	-
1999	R85, 926, 780	8.73%
2000	R97, 238, 829	13.16%
2001	R110, 478, 059	13.62%

Cf Table 5,5

The size of fund balances at the end of 1999 showed an improvement of 8.73% as compared to that of the financial year-end 1998. The fund balance level improved even more by a margin of 13.16% and by 13.62% between financial year-end period 2000 and 2001. The most intriguing aspect of this, is, despite this huge fund balances reflected in Table 6.20, the municipal was not able to finance operational costs without short-term borrowing and bank overdrafts.

6.2.3.5 Revenue reserves

Revenue reserves were defined in Chapter 3 as an amount of revenues set aside by municipalities for emergency purposes. Table 6.21 below shows that the Mafikeng Local Municipality also set aside some of its revenues for emergency purposes.

Table 6.21 Revenue reserves

FY	Amount	% Change
1998	R16, 925, 731	-
1999	R20, 856, 407	23.22%
2000	R24, 640, 875	18.15%
2001	R25, 900, 039	5.11%

Cf. Table 5.6

The Mafikeng Local Municipality increased its revenue reserves by 23.22% between 1998 and 1999. Revenue reserves increase by 18.15% between 1999 and 2000 and further increased by 5.11% between 2000 and 2001. This trend reflects that between 1998 and 2000, as part of its risk management process, the Mafikeng Local Municipality channelled more money to reserves in order to mitigate any risks that may befall the municipal area, so that the well-to-do and poor members of the area would not be adversely affected in case of an unexpected disaster

6.2.3.6 Municipal Investments

Due to widespread non-payment of services as discussed previously in 6.2.3.3 (a) and (b), Mafikeng Municipality divested most of its long-term investment and channelled them into short-term investment so that it can be able to liquidate its immediate cash needs without incurring huge operational deficits and bank overdrafts. This is depicted in Table 6.22 whereby the level of long-term investments decreased from R12, 000, 000 in 1998 to only R4, 531, 233 in 2001 whereas short-term investment increased from over R2 million in 1998 to more than R9 million in 2001.

Table 6.22 Municipal Investment

FY	Amount	% Change
	Long-term Investments	
1998	R12, 000, 000	-
1999	R14, 852, 238	23.77%
2000	R7, 000, 000	-52.87%
2001	R4, 531, 233	-35.27%
	Short-term Investment	
1998	R2, 030,960	-
1999	R1, 738, 684	-14.39%
2000	R4, 456, 796	156.33%
2001	R8,562,280	92.12%

Cf Table 5.7

Close examination of long-term investment reveals that between 1998 and 1999, long-term investments increased by 23.77% and started to decrease by 52.87% between 1999 and 2000 and by 35.27% between 2000 and 2001. Short-term investment on the other hand declined by 14.39% between 1998 and 1999. Between 1999 and 2000, they picked up by 156.33% from over R1 million to approximately R4.5 million in 2000. During the period 2000 to 2001, short-term investments further increased by 92.12% from approximately R4.5 million in 2000 to over R8.5 million in 2001.

Briefly, the analysis of the overall finances of the Mafikeng Local Municipality paints and mixed picture of strategic financial management and a weak cash-flow management system. Therefore, the Mafikeng Local Municipality is neither in a healthy financial condition nor under extreme

financial distress, but analysing its balance sheet reveals seeds for future financial crisis (if the economic base continues to be eroded).

6.3 Summary

This chapter presented the analysis and interpretation of quantitative data collected during the study investigations. It examined and analysed data on the economic base, financial trends and financial condition of the Mafikeng Local Municipality between 1998 and 2001.

The following chapter will therefore present the summary of the previous chapters, present the findings from the analysis of data and make recommendations on the problems identified during the analysis and interpretation.

CHAPTER SEVEN
SUMMARY, FINDINGS AND RECOMMENDATIONS

7.1 Introduction

This chapter presents the summary of the whole study, discusses the findings of the investigation and make recommendations based on the findings.

7.2 Summary

The first chapter of the study introduced the study and outlined the background to the study. It progressed by outlining the statement of the problem, objectives of the study, significance of the study; methods used to carry out the study, and the organisation of the study.

The background to the study highlighted the concern on the deterioration of the municipal finances in South Africa. It discussed the historical background and the present extent of the problem of financial stress in municipalities. The liabilities of the accounting system of the previous government were also discussed. Lastly, the need for frequent (preferably annually) financial analysis was identified as one remedy to the prevailing financial malady in South African municipalities (cf. 1.2).

The second chapter presented the nature and scope of local government and municipal financial management. It emerged that local government is the lowest sphere of government in South Africa, and is mostly nearer to the people to cater for their daily needs through the delivery of services (cf. 2.2.1).

The purposes of the local governments were highlighted as to maintain high levels of liveability standards in urban and rural areas (cf 2.2.1) and mutual relationship between residents, business and the localities for good management and governance.

The second chapter discussed the concept of local government financial management which was defined as an economical use of resources to achieve goals of effectiveness and efficiency in service delivery. Other authors, namely Moak & Hillhouse (1978) identified municipal finance as

public finance exemplified and applied to the local level of government. They further subdivided municipal finance into the following interrelated activities: -

- Municipal budgeting
- Municipal borrowing
- Municipal borrowing and debt management
- Municipal financial accounting and auditing
- Municipal infrastructure management and financing, and
- Municipal cashflow management (cf. 2.3)

The above components were regarded as critical constituents of a very delicate process of financial management (even for the private sector) and have to be managed with utmost care and expertise that they collectively contribute toward the healthy financial condition of municipalities.

Chapter 3 presented the concept of local government financial analysis. The purpose of financial analysis was stated as to determine how well municipalities have met their past financial obligations, and how likely it is that they can meet their financial obligations now and in the future. The chapter also highlighted that for financial analysis to be successful it need to be performed within an analytical framework that is able to integrate all data (non-financial and financial) to determine the approximate financial condition of a municipality (cf. 3.2.2).

The chapter also reflects the definition of financial condition as a government's ability to generate enough revenues to cover its expenditure needs. A local government that is in a healthy financial condition was defined as one that can generate enough revenues/cash to pay its bills, sustain existing service levels (service solvency), withstand economic slumps and meeting the demands of the changing service needs (cf. 3.3.1).

Berne & Schramm (1986) outlined the analytic framework of financial condition as having four separate components, namely, revenue analysis, expenditure analysis, internal resource analysis and debt and pension analysis, but only revenue analysis and expenditure analysis were discussed, as they were the main subjects of the present study. Chapter 3 reviewed revenue analysis according to the following sequential steps: -

- Economic base analysis

- Revenue base analysis
- Analysis of actual revenues
- Revenue capacity and reserves (cf. 3.4)

Finally, expenditure analysis was referred to as the examination of the equitable use of municipal resources to satisfy the diverse needs of the municipal residents. It was reviewed in terms of expenditure by character, purpose and function (cf. 3.4.2.1).

The chapter concluded by presenting models for municipal financial analysis. The Financial Trend Monitoring System **(FTMS)** was discussed as one of the tried and tested models for financial analysis. The model was designed by the International County/City Management Association **(ICMA)** in the United States of America, to help municipalities to gain a better understanding of their financial condition, and monitor its changes to identify emergency problems before they reach serious and crisis proportions (cf. 3.5).

The review of the FTMS continued by focussing on the three main factors of the FTMS's analysis machinery, namely **financial, organisational and environmental** factors. The chapter also presented the testing of the model, the results of the test, assets and liabilities of the model (cf. 3.5.2).

The second model (not really a model) discussed was the Time Series technique towards financial analysis. The discussion of this technique disaggregated it into three broad methods, namely,

- Percentage change method
- Common size method
- Index number method (cf. 3.6)

Chapter 4 presented the research design and methodology used in carrying out the study. This study is a case study and therefore used a triangulation of a varied methods for data collection and analysis. It was also identified as an organisational case study using secondary data because it used the historical financial documents of the Mafikeng Local Municipality for data analysis. In this chapter, the merits and demerits of secondary data analysis were highlighted as well as the administration procedures of the study (cf. 4.2).

Chapter 6 presented the finances of Mafikeng Local Municipality as gleaned from the financial statements of the municipality for financial years 1998 to 2001. These financial statements were collected from the financial archives of the Treasury Department of the municipality.

Chapter 6 was for the analysis and interpretation of the data. Content analysis as a form of secondary data analysis was used to analyse both quantitative and qualitative data collected during the empirical investigations.

7.3 Research findings

The following are the findings that emerged from the study: -

The literature of the scope and nature of local government financial management and analysis revealed the following: -

7.3.1 LOCAL GOVERNMENT FINANCE

In terms of determining the nature and scope of local government financial management from literature, it was found that: -

- Local government, as a legitimate and constitutional sphere of government in South Africa, has an important role to play in the consolidation of democracy and the delivery of services for a better life for all in rural and urban areas. Local governments are expected to create conditions for liveability, economic competitiveness, financial stability and good governance and management (cf. 2.2.2).

- South Africa is presently experiencing an acute dearth in the literature on local government finance and financial management. Most of the literature used in this study is of American origin, especially from the National Committee of Standard in Accounting (NCSA) and the International City/County Management Association (ICMA). The available South African literature mostly refers to local government as cities only, that is, leaving rural areas as part of local government, and discusses financial management of local governments in term of city/urban financial management (cf. 2.3).

- The available literature review for this study also revealed that at the centre of a successful and working municipal service programme there should be prudent financial management practices. In this regard, municipal financial management was defined as the economical use of resources to achieve the goals of efficiency and effectiveness in the provision of municipal services (cf. 2.3).

