

NELSON MANDELA BAY MUNICIPALITY

CYCLE NO. 1/2017

REPORT OF THE CHIEF FINANCIAL OFFICER

TO THE

**BUDGET AND TREASURY COMMITTEE / EXECUTIVE MAYORAL COMMITTEE AND
COUNCIL**

**1. FINANCIAL REPORT FOR THE PERIOD JULY 2016 TO DECEMBER 2016
(MONTHLY BUDGET STATEMENT) AND THE ASSESSMENT OF THE
MUNICIPALITY'S FINANCIAL POSITION AS AT 31 DECEMBER 2016 (2016/17
FINANCIAL YEAR) IN LINE WITH SECTION 72 OF THE MFMA**

1.1 PURPOSE

The purpose of this report is to assess the financial performance and financial position of the Municipality and its consequential impact on the implementation of the approved 2016/17 Operating / Capital Budget. This report presents an assessment of municipality's financial position as at 31 December 2016 as required in terms of Section 72 of the Municipal Finance Management Act (MFMA) 56 of 2003.

1.2 LEGISLATIVE REQUIREMENTS

The Municipality is required to assess on an ongoing basis whether it collects sufficient revenue to meet its commitments, such as paying Employees, Councillors, Eskom, Department of Water Affairs, service providers, etc. In accordance with Section 71 of the MFMA, the Accounting Officer is required to submit to the National and Provincial Treasuries a monthly statement on the state of the municipality's budget. In terms of Section 52(d) of the MFMA the Mayor of a municipality must, within 30 days of the end of each quarter, submit a report to the Council on the implementation of the budget and the financial state of affairs of the municipality. This preliminary financial report is prepared to comply with both sections of the MFMA (56 of 2003). Further to the above Section 72 of the MFMA requires that an assessment of the first half of the financial year be undertaken and the report be tabled to Council of the municipality on or before end of January of each year.

1.3 EXECUTIVE SUMMARY

This report provides a balanced and consolidated financial performance overview to assist the Committee / Executive Mayor / Council in their oversight role.

An analysis of the financial position and performance was undertaken to determine the relative financial strength and liquidity of the Municipality as at 31 December 2016. In order to provide a comprehensive analysis it was necessary to compare the Budget, the General Ledger and the actual cash inflows and outflows of the Municipality, thereby determining relationships and the associated spending and income trends experienced for the period July 2016 to December 2016. The aforementioned was complemented by analysing the cash flow position, the investment portfolio, ratios, the operating and capital budget performance for the period July 2016 to December 2016, so as to facilitate an informed assessment of the relative liquidity and financial position of the Municipality.

The financial performance highlights are as follows:

- Operating revenue amounted to R4.552 billion, whilst operating expenditure amounted to R4.450 billion, resulting in an operating surplus of R101.94 million.
- Capital expenditure constituted 37.40% of the approved Capital Budget.
- Overdue consumer debts decreased by R160.62 million (6.40%) since June 2016.
- An amount of R150.22 million is owing to creditors, of which R145.17 million (96.64%) represents current creditors.
- The municipality's investment portfolio has increased by R32.80 million (2.03%) since June 2016 from R1.615 billion to R1.648 billion.
- Bridge-funding of housing top structures, a non-core municipal function is standing at R209.87 million as at 31 December 2016. It was standing at R177.94 million as at 30 June 2016.

In line with the Financial Recovery Plan the following financial ratios are monitored on an ongoing basis:

Ratio	Actual as at June 2011	Actual as at June 2012	Actual as at June 2013	Actual as at June 2014	Actual as at June 2015	Actual as at June 2016	Actual as at Dec 2016	Targets
Current Ratio	0.77	0.96	1.14:1	1.39:1	1.49:1	1.54:1	1.54:1	1.35:1
Liquidity Ratio	0.26:1	0.55:1	0.67:1	0.70:1	0.67:1	0.71:1	0.74:1	0.63:1
Average Debtors' Collection Rate	96.6%	94.56%	92.60%	93.71%	94.27%	91.40%	93.4%	94.00%
Creditors' payment Rate	32 days	31 days	31 days	31 days	29 days	36 days	27 days	30 days
Cost Coverage (excluding unspent conditional grants)	0.49 months	1.22 months	1.98 months	2.34 months	2.09 months	2.11 months	1.95 months	1.94 months
Debt servicing costs to Operating Revenue Ratio	4.6%	4.4%	4.2%	4.02%	3.52%	3.09%	2.56%	2.64%

