



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

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Ref: KZN 282/47

Mr N Zulu
The Municipal Manager
uMhlathuze Local Municipality
Private Bag X1004
RICHARDS BAY
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Dear Mr Zulu

OBSERVATIONS AND RECOMMENDATIONS EMANATING FROM THE BUDGET AND BENCHMARK ENGAGEMENT HELD ON THE ON 15 MAY 2023

The annual budget and benchmark engagement focused on the City's tabled budget for the 2023/24 Medium Term Revenue and Expenditure Framework (MTREF) and the strategic objectives as articulated in the longer-term strategic plans such as Municipal Spatial Development Framework (MSDF) and the Integrated Development Plan (IDP).

The objectives of the engagement were to:

- assess the alignment between planning, budgeting, and reporting;
- assess the level of integrated intergovernmental planning;
- assess whether the City's plans and budget are financially sustainable in the longer term and enable improved service delivery performance; and
- efforts to address the negative impact of load shedding and its impact on the economy.

The budget was assessed in terms of the following:

- **credibility** - whether the budget assumptions are credible and whether the budget is funded in accordance with the provisions of section 18 of the Municipal Finance Management Act (MFMA);
- **relevance** - whether the budget responds to the objectives articulated in the municipality's plans and the alignment between planning and budgeting; and
- **sustainability** - whether the municipality is financially sustainable.



In addition, the overall assessment of the municipality's performance was undertaken in accordance with the four pillars namely, **institutional arrangement, service delivery, financial governance** and **financial health**.

The engagement was well-attended by the City, National Treasury, Department of Cooperative Governance and Traditional Affairs (CoGTA). The City was well-prepared for the engagement and all relevant documents were received prior to the engagement.

A summation of the observations, recommendations and resolutions emanating from the discussions is presented below. To the extent possible, these recommendations must be incorporated in the budget before final adoption.

KEY OBSERVATIONS

Institutional arrangement: Fragile

- The institutional arrangement was assessed to be fragile because of the risk that the coalition government may pose to the institution. It was noted that the Economic Freedom Fighters (EFF) abandoned the coalition Council and left the position of the Deputy Mayor vacant.
- The administration is stable and there are no vacant posts for section 56 senior managers. However, there are posts at lower levels which are funded.
- The senior managers meets the minimum competencies because the City requires candidates to have NQF level 9 and meet minimum competencies when filling vacancies.
- The City is reliant on consultants in areas of scarce skills as well as on the SAP system.
- The City indicated that the audit action plan is developed using the management report issued by the Auditor-General (AG). The issues that were raised by the AG related to Information Communication and Technology (ICT), Supply Chain Management (SCM) and Performance Management System (PMS). There is a functioning internal audit and audit committee for improved control environment and quality assurance.
- There is consistent risk reporting in the City and the risk Maturity audits published in 2015 and 2022 shows improvement.
- The Municipal Public Accounts Committee (MPAC) is functional and chaired by a member of the opposition within the Coalition Council.
- Consequence management is highly implemented as there were cases of electricity theft that have been escalated with cases opened.
- The AG findings related to ICT are discussed at the monthly ICT steering committee that also provide inputs on the impact on mSCOA implementation.



- The City is still experiencing challenges with intergovernmental planning regardless of the District Development Model e.g. majority of government departments and private sector are not reporting. The DDM is seen as a duplication of the IDP process. However, it was indicated that the challenges and proposed solutions were discussed with CoGTA.
- The following challenges that are impacting negatively on the City's sustainability were identified:
 - The majority of households in the Ingonyama Trust Board (ITB) areas are not levied property rates as these properties are not divided into separate erven, therefore households do not have title deeds. These communities are receiving municipal services funded by property rates but not with commensurate revenue collection.
 - The Council received a level II accreditation however, the subsidisation of housing services which is an unfunded mandate puts pressure on its finances as R24.7 million was funded from property rates.
 - The failure of Transnet Freight Rail and Port Terminal contributes to severe truck management challenges in Richards Bay and surrounding roads. This results in additional requirements for repairs and maintenance as the roads were not designed to carry the load that is currently experienced. In addition, funding is required for a truck placing strategy that the City is developing.

mSCOA implementation

- The live demonstration on how *mSCOA* operates within the Systems Application and Products (SAP) environment was done and the municipality explained how the workflow between the SAP ECC, SAP BW, SAP BPC and other modules are functioning. The demonstration was well received and it was proposed that a dedicated engagement be arranged for *mSCOA* system demonstration on billing and asset management.
- The Human Capital Management (HCM) module is still under development and will be integrated into the SAP system in the forthcoming financial year.

Financial Governance: Sound

- The City has strong governance structures to enable political oversight on the IDP process which includes, amongst others, the IDP and Budget Steering committee.
- The IDP public participation was first undertaken between September and October 2022 (ward committees, stakeholder forums etc.) with the second one being in April.
- The City used various channels to solicit inputs from stakeholders which includes placing notices for input on the Local Newspaper, Municipal Website and Municipal Social Media Platforms.
- The issues raised by communities included the condition of roads, provision of basic services, unemployment, safety and human settlements.
- The City considered the inputs received from various stakeholders in line with the available budget and the macro- and socio-economic conditions over the MTREF.



- It was concluded that there is alignment between the IDP and the 2023/24 MTREF because of the extent to which the strategic objectives were budgeted for. It was indicated that 92 per cent of the capital budget is allocated against the efficient and integrated infrastructure and services objective.