- Municipal financial management is made up of the following interrelated components:-

    - Budgeting
    - Accounting
    - Debt management
    - Financial Accounting and Auditing
    - Infrastructure financing
    - Cash flow management (cf. 2.3.2).

- **Municipal budgeting** forms an integral part of municipal financial management whereby future municipal revenues are appropriated to meet the policies of municipal councils to deliver the kind of services that are required by the local residents. The literature divided municipal budgets into two - the operating budget which is financed from the current revenues of the municipalities and is used to defray day-to-day expenses, and the capital budget which is mainly financed through long-term municipal loans to erect major capital infrastructure of municipalities for the delivery of basic services to the population (cf. 2.3.2.1).

- **Municipal accounting** is the process of recording, summarising, analysing and interpreting financial transactions that occur in one financial year to the other. The literature revealed that the nature of local government accounting is non-profit accounting and have to conform to the Generally Accepted Accounting Principles (GAAP), which requires municipal accounting to be carried on a fund basis. A fund was defined as a fiscal accounting entity with self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and

residual equities or balances. Essentially, municipal accounting is structured into three types of funds, namely: -

- Governmental funds
- Proprietary funds
- Fiduciary funds (cf. 2.3.2.3).

❖ **The municipal auditing function** is very important in that it exists to verify the reliability of the recorded information and to assess the appropriateness of the underlying financial activities. An audit was defined as an important component without which municipalities would not be able to detect whether their finances are used prudently on the delivery of needed services or finances are wasted through corrupt activities or misadministration (cf. 2.3.2.4).

❖ **Municipal cashflow management** is managing the timing of the revenues that are paid to a municipality and the expenditure incurred to finance municipal obligations. This component of financial management was singled out as very important for keeping municipalities "liquid" – being able to pay for municipal financial obligations when they become due (in the short, medium and long run). The literature challenged municipalities to revamp their billing systems together with their collection methods in order to keep themselves in a solvent state (cf. 2.3.2.6).

❖ **Managing municipal debt** is a very critical element of municipal financial management. This element should be fully integrated with the budgeting and the cash flow management components, because at the beginning of each financial year, municipalities are expected to appropriate enough revenues to pay for the short-term and long-term debt. Prudent cash flow management practises often lead to the availability of enough cash to pay for municipal debt when it becomes due (cf. 2.3.2.7).

Finally, the literature study revealed that all the processes of municipal financial management mentioned above are mutually inclusive in making sure that the municipalities are in a healthy financial footing to finance policies for the delivery of the basic goods and services that are needed by municipal residents.

7.3.2 LOCAL GOVERNMENT FINANCIAL ANALYSIS

In terms of determining the nature and scope of local government financial analysis from literature, it was found that: -

- **Local government financial analysis** is a new field of study in South Africa and that there is limited literature on this subject. The available literature is of American origin, especially from the United States of America and Canada.

- The available literature defined financial analysis as an instrument to measure how well municipalities are able to meet their past, present and future financial obligations. In other words, local government financial analysis has a "watchdog" function over the local government financial management functions. The literature pointed out that for the analysis to be successful, there is a need to arrange the whole financial analysis apparatus into an analytic framework that would be able to integrate the non-financial and financial data in order to develop trends that would signal improvement or deterioration of financial condition (cf. 3.2).

- The analytical framework of local financial analysis consists of the following components, revenue analysis, expenditure analysis, internal resource analysis, and debt and pension analysis. The most important components were singled out as the revenue and expenditure analyses (cf. 3.4).

- The Financial Trend Monitoring System (FTMS) is one of the tried, tested and credible models for financial analysis across the globe. The FTMS was designed by the ICMA (International County/City Management Association to pull together pertinent information from the municipalities' financial reports and statement and mix it with appropriate economic and demographic data to create a series of indicators that when plotted over a period of time can be used to monitor changes in the financial condition of local authorities (cf. 3.5.1).

- The FTMS is built on three main factors, namely, the organisational, environmental and financial factors to analyse the finances of municipalities and that each factor affects the municipal financial condition equally (cf. 3.5.1).

- The FTMS functions ideally when used in conjunction with the time series techniques, such the index method, the percentage change method and the common size methods to assess the change in trends from one financial year to the other (cf. 3.5.1).

7.3.3 THE ECONOMIC BASE OF MAFIKENG LOCAL MUNICIPALITY

Content analysis of the Integrated Development Plan (IDP) of Mafikeng Local Municipality (Annexure 7) revealed the following on the economic base of Mafikeng Local Municipality -

- The population of the Mafikeng Local Municipality has been steadily declining from 1998 and 2001. It decreased by a massive 28%, and the age cohorts that realised the largest decrease were those of 35 to 64 years. The younger members of the population in the area form the largest part of the population, meaning that the economy of Mafikeng is expected to sustain the needs of this age group. The population in the age cohort of 65 and over has decreased dramatically. In 2001, the age cohort of those between the age of 20 and 54 made up 59% of the total population, those between 0 – 19 years made up 20% of the population, those aged between 55 and 65 years made up 16% and those around the ages 65 and over made up 5% of the local population.

- In 2001, 44% of the economically active population of Mafikeng was unemployed, 36% employed and 20% were the minors of no-working age. Employment decreased by 38% between 1998 and 2001, the number of those unemployed decreased by 21% and the minors decreased by 24%. It was expected that the decrease in employment would increase the rate of unemployment, but the exodus of people from Mafikeng (especially those who were unemployed) caused a decrease in the rate of unemployment. The latter impliess that the Mafikeng local economy was not able to absorb this percentage into jobs, but lost them to other towns in the North-West Province and South Africa at large.

- The overall production structure of the economy of the Mafikeng Local Municipality shows that the total Gross Geographical Product (GGP) of the Mmabatho-Mafikeng magisterial district during 1999 was estimated to be around R2.56 billion. Clearly, the vast majority of economic activity takes place in the community, social and personal services sector, which is mainly public sector-inclined and accounts for 52% of economic production in the area. Other notable sectors are financial, insurance, real estate and business services sector (contributing 12.1% to the GGP), wholesale and retail trade sector (11%), transport storage and communication sector (7.8%) and the manufacturing sector (6.6%). These figures clearly indicate the extent to which the local economy is dependant on the community social and personal services sector and the relatively un-diversified nature of the economy.

- Although much of the Mafikeng Local Municipality area can be described as suitable for agricultural production, the contribution of the agricultural sector towards economic production is relatively limited. The estimated output for this sector in 1999 was roughly R130 million, accounting for only 5.1% of total GGP in the area. This sector's role as far as employment is concerned was and is still limited accounting to 5% of employment opportunities in 2001. The average annual labour remuneration in the area is R13 500.00 which is significantly lower than the comparative figures for other sectors.

- The mining and quarrying sector plays a insignificant role in the economy of the district representing less than 1% of total economic output in the area, and contributing only 2% of total employment in 2001.

- The manufacturing sector contributed approximately 6.5% of total output to the local economy in 1999. The important sub-sectors within manufacturing includes the food beverages, and tobacco product sector (29.1%), metal products machinery and household appliances (23.1%), and other non-metallic mineral products (20.5%). These three manufacturing sub-sector jointly contribute more than 75% of economic output in the manufacturing sector in the region.

- As far as employment is concerned, in 1999 the manufacturing sector contributed roughly 6% of total formal sector employment opportunities in the area. The food, beverages, and tobacco sub-sector was dominant, accounting for 38% of formal sector employment opportunities in the manufacturing sector. Metal products machinery and household appliances proportion of formal employment was 14.6%. Textile clothing and leather goods, wood products as well as other non-metallic mineral products all accounted for between 9% and 10% of formal sector employment in the study area. The estimated average annual labour remuneration in the manufacturing sector is R35 500.00.

- The electricity, gas and water supply sector contributed only 1.7% of the total economic production in the study area and less than 1% of total formal employment. This sector's role in the local economy is thus relatively limited.

- The construction sector contributed only 2.9% to Gross Geographical Product in 1999 and 4.3% of formal employment opportunities in the study area. Due to the construction of major highways in Mmabatho-Mafikeng area in 1999/2000, the sector's employment opportunities rose to 6% of total employment in the same period. These lower than expected figures are indicative of the current lack of economic growth and development in the Greater Mafikeng area.

- In 1999, the wholesale and retail sector contributed 11% towards total economic production and 9.9% towards formal sector employment opportunities. In 2001, the contribution increased to 20% partly due to the opening of new Game Stores chains and the Boxers retailers and wholesalers in the area. The contribution of various sub-sectors to production in the wholesale and retail trade sector is dominated by the "retail trade and repairs of goods" sub-sector contributing 23.7% of production in this sector. Hotels and restaurants contributed 18.8%, wholesale and commission trade 19.4% and sales and repairs on motor vehicles and sales of fuel 14.2% of total output in this sector. The proportional contribution towards formal employment opportunities is very similar with the retail trade and repair of goods sub-sector contributing 43.7%, hotels, and restaurants 23.2% in this regard. The average annual labour remuneration of the

wholesale and retail sector in the Mmabatho-Mafikeng magisterial area is estimated to be in the region of R42 000.00.

- The estimated contribution of the transport, storage and communication sector to total economic production in the Greater Mafikeng area is 7.8% and 4.2% towards formal sector employment opportunities. The main contributors to this sector are land transport sector, accounting for nearly 62% of production and post and communication, representing 32.4% of production in this sector. Air transport and storage activities both contributed less than 5% to overall production in this sector.

7.3.4 PATTERNS AND TRENDS OF FINANCES OF THE MAFIKENG LOCAL MUNICIPALITY

It has also been observed from the patterns and trends of the finances of the Mafikeng Local Municipality between 1998 and 2001 that: -

- Assessment/Property rates formed a large portion of own-revenue for the Mafikeng Local Municipality for the period 1998 to 2001 and that the shrinking property tax base caused periodic up and down-swings of property tax revenues. Revenues accrued from the provision of general community services also formed a significant portion of municipal revenues, and central and provincial grants remained the smallest and relatively insignificant portion of revenues for the Mafikeng Local Municipality between 1998 and 2001.