The Average 12 month Debtor's Collection Rate of 93.41% vs. the Target of 94% in the 2016/17 financial year is a cause for concern due to its direct impact to the financial position of the institution and the ability to deliver services required as the 2016/17 approved budget was based on the municipality being able to collect 94% and above of its arrear debt. This ratio must be closely monitored and further actions be taken where necessary in order to improve the situation.

1.4 STRATEGIES ADOPTED

To achieve and maintain a sound financial position, the Municipality must continue to ensure that strict financial discipline, as previously approved, is exercised and that expenditure does not exceed the approved Budget, as that will pose a financial risk to the institution.

In order to further strengthen the Municipality's cash position, the following strategies, previously approved, are being implemented on a continuous basis by various role players:

- Ongoing implementation of the Municipality's Operational Efficiencies Work Plan / Cost Containment Measures;
- Disposal of serviced land;
- Maintenance of Housing Revolving Fund Management to acceptable levels;
- Cash Flow Forecasting & Cash Flow monitoring against the forecast;
- Dedicated attention to managing available cash flows effectively;
- Cash Management – Payment of Creditors;
- Collection of traffic fines; and
- Leasing of municipal land and properties.

ONGOING IMPLEMENTATION OF THE MUNICIPALITY'S OPERATIONAL EFFICIENCY WORK PLAN / COST CONTAINMENT MEASURES

- When the municipality experienced financial problems in and around 2010/11 the Executive Management (EXCO) introduced Operational Efficiency Work Plan, whereupon the Acting Municipal Manager, that time, issued instructions to Directorates as such. A number of expenditure line items were identified from the Operating Budget and Directorates were instructed on how to control spending against those line items, Budget and Treasury monitoring expenditure as such. This instruction continues to be implemented as to date.
- In early 2014 National Treasury issued Cost Containment Measures applicable to National and Provincial Government Departments, National and Provincial entities, as well as Chapter 9 (of the Constitution of the RSA Act) institutions. Council approved National Treasury's circular of early 2014 on the 23 May 2014 for implementation with immediate effect.
- Again in March 2016 National Treasury issued a Cost Containment Circular (Number 82) which was aimed to the municipalities across the country. Budget and Treasury prepared a combined Operational Efficiency Work Plan taking into account additional issues raised in terms of the Cost Containment Circular from National Treasury. The combined document was tabled to EXCO for comments and the Circular was incorporated into the Budget Report that was tabled to Council in late May 2016. EXCO resolved that the COO's office prepare monitoring tools for the implementation of the combined Operational Efficiency Work Plan, and that is what the COO's office is busy with.
- The City Manager has also issued "in writing" a communication relating to the delegation to all Executive Directors to monitor the implementation of Operational Efficiency Work Plan (Cost Containment Measures). Based on this communication Executive Directors are responsible for approving any expenditure incurred against items that are listed under the Operational Efficiency Work Plan. The delegations thereof mean that there is a responsibility for reporting by Directorates; be it to EXCO or to the Portfolio Committee etc.

HOUSING REVOLVING FUND MANAGEMENT

- It is imperative that the Human Settlements Directorate implement the necessary control measures to ensure that bridge-funding via the Housing Revolving Fund remains within the determined threshold of R100 million in 2016/17 financial year. The net cash-outflow from the Housing Revolving Fund was **R209.87 million** as at 31 December. Weekly meetings are held with officials from the PDoHS, the NMBM Human Settlements Directorate and Budget and Treasury in order to address problem areas.

