

Financial and Institutional Analysis

9.1 FINANCIAL OVERVIEW

9.1.1 EXISTING FINANCIAL STRATEGIES AND POLICIES

Prior to the adoption of the national Municipal Demarcation Board's recommendations relating to municipal boundaries, the East London Transitional Local Council (EL), King William's Town TLC (KWT) and the erstwhile Amatola District Council (ADC) existed as separate entities, with separately managed finances.

The summarised financial statements (Tables 9.1 and 9.2 below) and the related analysis (Tables 9.3 - 9.5 below), give the consolidated position for the whole of Buffalo City.

9.1.2 SUMMARISED FINANCIAL STATEMENTS

The Financial Statements listed below relate to the last 3 years of audited financial information viz. 1998/99, 1999/2000 and 2000/01.

TABLE 9.1 : Income Statements for Respective Years [1 July – 30 June]
(Source: Audited Financial Statements)

	2001 R millions	2000 R millions	1999 R millions
INCOME			
Government grants	103	88	116
Assessment rates	160	138	122
Sale of electricity	274	257	235
Sale of water	73	64	54
Other service charges	218	191	168
Total income	827	738	695

EXPENDITURE			
Salaries	297	230	201
General expenses	213	183	227
Purchase of electricity	170	163	161
Purchase of water	33	33	27
Repairs and maintenance	74	58	59
Capital charges	136	118	99
Contributions	34	32	49
Amounts charged out	-136	-53	-118
Total expenditure	822	763	706
SURPLUS / -DEFICIT	5	-25	-11

TABLE 9.2 : Balance Sheets as at 30 June
(Source: Audited Financial Statements)

	2001	2000	1999
	R millions	R millions	R millions
CAPITAL EMPLOYED			
Statutory funds and reserves	281	287	293
Accumulated surplus / (-deficit)	26	16	28
Long term liabilities	319	272	245
Other	81	57	91
TOTAL	707	632	656
EMPLOYMENT OF CAPITAL			
Fixed assets	561	542	499
Investments	61	64	101
Long term debtors / other assets	27	29	31
Current assets	314	270	210
Debtors	258	250	196
Cash and short term investments	40	3	2
Other current assets	16	17	13
Current liabilities	256	273	185
Creditors	95	151	102
Bank overdraft	115	63	32
Other current liabilities	46	59	51
TOTAL	707	632	656

9.1.3 FINANCIAL ANALYSIS – SELECTED FINANCIAL INDICATORS

The selected trends and financial ratios relating to Buffalo City for the period under review are listed below. These provide a platform to analyse the current financial situation of the city. The trends and ratios have been divided into the following categories:

- ❑ Income and expenditure
- ❑ Revenue management/liquidity and
- ❑ Borrowing management.

TABLE 9.3 : Income and Expenditure

	2001 R millions	2000 R millions	1999 R millions
Total income	827	738	695
<i>% increase over previous year</i>	12%	6%	13%
Total expenditure	822	763	706
<i>% increase over previous year</i>	8%	8%	16%
Surplus / - Deficit	5	-25	-11
Budgeted expenditure	818	751	703
<i>% increase over previous year</i>	9%	7%	11%
Salaries	297	230	201
<i>% of income</i>	36%	31%	29%
<i>% of expenditure</i>	36%	30%	28%
<i>% increase over previous year</i>	29%	14%	18%
Number of employees	4,457	4,117	4,040
<i>% increase over previous year</i>	8%	2%	4%
Repairs and maintenance	74	58	59
<i>% of expenditure</i>	9%	8%	8%
<i>% increase over previous year</i>	26%	0%	16%
Capital charges	136	118	99
<i>% of expenditure</i>	17%	15%	14%
<i>% increase over previous year</i>	15%	18%	15%
External interest	46	41	30
<i>% of expenditure</i>	6%	5%	4%
<i>% increase over previous year</i>	13%	33%	-9%

Total Income versus Total Expenditure

The net consolidated deficit for the period under review amounted to R31m. While this is not significant when expressed as a percentage of total income (just over 1%), the City should ideally be generating surpluses to strengthen its financial position. This would enable it to be more effective in the delivery of services and to become less reliant on loan funding.

Total income has increased by 13%, 6% and 12% during the 1999, 2000 and 2001 financial years respectively. Of the total income for the 2001 financial year of R827m, rates and other services accounted for 45% with trading services (water and electricity) making up 42% of income.

Total expenditure has shown annual increases of 16% (1999), 8% (2000) and 8% (2001) compared to national guidelines of 6%, 5.5% and 5% respectively.

Expenditure versus budget analysis shows that there have been small budget overruns during the last 3 financial years. The consolidated net over-expenditure for these years amounts to R18m, which represents less than 1% of total expenditure.

Salaries accounted for 32% of total expenditure during the period under review. It is generally accepted that the norms for local government are between 25% and 30%. Strategies need to be identified to reduce this expense item in future years.