- Throughout 1998 to 2001, the Mafikeng Local Municipality expended most of its revenues on defraying personnel costs in the form of salaries, wages and allowances. Purchasing of bulk water formed only 10.15% of municipal expenditures in 1998 and this trend followed throughout the research period. Repairs, capital charges and contribution to reserve fund and accumulation of fixed assets formed a less "financial slice" in terms of expenditure from the Mafikeng Local Municipality.

- The Mafikeng Local Municipality is facing a very huge problem of a mounting debt due to the municipality. It was revealed during the study that in 1998, the municipality was

owed in the region of R65 million, which escalated to R83,5 million in 1999, and further to R98.6 million in 2000. In 2001, the municipality was owed R116, 2 million in form of current debtors that financial year.

- Investment done by the Mafikeng Local Municipality have increased from R2 millions in 1998 to R8.5 million in 2001. There has been a steep decline in long-term investments: from R12 millions in 1998 to R4.5 million in 2001. The Mafikeng Local Municipality has also run an overdrafted bank account from 1998 to 2000. In 2001, its bank balance was a mere R83, 026.00.

- The Mafikeng Local Municipality has a relatively small commitment towards creditors, but has realised a growth in creditor balances from R2.6 million in 1998 to R9.8 million in 2001. Bank overdrafts have also increased from R6.4 million in 1998 to R17.4 million in 2001.

- The Mafikeng Local Municipality has maintained adequate fund balances, controlled debt service operating expenses and long-term debt. Economic and demographic indicators are extremely negative – property values have decreased significantly in proportion to the exodus of people from the Mmabatho town of the Mafikeng Local Municipality. The unemployment rate has also reached a record high of 44% in 2001.

- The average of the above financial variables projects the financial condition of the Mafikeng Local Municipality as neither healthy nor bad, but as deteriorating. Given the size of debt due to the entity and the amount of overdrafts, one can confidently say that the financial condition of the municipality is suspect.

- By almost all accounts, the Mafikeng Local Municipality's eroded economic base is causing the municipality to teeter towards financial distress. Although the municipality is presently in a safe financial position, a close scrutiny of its finances shows seeds for financial crisis in future.

7.4.1 RECOMMENDATIONS

The following recommendations are made from the findings in this study:-

1. It is recommended that more efforts be taken to undertake vigorous research on local government or municipal finance and financial analysis in South Africa. More funding should also be secured towards the development of the South African financial analysis model.

   The search for literature on financial analysis revealed that there is presently a dearth of such literature in South Africa, and that the municipal financial management practitioners have ignored local government financial analysis as a component of the financial management process. Therefore, a broad based exchange of ideas and research by practitioners, scholars of Public Administration and municipal councillors will, in the long-term, contribute towards the development of an analytic framework that will be tailor-made to fit into the South African system of government, especially at the local level of government. Project Viability, which is an ad hoc interventionist approach to the normalisation of local government finances, can also be enhanced, through further research, to be a permanent financial analysis tool for the South African municipalities.

2. It is also recommended that the Mafikeng Local Municipality engage in intensive local economic development programmes for the growth of the local economic base, especially in the service sector and to turn the normally low-rated informal sector into its fold for re-engineering of the local economy.

   The historical nature of the economy of Mafikeng is that, it had registered minimal presence of manufacturing and fabrication concerns/ industries. The area gained economic prominence by becoming the capital of the former Bophuthatswana government, and thus became the service centre of the large rural former north-western part of the former Transvaal Province. As such, the structure of the economy was based on the presence of the kind of services that were needed by the Bophuthatswana government and its citizens. With the advent of the new political order in South Africa,

the area retained the status to be the capital of the present North-West Province, but its importance as a service centre of the area disintegrated. Multiple service centres were developed across the North-West Province, for example, in Klerksdorp, Potchefstroom and Rustenburg. This worsened by the relocation of the Department of Education headquarters, the provincial Head Office of the SAPS, and the Provincial Commando of the South African National Defence Force to Potchefstroom. The shifting of these strategic government agencies dealt a savage blow to the local economy such that the consumer base for services narrowed, and consequently service businesses had to either close, downgrade their operations or follow the consumers.

The above phenomenon decreased value in the local economy and in order to revitalise the economy, the municipal officials have to recognise the nature of the Mafikeng local economy to attract correct investment into the area. Local economic programmes in which local citizens, the remaining businesses and the municipality have to plan for the future growth of the area, should be developed with the aim of adding value into the area

Again, with the area losing jobs at an accelerating proportion, and the prospects of further new employment opportunities being nil, the Mafikeng Municipality should start to recognise the importance of the informal sector of the economy (hawking) seriously in order to turn this widely despised form of economy into a credible value-adding business. In 2001, 16% of all the people employed in Mafikeng were hawkers. In order to consolidate this sector's contribution to the local economy, the Mafikeng Local Municipality should offer this sector support in terms of business space, access to credit facilities, training in the areas of business management and entrepreneurship. This will empower this sector and contribute towards the growth of the **SMME** (Small, Medium and Micro Enterprises) sector in Mafikeng.

3. In order to sustain the delivery of community and other basic services, the Mafikeng Local Municipality should strictly control its expenditure against the revenues realised.

The large deficits realised by the Mafikeng Local Municipality from 1998 to 2001 show the municipality's inability to raise enough revenues to pay for its expenditures without incurring any deficits. This will in the long-run have immense negative consequences on the municipality's financial condition and creditworthiness. Inasmuch as it is expected

that the municipality should deliver basic services to the people, this should not be done in a way that leaves the municipality vulnerable to insolvencies. In order to control its deficits the municipality should either adopt a practice of strict financial management or decide on expanding its revenue base through local economic programmes. If this is not taken as a matter of urgency, the municipality will in the near future be unable to pay its creditors, suppliers, and personnel on time or/and fail to maintain the municipal infrastructure and equipment.

4. The Mafikeng Local Municipality should put into place a credible and working cash flow management system for the timely billing and collection of revenues.

The Mafikeng Local Municipality's weakening credit record and huge amount of debts due to the municipality shows that the municipality is either having a badly administered billing, collection of taxation and user enforcement system. In order to reduce the size of deficits, which have spiralled out of control between 1998 and 2001, there is a need for the Mafikeng Local Municipality to exhaust ant administrative capacity and statutory powers to recover all debts from residents who have defaulted on their municipal accounts. This can be done based on the social contract that the municipality must deliver the services, and the residents pay for such services for continued maintenance of the service provision machinery.

5. Lastly, the Mafikeng Local Municipality should integrate financial analysis within its financial management functions. In addition to that, it should also employ financial analysts to be part of its financial management team.

In order to keep check on the financial condition of the municipality, the Mafikeng Local Municipality pay equal attention to financial analysis as to other components of financial management, because financial analysis is very important towards the ability of the municipality to sustain its mandate of service delivery to the people. In order to trace changes in the economy and finances, municipal analysts task will be to collect periodic data on the economic performance of the area, compare it with the trends and patterns of the finances and then give the municipality's data upon which expenditure and service

allocation decisions can be made. The lack of available information on the population, income statistics, economic performance from the municipality also confirms the need for municipal financial analysts.

7.5 Conclusion

This chapter presented the results of the study wherein it became evident that the economy and finances of the Mafikeng Local Municipality are in an unhealthy state. The absence of any financial analysis mechanism may have contributed towards such a sorry state of affairs. Inasmuch as financial analysis is a new phenomenon in the South African system of public financial management, there is a need to "fast-track" the process of developing a framework for financial analysis to help municipalities to monitor upwards and downward swings in their economies and finances. This will help them plan accordingly for their economies and service provision plans and to adjust their operational plans on time.

While this study has revealed the nature and scope of financial analysis in local government, it has also put to the fore the dangers that face municipalities when financial analysis is non-existent. In other words, without proper financial analysis, most municipalities will fail in their mandate to provide their populations with quality, uninterrupted services.

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ANNEXURE 1

Madison Borough Budget 1998/1999

Expenditures		
	1998 $	1999 $
Salaries & Wages	6,338,420	6,527,581
Water Services	7,457,800	8,236,817
General Services	3,008,666	4,000,204
Metro Police	2,683,211	3,122,715
Total	$19, 488, 091	$21,890,317

Annexure 2 – Letter of permission to access financial records of Mafikeng Local Municipality

University of North-West
Faculty of Commerce & Administration
Department of Public Administration
Mmabatho
2735
05 February 2002

Treasury Division
Mafikeng Local Municipality
North-West Province
Mafikeng
2745

Dear Madam

Request To Access Mafikeng Local Municipality's Financial Statement: 1998 - 2001.

I am a final year M.Admin student in the above-mentioned faculty at the University of North-West and presently carrying out a research project on **"The financial analysis of local government in the North-West Province: The case of Mafikeng Local Municipality"**. I hereby request your permission to access your local municipality's audited financial statements for the period 1998 to 2001 and any other municipal planning documents, so as to successfully complete my dissertation.

Any information provided by the Mafikeng Local Municipality will be treated with the type of confidentiality it deserves and will only be used for its intended purpose, which is purely academic. Upon the completion of the dissertation, the whole report will be forwarded to you.