CASH FLOW FORECASTING & CASH FLOW MONITORING AGAINST THE FORECAST

- It is considered imperative that the NMBM maintains at least the budgeted collection rate of 94%, in order to ensure service delivery aligned to the 2016/17 Operating Budget. The average collection rate for the period January 2016 to December 2016 is 93.41%. The average collection rate for the 1st half year (i.e. July to December 2016) was 95.11%. In this regard, a service provider was appointed to assist the municipality in Revenue Enhancement. The Directorate must keep a close monitoring of the improvements achieved thereof as by now there must have been improvements that are visible in terms of improved collection rates, etc. The ratio is calculated after eliminating ATTP transactions that are to be funded via the Equitable Share. However it is clear that the total billed is less than the amount budgeted for Property Rates and Services revenue and therefore as at 31 December the shortfall despite a 95.11 collection rate for the first half year is approximately R100 million.
- In order to ensure the ongoing financial sustainability of the Municipality as well as growth in the reserves, it is considered important that the cost coverage ratio exceeds the target of 1.5 months as set in the IDP. In this regard the municipality is required to develop a long-term financial strategy to address issues, such as the appropriate cash backing of reserves, replenishment of the Capital Replacement Reserve and long-term financial planning. This implies that the NMBM needs as soon as possible to exceed the budgeted collection rate of 94%. The development of the long-term financial strategy is now being pursued, as part and parcel of National Treasury's City Support Programme. The target as determined in the IDP should be reviewed in line with the 3 month target as required by National Treasury which will indicate a sustainable and viable municipality.
- The cost coverage ratio (excluding unspent conditional grants) requires close monitoring, scrutiny and improvement as the available investments only cover 1.95 months' operating expenses. In this regard the 2016/17 Operating Budget has been based on a cost coverage ratio of 1.94 months, whilst National Treasury expects municipalities to move to three months over the medium term. The cost coverage ratio will decrease over the period January 2017 and February 2017 as Fuel Levy and Equitable Share allocations received during December 2016 are to be spent in accordance with budgetary provisions.
- Also to mention in this report is that the Investment Portfolio of the NMBM must always be considered with commitments against the amount available for Investments. The amount quoted of R1.648 billion is committed to amongst others (i) Unspent Conditional Grants, (ii) Housing Revolving Funds, (iii) Other Operational Requirements, so it must not be seen as meaning that the institution is cash-flush.
- It would also appear that the total billing is less than anticipated and therefore despite a collection rate of 95.11% the municipality is still experiencing a shortfall of approximately R100 million in cash as at 31 December 2016. The main reason is that

due to the New Indigent Policy allowing all consumers with a property value of up to R1000000 to automatically qualify for ATTP subsidy (rebates) regardless of whether they are poor or not, has resulted that the good payers within the 23000 new ATTP consumers are now not paying, but are funded by the Equitable Share. Therefore a material loss of cash flow is experienced by the Municipality. Further the 90 days automatic write-off for ATTP customers are also reducing cash flow as all ATTP customers are aware of the fact that their debt are always being written off. Effectively, except for the pre-paid electricity approximately 116 000 ATTP customers are receiving all their services for free, putting the stress of financing the municipal services package on the small revenue base remaining. In conclusion the true value of free services received by the ATTP consumers far exceeds the National Policy allowances for free basic services. If the Indigent Policy is not amended immediately to be in line with the National Policy, the municipality will not be financially sustainable and will run out of cash flow within the short term.

COLLECTION OF TRAFFIC FINES, SELLING AND LEASING OF MUNICIPAL LAND AND PROPERTIES

- The Human Settlements Directorate has been requested to provide the Budget and Treasury Steering committee with an updated report on the disposal of serviced land, including a cost / benefit analysis if available serviced land is not sold. The disposal of serviced land takes place in terms of Section 14 of the MFMA, read together with the Asset Transfer Regulations and the relevant Policy of the NMBM.
- As part of the municipality's revenue enhancement initiatives all revenue sources such as fines, rentals charged for properties, etc. must be maximized to the fullest extent possible.

