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1. Introduction and Background

The last five years' financial statements and budgets for Emfuleni Local Municipality were analysed to establish how the municipality was managed. We were approach by the community of ELM to determine whether the municipality had fulfilled its obligations regarding sanitation services. They complained to a lack of sewer purification services and sewer leaks in the town and Vaal River. Businesses are packing up, due to electricity interruptions by Eskom and insufficient water pressure by Rand Water, leaving business and residents without sufficient services, due to the long outstanding and increasing debt ELM owned its service providers and suppliers.

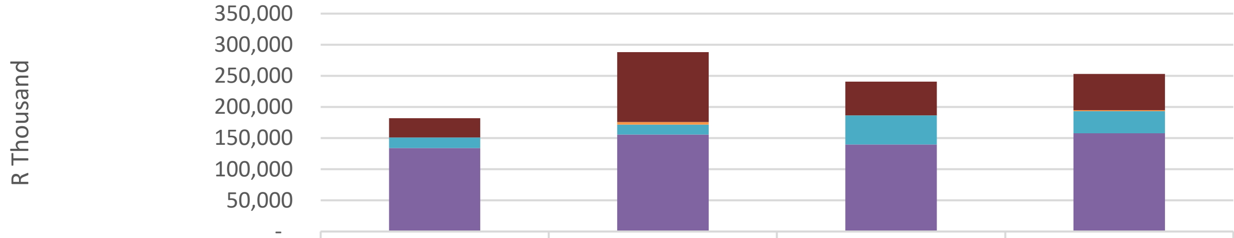
Furthermore, our work at the municipality assisted us to provide meaningful input on the recovery plan of October 2018, to comment on the timing, viability, sustainability and feasibility of the proposed recovery plan in the best interest of the community. Our report layout is to indicate the deteriorating financial position and trend over last five years (and more) and to motivate the fact that financial intervention without the required funds to address service delivery is meaningless.

National Treasury website was used to obtain the audited financial statements and applicable budgets and audited outcomes. Discrepancies were found in the National

Treasury website that does not reconcile to the audited financial statements for 2016/17. Furthermore, National Treasury provided us with the budgets and audited outcome for capital expenditure and maintenance thereof. Significant variances were found between the audited outcomes of the budgets and the audited financial statements; e.g. repairs and maintenance budget document, referring to audited outcome does not correspond with the financial statements.

2. Capital Expenditure (Budget Information)

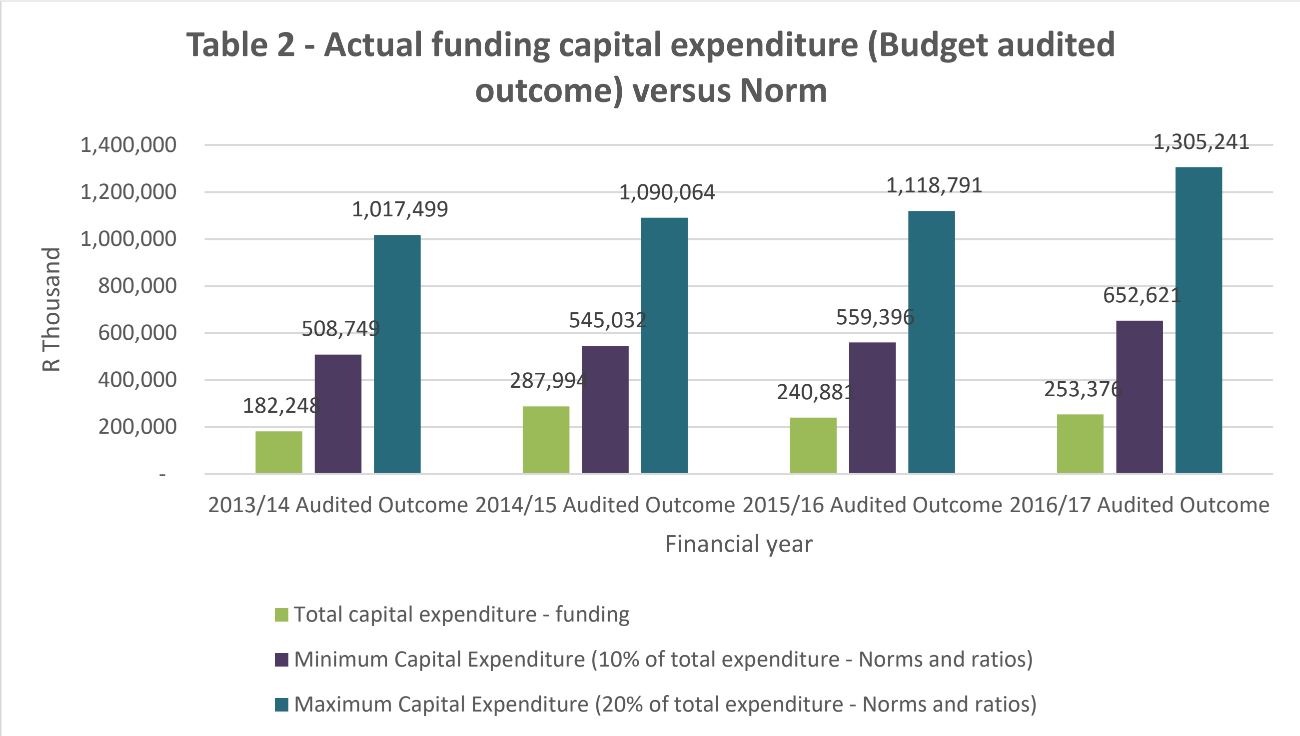
Table 1 - Funding - Capital Expenditure - Budget audited outcome