Thanking you in anticipation

Yours truly,

Lokisang G. Molwana
(Student)

Mr. I.A Tabane (Supervisor)

Annexure 3 – Financial statements of Mafikeng Local Municipality 1998 – 2001

Annexure 3 (1)

ANALYSIS OF OPERATING INCOME AND EXPENDITURE FOR THE YEAR ENDED 30 JUNE 1999

ACTUAL 1997/98 R		ACTUAL 1998/99 R	BUDGET 1998/99 R
	INCOME		
7,006,827	**GRANTS AND SUBSIDIES**	10,128,272	14,320,000
-	Central Government	2,680,418	1,380,000
7,006,827	Provincial Government	7,448,354	12,940,000
-	Regional District Council		
75,321,347	**OPERATING INCOME**	80,314,455	72,885,720
35,144,595	Assesment Rates	33,316,497	35,896,900
20,926,841	Sale of Water	28,452,576	23,600,000
19,249,911	Other Service Charges	18,545,382	13,388,820
82,328,174	**Total Income**	90,442,727	87,205,720
	EXPENDITURE		
40,515,943	Salaries, Wages and Allowances	43,563,088	45,310,957
46,224,072	General Expenses	50,924,021	51,065,400
11,153,688	Purchase of Water	15,246,646	16,700,000
35,070,384	Other Expenses	35,677,375	34,365,400
7,041,615	Repair and Maintenance	7,576,016	7,190,770
12,780,195	Capital Charges	12,292,688	13,331,320
184,057	Contributions to Fixed Assets	46,544	472,440
3,187,956	Contributions *	2,846,680	2,846,680
109,933,838	Gross Expenditure	116,749,887	119,866,768
32,206,264	Less: Amounts Charged Out	33,733,991	33,279,778
77,727,574	**Net Expenditure**	85,015,896	86,585,990
4,600,600	**Surplus/ (Deficit)**	5,425,831	619,730

***Breakdown of Contributions :**

Amounts Budgeted under Contributions	2,491,030
Amounts Budgeted under Other Expenses i.r.o. Reserves	355,650
Total	2,846,680

Annexure 3 (2)

ANALYSIS OF OPERATING INCOME AND EXPENDITURE FOR THE YEAR ENDED 30 JUNE 2000

ACTUAL 1998/99 R	INCOME	ACTUAL 1999/2000 R	BUDGET 1999/2000 R
10,128,272	**GRANTS AND SUBSIDIES**	4,207,370	9,309,000
2,680,118	Central Government	1,659,560	6,659,000
7,448,154	Provincial Government	2,547,810	2,650,000
	Regional District Council		
80,314,455	**OPERATING INCOME**	87,812,126	83,500,170
33,316,197	Assesment Rates	37,802,464	37,016,650
28,452,576	Sale of Water	24,794,864	30,595,000
18,545,382	Other Service Charges	25,214,804	15,888,520
90,442,727	**Total Income**	92,019,496	92,809,170
	EXPENDITURE		
43,563,088	Salaries, Wages and Allowances	46,535,180	48,187,412
50,424,021	General Expenses	50,525,631	55,747,992
15,276,046	Purchase of Water	14,990,624	17,000,000
35,147,975	Other Expenses	35,534,007	38,747,992
6,575,906	Repair and Maintenance	6,246,930	6,957,749
2,292,688	Capital Charges	2,093,791	2,851,130
16,504	Contributions to Fixed Assets	3,426	37,300
2,846,680	Contributions	1,763,715	1,763,715
106,718,887	Gross Expenditure	107,083,875	116,514,249
(20,731,991)	Less: Amounts Charged Out	(20,199,077)	(23,868,717)
85,016,896	**Net Expenditure**	86,884,798	92,645,532
5,425,831	**Surplus/ (Deficit)**	5,136,698	163,638

Breakdown of Contributions :

2,491,030	Amounts Budgeted under Contributions	1,611,030
355,650	Amounts Budgeted under Other Expenses l.r.o. Reserves	152,685
2,846,680	Total	1,763,715

Annexure 3 (3)

ANALYSIS OF OPERATING INCOME AND EXPENDITURE FOR THE YEAR ENDED 30 JUNE 2001

ACTUAL 1999/2000 R	INCOME	ACTUAL 2000/2001 R	BUDGET 2000/2001 R	VARIANCES
4,207,370	**GRANTS AND SUBSIDIES**	8,285,375	9,540,225	(1,254,850)
1,659,560	Central Government	2,004,361	1,659,000	345,361
2,547,810	Provincial Government	6,281,014	7,881,225	(1,600,211)
	Regional District Council			-
87,812,126	**OPERATING INCOME**	94,490,376	87,697,261	6,793,115
37,802,461	Assesment Rates	38,325,771	37,350,141	975,630
24,794,861	Sale of Water	28,078,423	30,300,000	(2,221,577)
25,214,804	Other Service Charges	28,086,182	20,047,120	8,039,062
92,019,496	**Total Income**	102,775,751	97,237,486	5,538,265
	EXPENDITURE			
46,585,180	Salaries, Wages and Allowances	49,514,593	50,706,373	(1,191,780)
50,525,851	General Expenses	57,983,191	57,728,841	254,350
14,990,224	Purchase of Water	18,863,293	17,000,000	1,863,293
35,535,627	Other Expenses	39,119,898	40,728,841	(1,608,943)
6,245,930	Repair and Maintenance	6,937,411	7,977,680	(1,040,269)
2,005,493	Capital Charges	2,412,165	2,154,336	257,829
5,425	Contributions to Fixed Assets	64,061	466,887	(402,826)
1,763,715	Contributions	2,254,820	2,054,820	200,000
107,081,875	Gross Expenditure	129,166,241	131,088,937	(1,922,696)
(20,199,177)	Less: Amounts Charged Out	(29,974,893)	(33,868,717)	3,893,824
86,882,798	**Net Expenditure**	99,191,348	97,220,220	1,971,128
5,136,698	**Surplus/ (Deficit)**	3,584,403	17,266	3,567,137

Breakdown of Contributions :

1,611,030	Amounts Budgeted under Contributions	2,054,820	
152,685	Amounts Budgeted under Other Expenses l.r.o. Reserves	200,000	Audit Fees
1,763,715	Total	2,254,820	

BALANCE SHEET AS AT 30 JUNE 1999

	1999	1998
CAPITAL EMPLOYED		
FUNDS AND RESERVES	106 783 487	95 954 427
STATUTORY FUNDS	85 926 780	79 028 696
RESERVES	20 856 707	16 925 731
ACCUMULATED SURPLUS	6 093 004	5 056 002
	112 876 491	101 010 429
TRUST FUNDS	5 204 039	2 250 549
LONG-TERM LIABILITIES	26 196 128	27 446 308
CONSUMER DEPOSITS:SERVICES	1 883 165	1 882 355
	146 159 823	132 589 641
EMPLOYMENT OF CAPITAL		
FIXED ASSETS	72 163 625	72 250 502
INVESTMENTS	10 852 218	12 000 000
LONG-TERM DEBTORS	4 809 662	2 904 436
DEFERRED CHARGES	88 825 505	87 154 938
NET CURRENT ASSETS	57 334 318	45 434 703
CURRENT ASSETS	80 440 043	68 638 046
Inventory	926 244	1 039 810
Debtors	35 515 508	65 551 276
Short-term Investments	43 998 291	2 046 960
CURRENT LIABILITIES	23 105 725	23 203 343
Provisions	5 308 139	2 840 426
Creditors	10 791 341	10 845 879
Short-term portion of Long-term Liabilities	6 923 645	2 668 835
Bank Overdraft	10 704 008	6 848 080
	146 159 823	132 589 641

BALANCE SHEET AS AT 30 JUNE 2000

	2000	1999
CAPITAL EMPLOYED		
FUNDS AND RESERVES	121 879 704	106 783 187
Statutory Funds	97 238 829	85 926 780
Reserves	24 640 875	20 856 407
(Accumulated Deficit)/Retained Income	5 196 494	6 093 004
	127 076 198	112 876 191
TRUST FUNDS	5 279 738	5 204 039
LONG-TERM LIABILITIES	25 479 085	26 196 428
CONSUMER DEPOSITS:SERVICES	1 639 676	1 883 165
	159 474 697	146 159 823
EMPLOYMENT OF CAPITAL		
FIXED ASSETS	71 506 455	72 155 625
INVESTMENTS	7 000 000	14 852 238
LONG-TERM DEBTORS	1 522 405	1 698 331
	80 028 860	88 706 194
NET CURRENT ASSETS\LIABILITIES	79 445 837	57 453 629
CURRENT ASSETS	104 039 198	86 180 015
Inventory	934 684	926 244
Debtors	98 647 718	83 515 087
Short-term Investments	4 456 796	1 738 684
Short-term Portion of Long-term Debtors		
CURRENT LIABILITIES	24 593 361	28 726 386
Provisions	5 717 234	5 002 397
Creditors	9 603 236	11 791 341
Short-term Portion of Long-term Liabilities	701 885	1 228 640
Bank Overdraft	8 571 006	10 704 008
	159 474 697	146 159 823

BALANCE SHEET AS AT 30 JUNE 2001

	[illegible]	[illegible]
CAPITAL EMPLOYED		
FUNDS AND RESERVES	[illegible]	[illegible]
Statutory Funds	[illegible]	[illegible]
Reserves	[illegible]	[illegible]
(Accumulated Deficit)/Retained Income	[illegible]	[illegible]
	[illegible]	[illegible]
TRUST FUNDS	[illegible]	[illegible]
LONG-TERM LIABILITIES	[illegible]	[illegible]
CONSUMER DEPOSITS:SERVICES	[illegible]	[illegible]
	[illegible]	[illegible]
EMPLOYMENT OF CAPITAL		
FIXED ASSETS	[illegible]	[illegible]
INVESTMENTS	[illegible]	[illegible]
LONG-TERM DEBTORS	[illegible]	[illegible]
	[illegible]	[illegible]
NET CURRENT ASSETS\LIABILITIES	[illegible]	[illegible]
	[illegible]	[illegible]
CURRENT ASSETS	[illegible]	[illegible]
Inventory	[illegible]	[illegible]
Debtors	[illegible]	[illegible]
Cash	[illegible]	[illegible]
Short-term Investments	[illegible]	[illegible]
Short-term Portion of Long-term Debtors	[illegible]	[illegible]
	[illegible]	[illegible]
CURRENT LIABILITIES	[illegible]	[illegible]
Provisions	[illegible]	[illegible]
Creditors	[illegible]	[illegible]
Short-term Portion of Long-term Liabilities	[illegible]	[illegible]
Bank Overdraft	[illegible]	[illegible]
	[illegible]	[illegible]