FURTHER FINANCIAL INFORMATION AFFECTING THE MID-TERM REPORT (2016 / 2017)

It is critical that Council must be made aware of other areas of concern that impact to the financial position of the institution which may put the budget of the municipality in huge deficit position as opposed to the surplus position of R4.8 million which was tabled when the 2016/17 budget was approved by Council on the 7 June 2016. The reported surplus of over R100 million must be read within the context that the figures as reported in this item include grant income which is subject to certain conditions and also the figures include those of the Entity (i.e. MBDA).

The big risk is as a result of the Council decision relating to the change of the Assistance to the Poor (ATTP) Policy, whereby automatic qualification was implemented based on the value of the property (i.e. R100 000) regardless of the size of income in that specific household.

The following are items that must be highlighted to Council: -

i. DEBT IMPAIRMENT (LINE ITEM 0527)

The actual expenditure incurred as at December 2016 against the category “**Debt Impairment**” in the 2016/17 financial year is of great concern. The reason for this level of expenditure is attributed to the introduction of automatic ATTP to all properties valued at R100 000 which came into effect from 1 July 2016.

It must be remembered that the budget provision made under category “Debt Impairment” is on the basis of the Collection Rate. If it is anticipated that the Collection Rate will be at 94% of billable revenue in a financial year, the other difference of 6% (or 100 – 94%) of the total billable income / revenue is budgeted for as Debt Impairment.

The total budget for the 2016/17 financial year for Debt Impairment category amounts to R423.3 million and the actual expenditure as at end December 2016 is already at R521.8 million on the financial system which means that at mid-year the budget has been exceeded or exhausted by **R98.5 million**. Revenue Management and Customer Care (RMCC) Sub Directorate has calculated the total qualifying debts to be written off for the period July to December 2016 and projected the spending from the period January to June 2017, as follows (Excl Vat): -

MONTH	DEBT RELIEF WRITE-OFFS	90 DAYS ATTP WRITE-OFFS	NEW ATTP APPLICANTS WRITE-OFFS	TOTAL WRITE- OFFS
Jul-16	R 3,344,403.42	R 6,850,275.66	R 378,501,858.63	R 388,696,537.71
Aug-16	R 5,255,519.88	R 6,623,332.70	R 2,208,423.86	R 14,087,276.44
Sep-16	R 5,113,224.72	R 13,337,503.93	R 7,918,042.57	R 26,368,771.22
Oct-16	R 3,667,254.20	R 17,573,184.30	R 14,261,498.33	R 35,501,936.83
Nov-16	R 7,957,714.94	R 12,516,652.69	R 7,661,268.55	R 28,135,636.18
Dec-16	R 4,475,670.87	R 15,384,280.23	R 9,166,029.83	R 29,025,980.93
TOTAL	R 29,813,788.03	R 72,285,229.51	R 419,717,121.77	R 521,816,139.31
Average Oct to Dec 2016	R 5,366,880.00	R 15,158,039.07	R 10,362,932.24	R 30,887,851.31
Projection Jan to June 2017 based on average	R 32,201,280.02	R 90,948,234.44	R 62,177,593.42	R 185,327,107.88
Growth of 1% as ATTP applications are still being verified for approval	R 32,523,292.82	R 91,857,716.78	R 62,799,369.35	R 187,180,378.96
Total Projection	R 62,337,080.85	R 164,142,946.29	R 482,516,491.12	R 708,996,518.27

The above table indicates that an amount of R708.9 million will be incurred up to 30 June 2017 against the budget of R423.3 million, meaning that there will be an over-expenditure of around R286 million under this category.

The expenditure that reflects against this category includes the bigger portion of write-offs that resulted from the change of formulae for the ATTP recipients whom, by virtue of the value of their properties automatically qualified for their arrear accounts being written off.