	2013/14 Audited Outcome	2014/15 Audited Outcome	2015/16 Audited Outcome	2016/17 Audited Outcome
- Internally generated funds	31,094	112,116	54,266	58,431
-Other Transfers and grants				
- District Municipality		4,063	44	1,362
- Provincial Government	17,210	16,019	46,581	35,766
- National Government	133,944	155,796	139,990	157,817

Financial Year

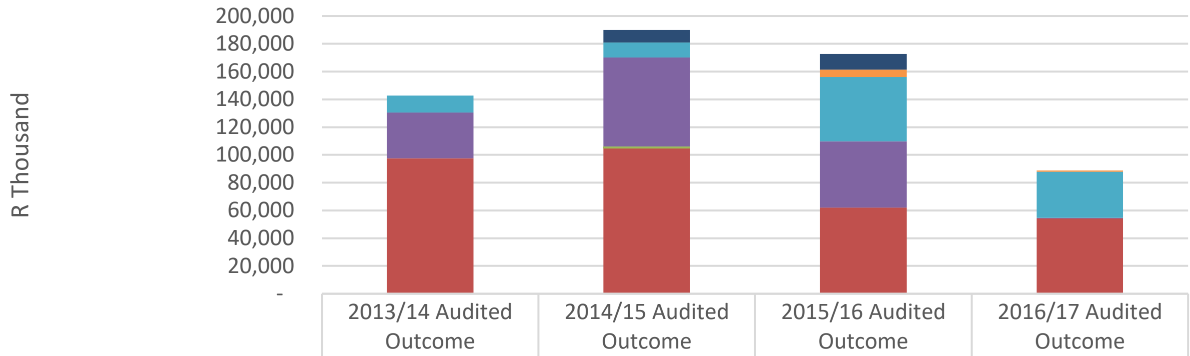
- National Government - Provincial Government - District Municipality -Other Transfers and grants - Internally generated funds



In terms of Uniform Financial Ratios and Norms (MFMA Circular 71) capital expenditure should be between 10% to 20% of total expenditure. Total expenditure in 2016/17 was R6.5 billion, therefore capital funding and expenditure should be between R650 million and R1.3 billion- Taking ELM capital expenditure backlog into account, the norm should be 20% of total expenditure – refer Table 2.