Annexure 4 – Municipal expenses expressed in percentage change

FY	Salaries & Wages	Purchase of water	Community services	Repair and mair	Capital charges	Contribution to fixed a	Contribution to reserves
97/98	R 40,515,943	R 11,153,688	R 35,070,384	R 7,041,615	R 12,780,195	R 184,057	R 3,187,956
98/99	R 43,563,088	R 15,276,046	R 35,147,975	R 7,575,906	R 12,292,688	R 46,504	R 2,846,680
99/2000	R 46,535,180	R 14,990,424	R 35,535,407	R 6,245,930	R 12,005,793	R 5,426	R 1,763,715
2000/2001	R 49,514,593	R 18,863,293	R 39,119,898	R 6,937,411	R 12,412,165	R 64,061	R 2,254,820
FY	Salaries & Wages	Purchase of water	Community services	Repair and mair	Capital charges	Contribution to fixed a	Contribution to reserves
Between 97/98 & 97/98	0%	0%	0%	0%	0%	0%	0%
Between 97/89 & 98/99	7%	27%	0%	7%	-4%	-296%	-12%
Between 98/99 & 99/00	6%	-2%	1%	-21%	-2%	-757%	-61%
Between 99/00 & 00/01	6%	21%	9%	10%	3%	92%	22%
FY	Salaries & Wages	Purchase of water	Community services	Repair and mair	Capital charges	Contribution to fixed a	Contribution to reserves
97/98	36.85%	10.15%	31.90%	6.41%	11.63%	0.17%	2.90%
98/99	37.31%	13.08%	30.11%	6.49%	10.53%	0.04%	2.44%
99/2000	39.75%	12.80%	30.35%	5.33%	10.25%	0.00%	1.51%
2000/2001	38.33%	14.60%	30.29%	5.37%	9.61%	0.05%	1.75%

Annexure 5 – Age of municipal debts in Mafikeng as at 31 January 2002

AGE ANALYSIS OF DEBTS PER AREA
AS AT 31 JANUARY 2002

AREA	CURRENT	30 DAYS	60 DAYS	90 DAYS +	TOTAL
Mafikeng (01)	(265,771.48)	8,074,008.23	1,181,408.79	31,680,890.87	**40,670,536.41**
Danville (02)	552,605.91	594,356.34	170,831.06	4,837,113.75	**6,154,907.06**
Mmabatho (03)	2,462,436.14	10,920,642.66	2,517,676.99	55,962,639.52	**71,863,395.31**
Montshiwa (04)	1,288,314.08	2,212,561.81	740,161.14	18,579,154.11	**22,820,191.14**
Roolgrond (09)	3,003.79	104,961.23	4,327.45	513,705.73	**625,998.20**
Otloshoop	1,175.68	18,948.93	6,222.18	67,776.63	**94,123.42**
TOTAL	**4,041,764.12**	**21,925,479.20**	**4,620,627.61**	**111,641,280.61**	**142,229,151.54**
PLUS: Cycle 02 Sundries	(6,981.75)	19,731.87	28,025.33	2,435,067.87	**2,475,843.32**
TOTAL	**4,034,782.37**	**21,945,211.07**	**4,648,652.94**	**114,076,348.48**	**144,704,994.86**
LESS: Deposit on Hand (Sundries)	(5,502.89)				**(5,502.89)**
TOTAL	**4,029,279.48**	**21,945,211.07**	**4,648,652.94**	**114,076,348.48**	**144,699,491.97**

NB: Current Assessment Rates included

Annexure 6- Notice on settlement of arrear debts (Incentive Options)

MAFIKENG LOCAL MUNICIPALITY

NOTICE

SETTLEMENT OF ARREAR DEBTS

The following measures and/or proposal were approved by Council to encourage all consumers who are in arrears in respect of the payment of their account, to settle these arrears within a reasonable period of time. It is an incentive which can only be offered for a limited duration of time, whereafter the Council will need to revert to normal sanction measures in respect of those consumers who remain in default.

INCENTIVE OPTION 1:

Consumers who settle their capital balances due **within twelve months** of the date on which they concluded a written agreement to settle, will have the remaining **100%** of the total interest accumulated written-off.

INCENTIVE OPTION 2:

Consumers who settle their total capital balances due **between twelve and twenty four months** of the date on which they conclude a written agreement to settle, will have the remaining **50%** of the total interest accumulated written-off.

INCENTIVE OPTION 3:

Consumers who settle their total capital balances due **between twenty-four and thirty-six months** of the date on which tey conclude a written agreement to settle, will have the remaining **25%** of the total interest accumulated written-off.

Applicable interest discounts will only be allowed after settlement agreement have been honoured and provided further that the current account is fully paid.

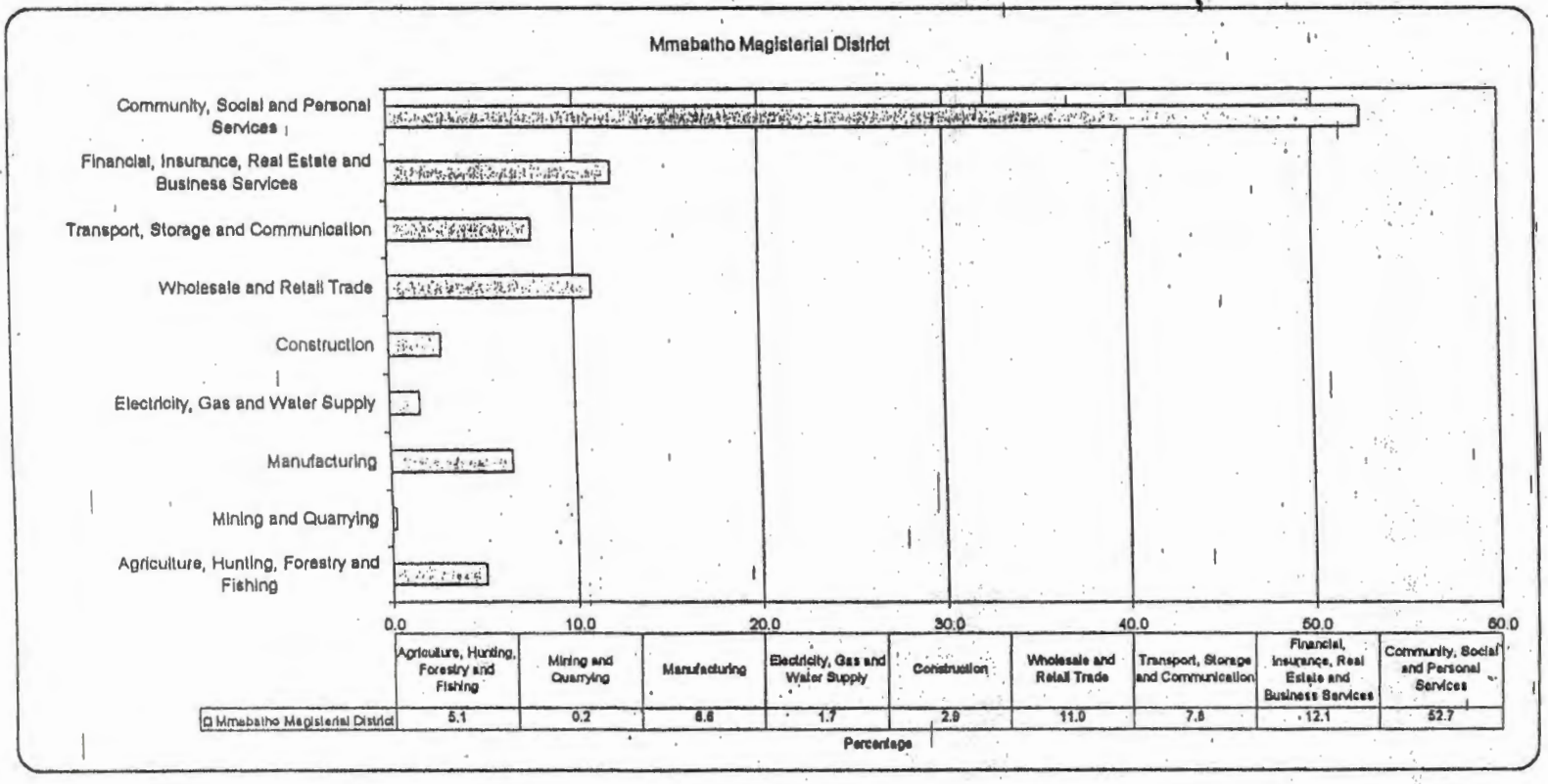
- Consumers who already have an arrangement with the Council, but whish to benefit from the discounts on offer, will be required to conclude a new agreement.
- Consumers who has been already handed over and legal action taken, or whose debt is being recovered by Council's appointed collection agents also qualify for the discount provided they meet all requirements.
- Incentives offered are applicable retrospectively as from 1 November 2001 and Arrangements must be made before 30 June 2002 in order to qualify for the above incentive.
- Consumers whose services are disconnected would be connected on condition that an acknowledgement of debt and agreement arrangements are completed and signed after all documents required are submitted before approval of arrangement.
- The total arrear amount, which is the subject of an arrangement, ceases to accumulate arrear interest if the arrangement is honoured.