If the above continues without any drastic actions being taken, Council must be aware that (i) the continuous tabling of a surplus budget starting from the 2016/17 Adjustments Budget is at risk, (ii) It will be difficult to maintain the reserves of the institution (e.g. CRR / COIDA, etc.) which are already under threat, (iii) Drastic measures affecting internally funded projects may have to be implemented and that will not be good for service delivery, (iv) harsh monitoring by

National Treasury will be at play commencing from the mid-term budget assessment that is to take place in February 2017, etc.

The implications resulting from the above, and more, are to be further reported in the Adjustment Budget as it is highly unlikely that the Adjustment Budget will be in a surplus position as a result of the above.

ii. MONTHLY WRITE OFFS AGAINST LINE ITEM 2742 (FUNDED FROM EQUITABLE SHARE)

Further resulting from the introduction of the new formula re ATTP based on the R100 000 property value, as reported in point “i” above the other replica effect is that on a monthly basis the municipal accounts of the ATTP recipients must be credited for their access to free basic services i.t.o. the Policy (i.e. Electricity / Water / Refuse / Sanitation / Rates). This expenditure is funded from the Equitable Share allocation received from the National Treasury in terms of the Division of Revenue Act (DORA). It must be remembered that Equitable Share is not only used to fund the ATTP costs but also funds other requirements for the institution as the ATTP is an unconditional grant.

The budget against the above line item for 2016/17 financial year amounts to R428.6 million and based on the projections until June 2017 it is anticipated that an amount of at least R588 million will be incurred in this category. This will be an over-expenditure estimated close to R160 million in this category alone, further threatening the surplus position of the budget.

The object of the Equitable Share, that funds this category of expenditure, is to provide a portion of free services to the Poor as per the guideline Policy issued by National Government (i.e. COGTA / National Treasury). An assumption was made that if your property value is less than R100 000 such household is deemed to be poor and should automatically be qualifying for free basic services. Although this may be factual in many instances it is also factual that some of the consumers that have been benefiting automatically due to the revised policy may have been good payers, and may not be necessarily in that category. Some may be employed in other sectors earning reasonable salary / income.

A strategy must urgently be put in place to determine a methodology to ensure that only the poor benefit and qualify for ATTP subsidy and that the Indigent Policy be amended accordingly. As it stands the current policy threatens to destroy the financial sustainability of the municipality. As the balance of the Equitable Share was allocated to various projects servicing the poor areas, those projects may have to be eliminated from the Adjustment Budget and the 2017/18 MTREF if the funded and surplus budget is to be tabled to Council as previously required by Council.

The further effect is that the good payers that have become automated ATTP consumers will not be paying their bills and as such this free service is regarded as Revenue Foregone as per the Generally Recognised Accounting Practice (GRAP). The Services and Property Rate revenue as budgeted will decrease to reflect the loss of income raised in respect of the 23 000 new ATTP consumers. This effectively means that the municipality will have to further reduce service delivery to reduce expenditure in line with the reduced revenue projected.

iii. HIGH ENERGY USERS WRITE-OFFS

It is important to note that despite the R216. 7 million write-offs in respect of the High Energy Users during the 2015/16 financial year, the outstanding balance for this category as at 30 November 2016 was already at R181.84 million. Should any write offs even be intended it will further impact on the total Write offs as indicated in point “i” above. This trend of high energy

users not paying the full account is detrimental to the financial health of the Municipality and contributes to the following; (i) The municipal cash flow is under pressure, (ii) The outstanding debt collection ratio is lower than budgeted for, (iii) The effect is that the domestic consumer and other businesses will pay higher rates and tariffs in order to fund the annual budgetary requirements that are ever increasing.

iv. ROLLOVERS NOT APPROVED BY NATIONAL TREASURY FOR THE 2015/16 FINANCIAL YEAR

Council must be aware that about R64.7 million of unspent conditional grants the 2015/16 financial year were not approved by National Treasury to be rolled over from 2015/16 to 2016/17 financial year. The conditional grants affected are (i) IPTS (I&E), (ii) Human Settlements Accreditation Grant (Human Settlements), and (iii) Infrastructure Skills Development Grant (E&E). The bigger portion of R56.4 million relates to IPTS or Public Transport Network Grant, whilst the Human Settlements Capacity Grant accounts for an amount of approximately R7.8 million and Infrastructure Skills Development Grant is R577 000. This matter was reported to the Budget and Treasury Portfolio Committee of October 2016.