The method of accounting for “salaries” and “amounts charged out” was adjusted in the 2000/01 financial year. This has resulted in a distortion for the increase in salaries between the 2000 and 2001 financial years. If the amounts were accounted for in a consistent manner the restated amounts for “salaries” and “amounts charged out” would be R255m and R94m respectively. The restated increase for salaries between the 2000 and 2001 financial years would be 11%.

TABLE 9.4 : Revenue Management and Liquidity.

REVENUE MANAGEMENT	2001	2000	1999
Annual debtors collection rate (%)	83%	84%	80%
Net debtors to annual income	29%	32%	27%
Days debtors outstanding	107	116	97
Bad debt provision %	42%	37%	36%

LIQUIDITY	2001	2000	1999
-----------	------	------	------

Current ratio	1.23	0.99	1.14
Liquid ratio	0.15	0.01	0.01

Revenue management

The trends involving debtors' payments, debtors' levels and provision for bad debts are areas of great concern and one of the major challenges that will need to be overcome in order to achieve financial sustainability. The days debtors' outstanding has increased over the period from 97 days (1999) to 107 days (2001), while the bad debt provision has grown from 36% of gross debtors (1999) to 42% of gross debtors (2001). The annual debtors' collection rate has ranged from 80% to 84% during the period under review.

Liquidity

The poor payment of debtors is a major contributing factor to the poor liquidity levels of the city. The generally accepted norms for the current ratio and the liquid ratio are 2:1 and 1:1 respectively. Compared to these norms the liquidity ratios have been low throughout the period under review and the bank overdraft has increased from R32m (1999) to R115m (2001), although this has decreased to significantly lower variable levels in 2002.

All of these indicators tell the story of poor payment by debtors, which in turn places pressure on cash flow. Recognising this, the City has put a number of remedial measures in place such as the strengthening of the credit control department from 8 to 54 people over the last two years. Over the medium term the City aims to increase repayment levels to over 90% and reduce the days debtors' outstanding to 60 days.

The pressure on the City's cash flow will be increased by the extension of municipal services to the rural areas. In addition to improving the debtors collection rate and attempting to reduce debt levels as a percentage of assets/income, the City also needs to address cost drivers that could fuel significant increases in expenditure. Specifically there is a need to focus on remuneration and debt servicing costs and identify a strategy to reduce these expenditure items in future years.

TABLE 9.5 : Borrowing Management

	2001	2000	1999
--	------	------	------

Total debt to total asset ratio	68%	67%	62%
Interest bearing debt / Total income	54%	47%	42%

The interest-bearing debt has grown from R291m (1999) to R447m (2001), with the total debt to total asset ratio growing from 62% (1999) to 68% (2001). Interest-bearing debt as a proportion of total income has increased from 42% (1999) to 54% (2001).

These statistics suggest a scenario of increasing debt with reducing ability to repay this debt. However, although these ratios are higher than is desirable, they are all within the norms set by the DBSA credit rating guidelines (DBSA Financial Report on Buffalo City Municipality, p.4). Care needs to be exercised before taking out further loans, and any further debt needs to be taken in terms of the City's medium-term budget framework and the debt capacity policy.

On the positive side, the City has made provision to meet significant long-term loan repayments through sinking fund investments with guaranteed maturity values of more than R150m (total long-term loans amount to R319m) which have been ceded as security against long term loans.

Over the medium-term, the City wishes to become less reliant on borrowed funds and reduce the above ratios to between 35% and 40%. This would be achieved through improved revenue management and the generation of more funding internally.

9.2 FINANCIAL KEY FINDINGS

The key findings within the financial context can be summarised in the following weaknesses, threats, strengths and opportunities.

9.2.1 WEAKNESSES AND THREATS

Buffalo City has a relatively narrow industrial base and is heavily dependent on few primary industries. The municipality has a limited tax base in proportion to its total new area, especially when the large rural settlements within Buffalo City are taken into account. Furthermore, the debtors' repayment levels are low, cash flow is poor and levels of debt are relatively high. There is a lack of adequate service-provision in previously disadvantaged areas, which has a negative impact on public relations and customer care.

Unemployment, low economic growth, HIV/AIDS, the risk of increased fraud and corruption and legal constraints on the budget are all significant threats to Buffalo City's future development and long-term financial viability and sustainability.

9.2.2 STRENGTHS AND OPPORTUNITIES

The financial department has access to competent staff and financial expertise as well as a fully functional accounting system. Opportunities for the future lie in an increased tax base, improved debtor repayment levels, the adoption of more commercially based accounting practices (GMAP) and the stimulation of an increasingly diversified commercial and industrial sector. Other opportunities that would benefit Buffalo City are increased domestic grant funding for infrastructural renewal, as well as prospects of foreign funding.

9.3 INSTITUTIONAL OVERVIEW

9.3.1 ORGANISATIONAL STRUCTURE OF BUFFALO CITY

The total number of employees working for Buffalo City is 4,248 people. The approved complement for Buffalo City is 5,011 posts, therefore there are 763 vacant posts.