Annexure 7 Integrated Development Plan of Mafikeng Local Municipality, Draft 1, Volume 1, 2002

GGP (1999 figures): Sector contribution per District (%)

	Agriculture, Hunting, Forestry and Fishing	Mining and Quarrying	Manufacturing	Electricity, Gas and Water Supply	Construction	Wholesale and Retail Trade	Transport, Storage and Communication	Financial, Insurance, Real Estate and Business Services	Community, Social and Personal Services	Total
Mmabatho Magisterial District	5.1	0.2	6.6	1.7	2.9	11.0	7.8	12.1	52.7	100

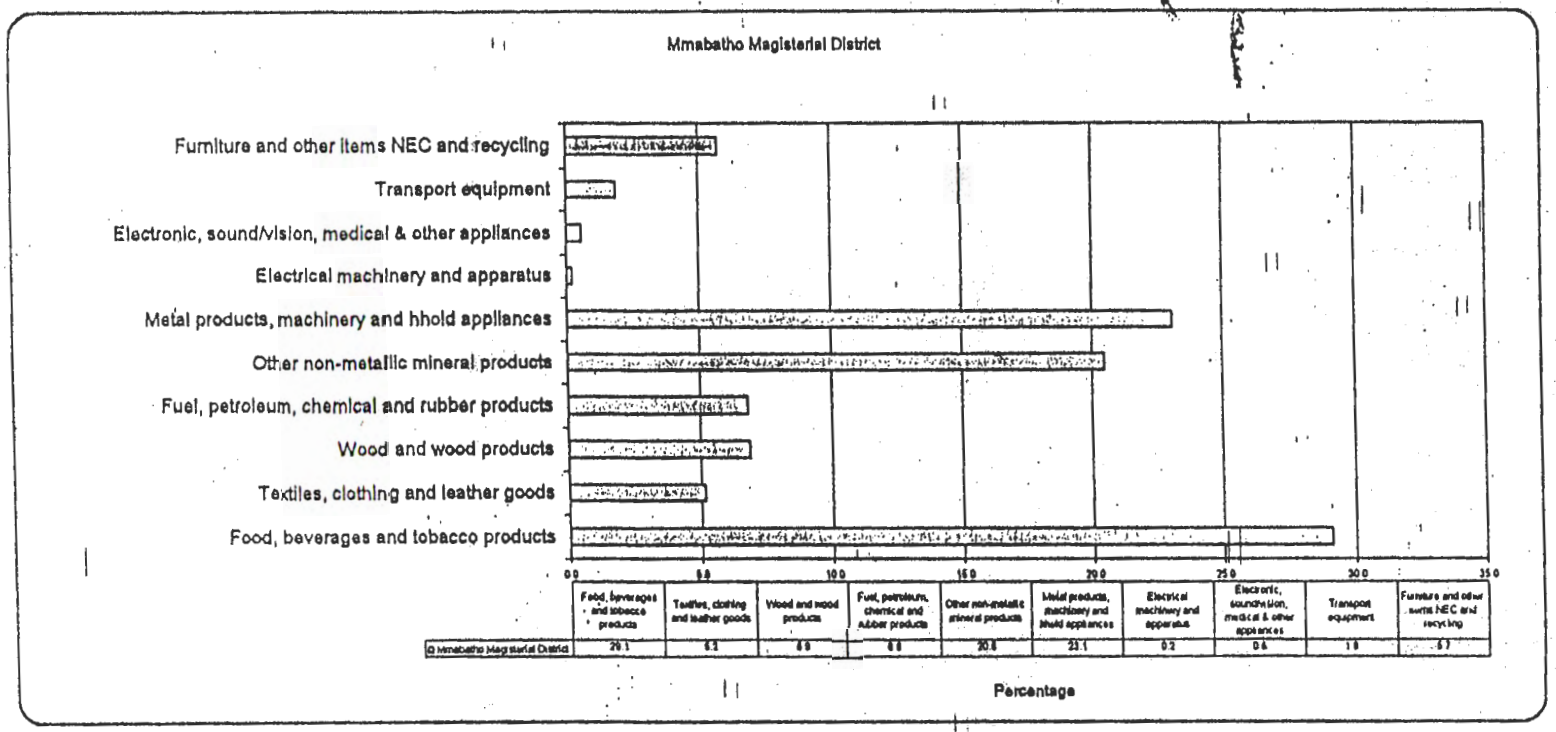
DATA SOURCE: DRI WEFA, REGIONAL ECONOMIC FOCUS, 2000



GGP (1999 figures) - Manufacturing Sector contribution per District (%)

	Food, beverages and tobacco products	Textiles, clothing and leather goods	Wood and wood products	Fuel, petroleum, chemical and rubber products	Other non-metallic mineral products	Metal products, machinery and hhold appliances	Electrical machinery and apparatus	Electronic, sound/vision, medical & other appliances	Transport equipment	Furniture and other items NEC and recycling	TOTAL
Mmabatho Magisterial District	29.1	5.2	6.9	6.8	20.8	23.1	0.2	0.6	1.9	5.7	100

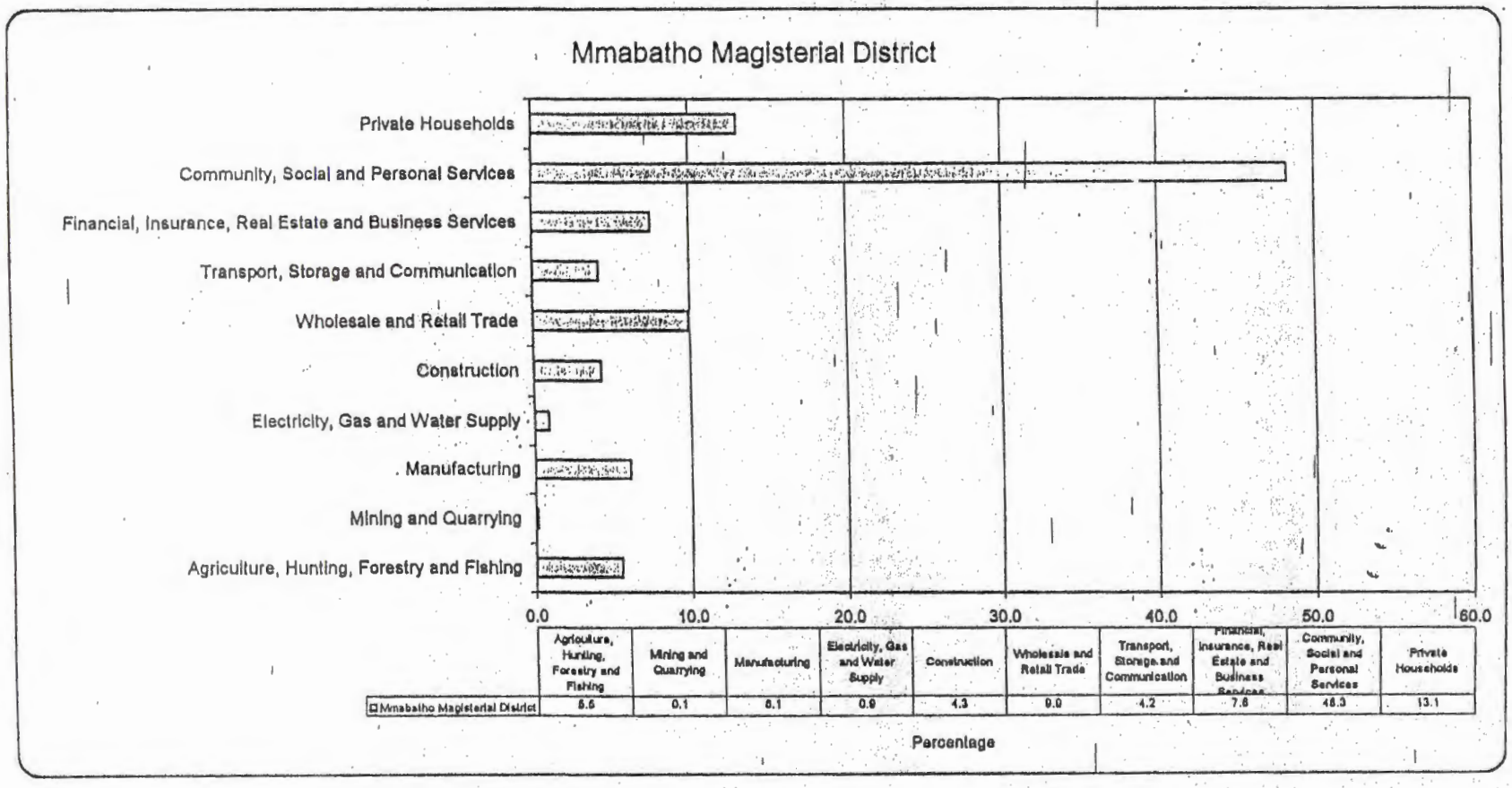
DATA SOURCE: DRI WEFA, REGIONAL ECONOMIC FOCUS, 2000



Formal Employment: Sector contribution per District (%)

	Agriculture, Hunting, Forestry and Fishing	Mining and Quarrying	Manufacturing	Electricity, Gas and Water Supply	Construction	Wholesale and Retail Trade	Transport, Storage and Communication	Financial, Insurance, Real Estate and Business Services	Community, Social and Personal Services	Private Households	Total
Mmabatho Magisterial District	5.5	0.1	6.1	0.9	4.3	9.9	4.2	7.6	48.3	13.1	100