The replica effect of this situation is the fact that National Treasury has already withheld the equivalent amount of around R64.7 million from the quarterly tranche of December 2016, meaning that the amount has been taken away from the available funding source of the budget and that will impact the budget position and will impact the projects, a threat to service delivery.

v. mSCOA OPERATIONAL COSTS

It has been determined that the mSCOA (Municipal Standard Chart of Accounts) operational costs that were budgeted for during the preparation of the 2016/17 budget are insufficient taking to account other demands that include the implementation of an allowance to staff members that are involved in this project. The additional amount of about R15 million is required in the 2016/17 Adjustment Budget and this was not originally budgeted for.

vi. NMBM'S STADIUM'S BUDGET

Council must note that when the budget for 2016/17 financial year was approved, the Operating Budget for the NMBM Stadium was drastically reduced with an instruction of the MMC, indicating that a new service provider would have been appointed w.e.f. 1 July 2016 and it was envisaged that this new appointment will result to cost savings. Unfortunately this has not materialized and MBDA will be required to operate the stadium and that is going to require additional funding that was not originally budgeted for. At this stage it is not clear as to what amount will be required in order to operate the stadium.

vii. OTHER PROJECTS WITH DIRECT BUDGETARY / FINANCIAL IMPLICATION

There are other projects that were either not sufficiently budgeted for or not budgeted for at all that will have impact to the budget as they must be brought into the Adjustment Budget more so when service providers are rendering services to the NMBM. Those projects include ISO9001 for the SCM Unit and Revenue Enhancement Strategy.

ISO9001 project was budgeted for the 2014/15 and 2015/16 financial year whilst the service provider is undertaking work in the 2016/17 financial year without a budget. When the service provider was appointed for Revenue Enhancement Strategy the bigger portion of the baseline commission was not accounted for or budgeted and as service provider is rendering services payments will have to be paid without a budget. This will result to unauthorised expenditure being incurred and Section 32 reports having to be prepared.

There are other issues of financial significance that may not have been covered in this report as it is possible that there could be more.

1.5 DETAILED REPORTS

In order to comply with Schedule C of the Municipal Budget and Reporting Regulations 2008 the following detailed schedules for the period ending 31 December 2016 are attached:

Annexure “A1” – Operating Revenue and Expenditure Performance

Annexure “A2” – Capital Budget Performance

Annexure “A3” – Projected Cash Flow Statement

Annexure “A4” – Consolidated Budget Tables (incl MBDA figures)

Annexure “A5” – Analysis of Municipalities Balance Sheet

- i. Outstanding Consumer Debtors
- ii. Overview of Creditors position
- iii. Investment portfolio
- iv. Grants receipts and Expenditure
- v. Councillor & Officials allowances & benefits
- vi. Key performance Indicators

Annexure “A6” – MBDA's Quarterly Report & Budget Tables

1.6 GENERAL

The Performance scorecards of the Budget and Treasury Directors and Assistant Directors are monitored by the CFO on an ongoing basis. It must also be stated that the MMC: Finance together with all other MMC's and the respective ED's met in early December 2016 to analyse the budget (Operating and Capital) and suggested / recommended changes were made for reducing certain budget line items / projects. These changes will form part of the 2016/17 Adjustment Budget which will be tabled to Council prior end February 2017.

1.7 RECOMMENDATION

- a. It is recommended that the Municipality's consolidated (including the Entity) December 2016 Monthly Budget statement and supporting documentation contained in this report be noted.
- b. It be noted that this report is prepared in compliance with Sections 52(d) and 72 of the Municipal Finance Management Act (56 of 2003).