Service Delivery: Sound

- The City has allocated budget for procurement of generators for priority waste water treatment works as a contingency measure to maintain the efficient functioning of the equipment when loadshedding is implemented. This will prevent sludge spillage into rivers, private property and the malfunctioning of the equipment.
- The loadshedding and cable theft placed severe strain on the switchgear and other electrical equipment when power surges happen. The electricity department officials visits substations to turn off equipment to prevent failure and also do maintenance where needed.
- The city has electricity losses of 9 per cent, of which 2 per cent is technical losses and 7 per cent non-technical losses. Theft and faulty metering management are one of the factors that contribute to non-technical losses.
- The City is investing in the SCADA system for monitoring of the electricity network.
- The persistent loadshedding required the municipality to investigate alternative energy sources such as gas to power and hydro-electric power from Independent Power Producers (IPP).
- The security cost to protect infrastructure from vandalism placed undue strain on the budget, however, the City is exploring other alternatives that will result in reduced costs. The City has also approved a safer city strategy and has partnered with the security cluster (district, provincial and national) and resuscitated the forum.
- The City is reducing the use of water tankers by private suppliers as it is not sustainable and results in high contracted services. There are projects planned to provide standpipes for areas without water. The City will also utilise its own water takers to provide water to rural communities and when it experience water shortages.
- The City has resuscitated the project for VIP toilets to address sanitation backlogs.
- The City has fostered good relationships with traditional authorities in addressing land invasions.
- The capital budget is mainly funded from borrowings followed by grants while funding from internally generated funds increases over the MTREF. The City is creating capital replacement reserve through allocations for depreciation and sale of land which will enable funding of the capital budget from own funds.

Financial Health: Fragile

- The draft budget of the City is faced by the following challenges: interest rates hikes by the Reserve Bank; aftereffects of the pandemic, Power loadshedding; lasting effects of the July 2021 violence and looting on businesses which were ratepayers before the incident.



- In addition, vandalism and breakages has a negative impact on security costs which has resulted in increased operating expenditure.
- The current socio-economic challenges are also impacting negatively on the consumers ability to pay for services. Therefore, the City kept the tariff increases at low levels.
- The tariffs for electricity and water are informed by the tariffs from National Energy Regulator of South Africa (NERSA) and the uMhlathuze water board respectively. The City also undertakes trend analysis and benchmark with other municipalities to be on a comparability trajectory of affordability.
- During the engagement, the City highlighted that the collection rate was negatively affected when Council suspended the credit control measures during the lockdown period hence, there is a sluggish return to attain the previous levels.
- It was also indicated that there is commitment from Council to support measures to improve the collection rates. The payment of consumer accounts in the Traditional Authority area remains a challenge but the Mayor emphasised that officials residing in these areas should set the example and pay for services.
- The City indicated that there is a dedicated section with roles and responsibilities which implements measures to address debtors over 90 days. This includes water restrictions, block prepayment, regular inspection of blocked meters for tamper then handing over of these accounts to the Attorneys.
- National Treasury assessed the budget using a collection rate of 91 per cent over the 2023/24 MTREF compared to the City's 95 per cent. The calculation is based on the audited results for the 2021/22 financial year. It should be noted that the same collection rate was applied for all three years without considering the possibility of it improving in the outer years of the MTREF.
- This has resulted in the projected cash and cash equivalents declining over the MTREF. The City's financial ratios are declining over the 2023/24 MTREF, with the liquidity ratio below the norm of 1. The cash available based on the 91 per cent collection rate, is not sufficient to cover creditors. The current ratio is improving over the MTREF and is above the norm of 1.5 - 2.
- The budget assumptions are credible and revenue estimates are realistic as increases are informed by tariffs and growth in consumption as well as bulk purchases. The budget is multi-year because the deviation is below 5 per cent and 10 per cent for the operating and capital budget respectively.
- The City must ensure that it achieves the collection rate of 95 per cent to maintain financial sustainability. The collection rate of 91 per cent assumed by National Treasury highlights risks in the outer years of the MTREF which will impact negatively on the City's sustainability.
- The budget is funded in 2023/24 and 2024/25 financial years respectively, but the 2025/26 financial year remains a challenge if the collection rate does not improve.



RECOMMENDATIONS/ RESOLUTIONS

It is recommended that:

- National Treasury must arrange a technical session with the City to discuss the outcome of the funding assessment.
- The City and National Treasury must arrange a separate session for the live demonstration of the System at the municipal offices to understand how the system operates in its entirety.
- National Treasury and CoGTA must consider reviewing the components of tariffs to include water losses in determining cost reflective tariffs.
- National Treasury, the City and COGTA must engage on the non-recovery of property rates in the traditional authority areas as this affects the financial viability.
- National Treasury must facilitate an engagement with TRANSNET on the impact of failure of rail on municipal roads infrastructure.
- The City must consider applying for the Budget Facility for Infrastructure (BFI) funding.

National Treasury appreciates the City's preparation efforts to ensuring robust and informative discussions for the duration of the engagement.

Yours faithfully

KGOMOTSO BALOYI
DIRECTOR: LOCAL GOVERNMENT BUDGET ANALYSIS
22 May 2023

CC: Mr M. Kunene, Chief Financial Officer