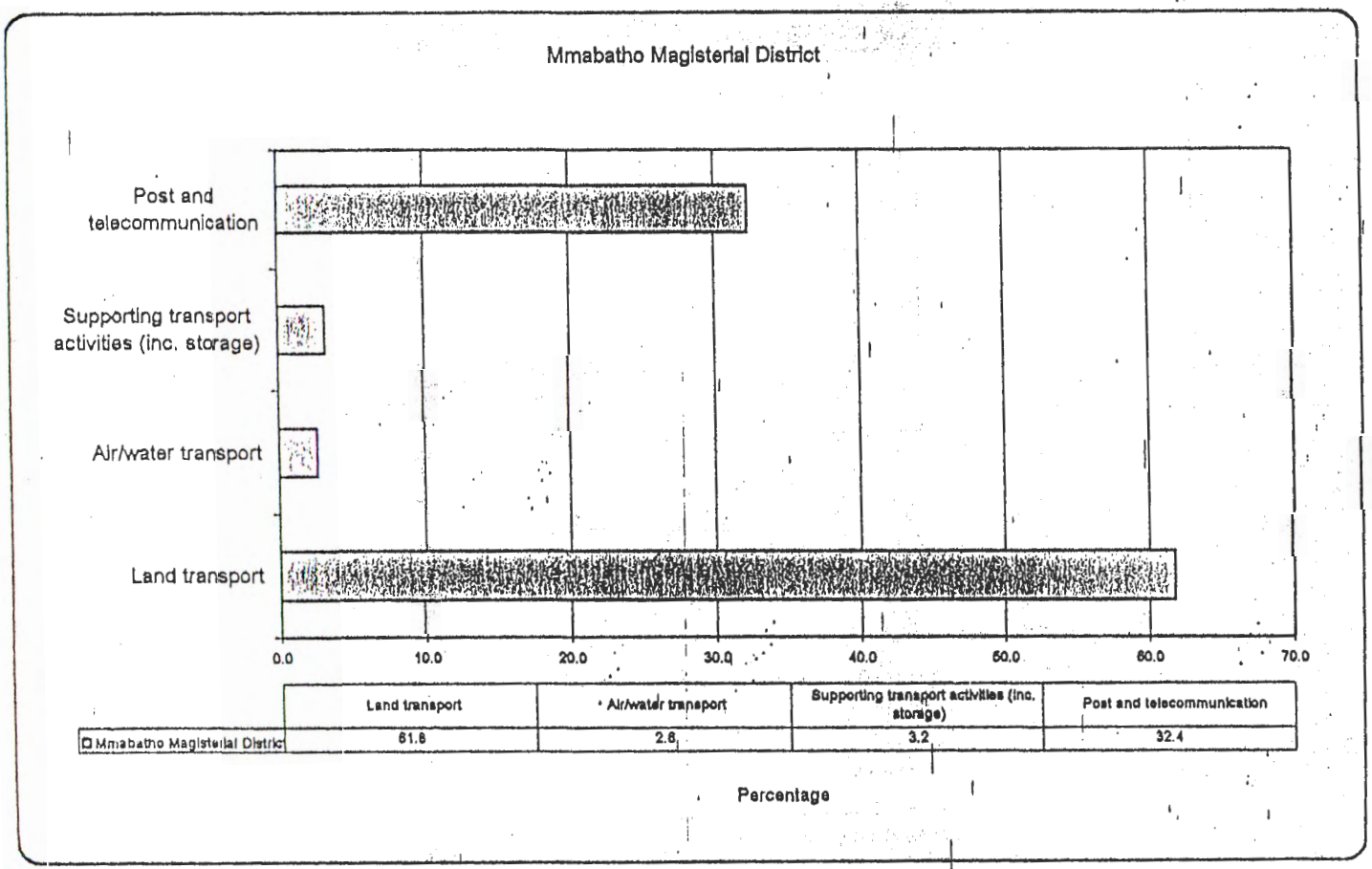
DATA SOURCE: DRI WEFA, REGIONAL ECONOMIC FOCUS, 2000



GGP (1999 figures) - Transport, Storage and Communication Sector contribution per District (%)

	Land transport	Air/water transport	Supporting transport activities (inc. storage)	Post and telecommunication	TOTAL
Mmabatho Magisterial District	61.8	2.6	3.2	32.4	100

DATA SOURCE: DRI WEFA, REGIONAL ECONOMIC FOCUS, 2000

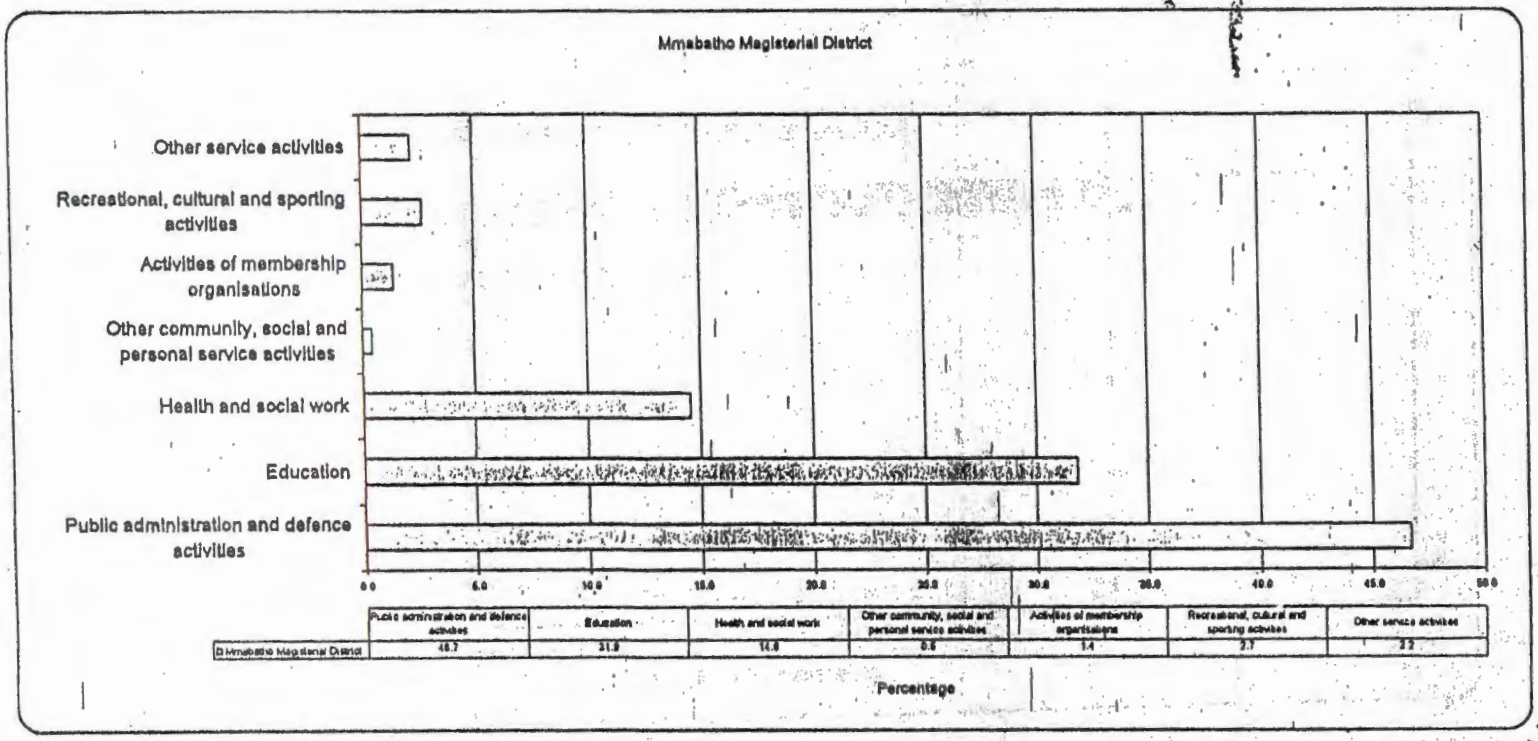


Sectoral Analysis

Formal Employment (1999 figures) - Community, Social and Personal Services Sector contribution per District (%)

	Public administration and defence activities	Education	Health and social work	Other community, social and personal service activities	Activities of membership organisations	Recreational, cultural and sporting activities	Other service activities	TOTAL
Mmabatho Magisterial District	46.7	31.9	14.8	0.6	1.4	2.7	2.2	100