9.3.2 POWERS, FUNCTIONS AND BY-LAWS

The powers and functions that are performed by local authorities in South Africa are defined primarily in sections 156 and 229 of the Constitution (Act 108 of 1996). Section 156 states that a municipality has executive authority in respect of, and has the right to administer the following areas :

- | | |
|---|---|
| <input type="checkbox"/> air pollution | <input type="checkbox"/> building regulations |
| <input type="checkbox"/> child care facilities | <input type="checkbox"/> electricity & gas reticulation |
| <input type="checkbox"/> fire fighting services | <input type="checkbox"/> local tourism |

- | | |
|---|---|
| <input type="checkbox"/> municipal airports | <input type="checkbox"/> municipal planning |
| <input type="checkbox"/> municipal health services | <input type="checkbox"/> municipal public transport |
| <input type="checkbox"/> municipal public works relevant to their constitutional or legal functions | <input type="checkbox"/> pontoons, ferries, jetties, piers and harbours |
| <input type="checkbox"/> storm-water management systems in built-up areas | <input type="checkbox"/> trading regulations |
| <input type="checkbox"/> water & sanitation services limited to potable water supply systems and domestic waste-water and sewage disposal systems | <input type="checkbox"/> beaches & amusement facilities |
| <input type="checkbox"/> billboards & public display of advertisements | <input type="checkbox"/> cemeteries, funeral parlours & crematoria |
| <input type="checkbox"/> cleansing | <input type="checkbox"/> control of public nuisances |
| <input type="checkbox"/> control of undertakings that sell liquor to the public | <input type="checkbox"/> facilities for the accommodation, care and burial of animals |
| <input type="checkbox"/> fencing and fences | <input type="checkbox"/> licensing of dogs |
| <input type="checkbox"/> licensing & control of undertakings that sell food to the public | <input type="checkbox"/> local amenities |
| <input type="checkbox"/> local sport facilities | <input type="checkbox"/> markets |
| <input type="checkbox"/> municipal abattoirs | <input type="checkbox"/> municipal parks and recreation |
| <input type="checkbox"/> municipal roads | <input type="checkbox"/> noise pollution |
| <input type="checkbox"/> pounds | <input type="checkbox"/> public places |
| <input type="checkbox"/> refuse removal | <input type="checkbox"/> refuse dumps and solid waste disposal |
| <input type="checkbox"/> street trading | <input type="checkbox"/> street lighting |
| <input type="checkbox"/> traffic and parking. | |

Furthermore, a municipality has executive authority in respect of, and has the right to administer any other matter assigned to it by national or provincial legislation.

In the 1996 Constitution (Act 108 of 1996), there are a number of matters listed which the national government and provincial governments must assign to a municipality, by agreement and subject to any conditions, if :

- | |
|---|
| <input type="checkbox"/> the matter would most effectively be administered locally; and |
| <input type="checkbox"/> the municipality has the capacity to administer it. |

The following matters listed in the Constitution could arguably be regarded in Buffalo City’s context, as necessarily related to local government:

- | | |
|--|---|
| <input type="checkbox"/> animal control and diseases | <input type="checkbox"/> cultural matters |
| <input type="checkbox"/> disaster management | <input type="checkbox"/> environment; health services |

- | | |
|--|---|
| <input type="checkbox"/> housing | <input type="checkbox"/> industrial promotion |
| <input type="checkbox"/> pollution control | <input type="checkbox"/> public transport |
| <input type="checkbox"/> tourism | <input type="checkbox"/> vehicle licensing |
| <input type="checkbox"/> welfare services | <input type="checkbox"/> ambulance services |
| <input type="checkbox"/> libraries other than national libraries | <input type="checkbox"/> liquor licences |
| <input type="checkbox"/> museums other than national museums | <input type="checkbox"/> veterinary services. |

9.4 INSTITUTIONAL KEY FINDINGS

The key findings within the institutional context can be summarised in the following weaknesses, threats, strengths and opportunities.

9.4.1 WEAKNESSES AND THREATS

Currently, Buffalo City suffers from a staff and skills shortage, a serious infrastructure backlog (IT, digital data and ageing fleets), low productivity, general lack of co-operation and internal communication.

Issues and areas that constitute threats for the future are negative public perception, HIV/AIDS, a dwindling income base, racial polarisation, the loss of skilled staff, the slow pace of economic growth, failure to implement equity and competition from other local authorities.

9.4.2 STRENGTHS AND OPPORTUNITIES

Buffalo City has at present a stable leadership and management, competent human resources, a fully functional administrative infrastructure, established policies and procedures and access to specialist knowledge and external information. The present IDP process along with skills development, foreign aid, the development of a cohesive organisation, advanced digital technology and the development of public-private partnerships constitute opportunities for the positive development of Buffalo City.