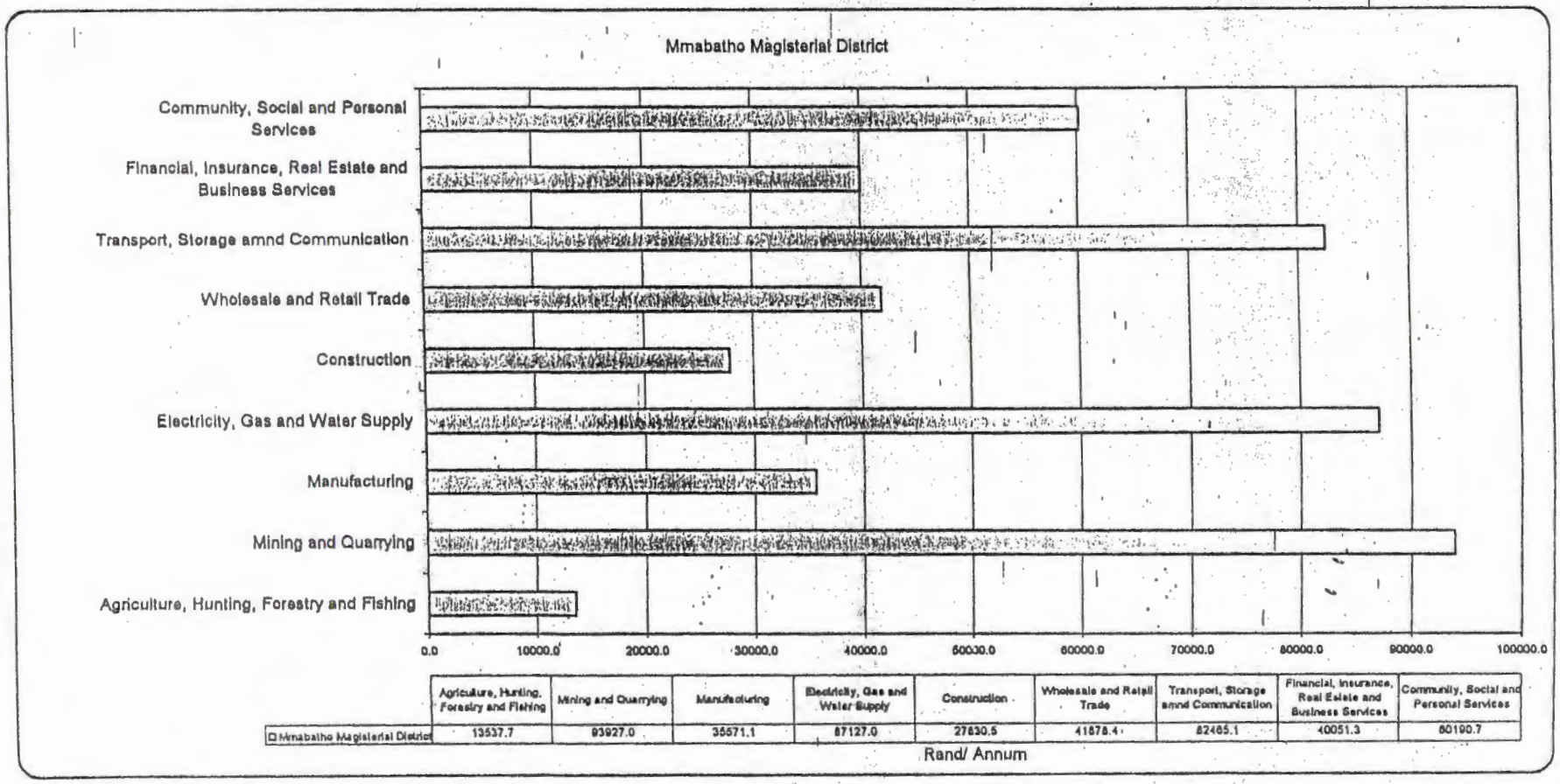
DATA SOURCE: DRI WEFA, REGIONAL ECONOMIC FOCUS, 2000



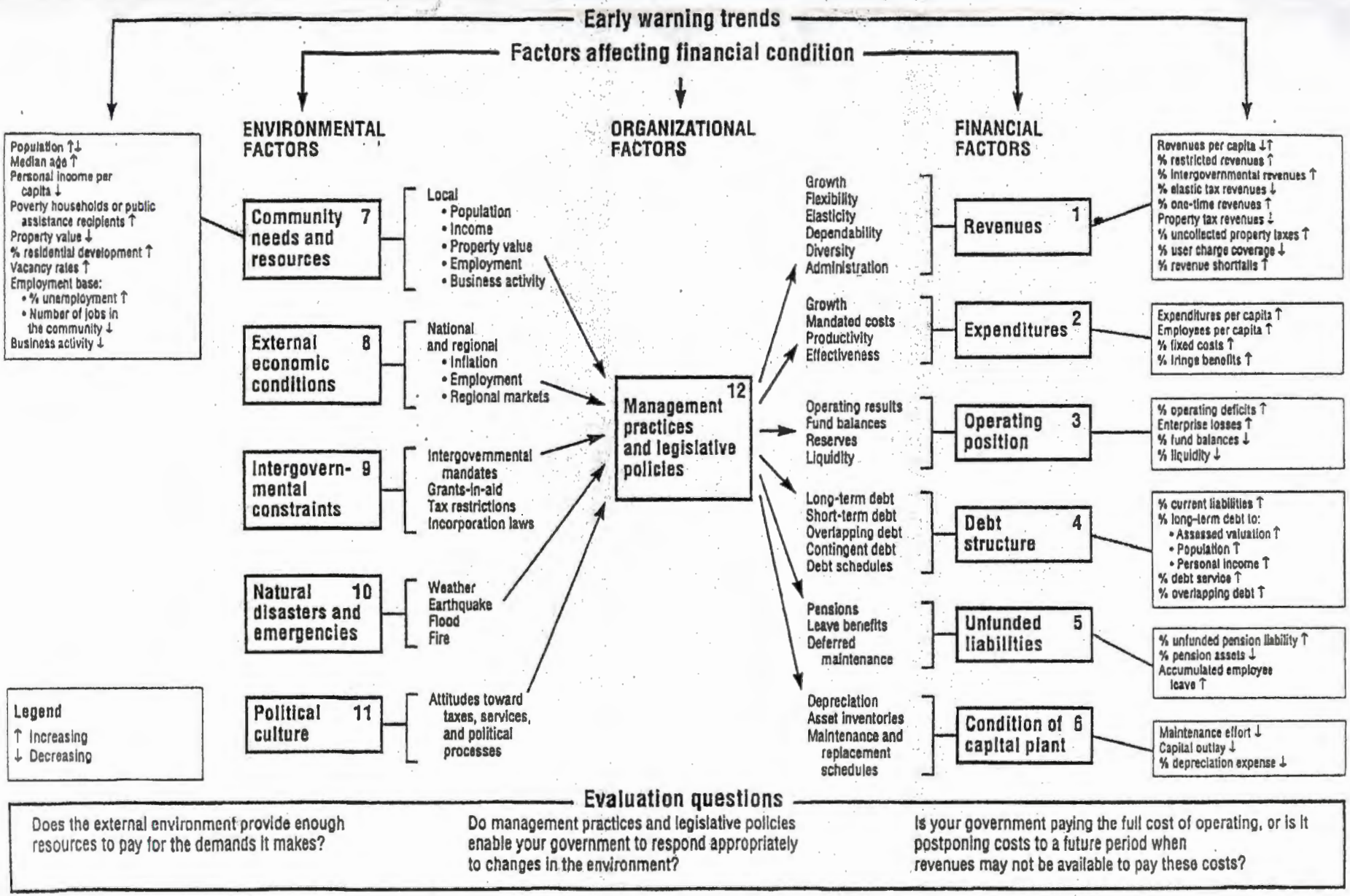
Average labour remuneration per district (R/annum)

	Agriculture, Hunting, Forestry and Fishing	Mining and Quarrying	Manufacturing	Electricity, Gas and Water Supply	Construction	Wholesale and Retail Trade	Transport, Storage amnd Communication	Financial, Insurance, Real Estate and Business Services	Community, Social and Personal Services
Mmabatho Magisterial District	13537.7	93927.0	35571.1	87127.0	27830.5	41878.4	82485.1	40051.3	60190.7

DATA SOURCE: DRI WEFA, REGIONAL ECONOMIC FOCUS, 2000



Annexure 8 - Financial Trend Monitoring System


Early warning trends
Factors affecting financial condition
Population ↑↓
Median age ↑
Personal income per capita ↓
Poverty households or public assistance recipients ↑
Property value ↓
% residential development ↑
Vacancy rates ↑
Employment base:
• % unemployment ↑
• Number of jobs in the community ↓
Business activity ↓
ENVIRONMENTAL FACTORS
Community needs and resources 7
Local
• Population
• Income
• Property value
• Employment
• Business activity
External economic conditions 8
National and regional
• Inflation
• Employment
• Regional markets
Intergovern-mental constraints 9
Intergovernmental mandates
Grants-in-aid
Tax restrictions
Incorporation laws
Natural disasters and emergencies 10
Weather
Earthquake
Flood
Fire
Political culture 11
Attitudes toward taxes, services, and political processes
ORGANIZATIONAL FACTORS
Management practices and legislative policies 12
FINANCIAL FACTORS
Growth
Flexibility
Elasticity
Dependability
Diversity
Administration
Revenues 1
Revenues per capita ↓↑
% restricted revenues ↑
% intergovernmental revenues ↑
% elastic tax revenues ↓
% one-time revenues ↑
Property tax revenues ↓
% uncollected property taxes ↑
% user charge coverage ↓
% revenue shortfalls ↑
Growth
Mandated costs
Productivity
Effectiveness
Expenditures 2
Expenditures per capita ↑
Employees per capita ↑
% fixed costs ↑
% fringe benefits ↑
Operating results
Fund balances
Reserves
Liquidity
Operating position 3
% operating deficits ↑
Enterprise losses ↑
% fund balances ↓
% liquidity ↓
Long-term debt
Short-term debt
Overlapping debt
Contingent debt
Debt schedules
Debt structure 4
% current liabilities ↑
% long-term debt to:
• Assessed valuation ↑
• Population ↑
• Personal income ↑
% debt service ↑
% overlapping debt ↑
Pensions
Leave benefits
Deferred maintenance
Unfunded liabilities 5
% unfunded pension liability ↑
% pension assets ↓
Accumulated employee leave ↑
Depreciation
Asset inventories
Maintenance and replacement schedules
Condition of capital plant 6
Maintenance effort ↓
Capital outlay ↓
% depreciation expense ↓
Legend
↑ Increasing
↓ Decreasing
Evaluation questions
Does the external environment provide enough resources to pay for the demands it makes?
Do management practices and legislative policies enable your government to respond appropriately to changes in the environment?
Is your government paying the full cost of operating, or is it postponing costs to a future period when revenues may not be available to pay these costs?