Furthermore, internally generated funding has significantly decreased in 2017/18 because of the deteriorated financial results of Emfuleni Local Municipality. National and Provincial government contributions also decreased since 2014/15, leaving the municipality with less funds for capital expenditure. (Table 1)

Table 3 - Total Infrastructure spent (New and upgrading of infrastructure - Budget information)



	2013/14 Audited Outcome	2014/15 Audited Outcome	2015/16 Audited Outcome	2016/17 Audited Outcome
Solid Waste Infrastructure	-	9,053	11,263	-
Sanitation Infrastructure	-	3	5,333	1,012
Water Supply Infrastructure	12,257	10,893	46,264	33,229
Electrical Infrastructure	32,943	63,913	47,813	491
Storm water Infrastructure	-	1,109	-	-
Roads Infrastructure	97,480	105,019	62,024	54,130

Axis Title

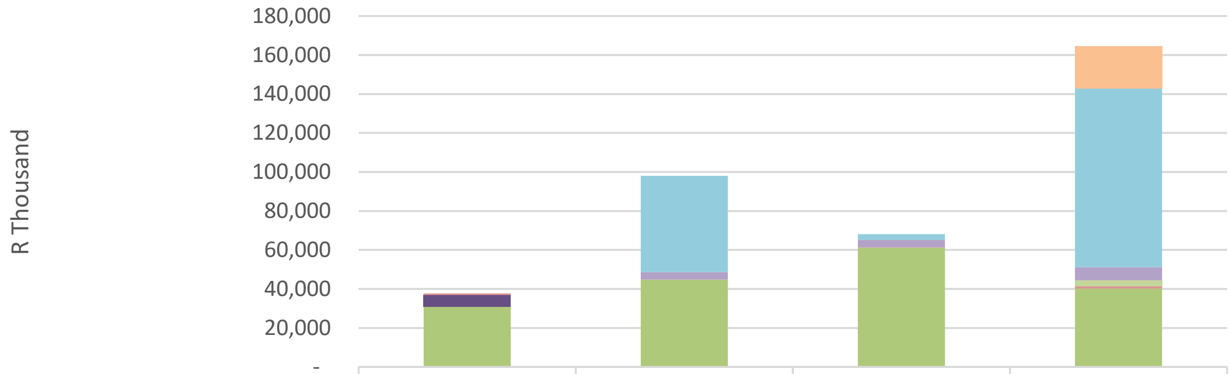
Roads Infrastructure, Storm water Infrastructure, Electrical Infrastructure, Water Supply Infrastructure, Sanitation Infrastructure, Solid Waste Infrastructure

The total infrastructure spent as per ELM budget's audited outcome is decreasing and represents a very small portion of the total income of Emfuleni. (Capital expenditure was R142,7 million in 2013/14; R190 million in 2014/15; R172,7 million in 2015/16 and R88.9 million in 2016/17). (Table 3)

Despite the failure of infrastructure and basic services in Emfuleni, the municipality spent more on other capital expenditure in 2017 (Table 4). More money was spent on furniture than on solid waste infrastructure; sanitation infrastructure; storm water infrastructure and electrical infrastructure altogether in 2017.

Furthermore, R165 million was available for other capital expenditure, when less than R90 million was spent on infrastructure in 2017. Community assets should not be more important, if basic services cannot be provided because of insufficient infrastructure. (Table 4)

Table 4 - Total Capital Expenditure, excluding Infrastructure (New and upgrading capital expenditure - Budget information)

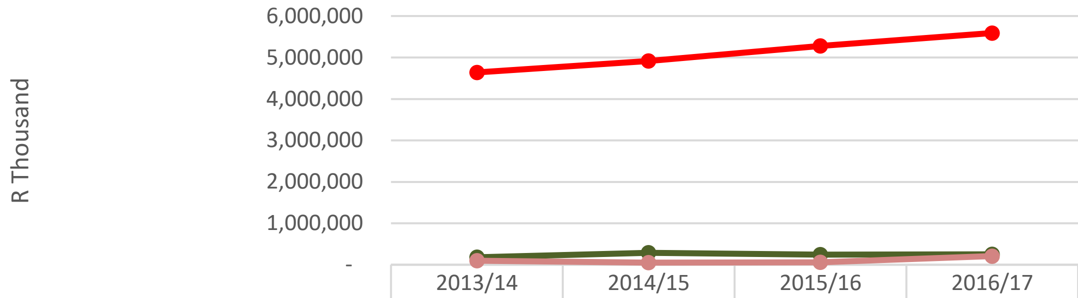


	2013/14 Audited Outcome	2014/15 Audited Outcome	2015/16 Audited Outcome	2016/17 Audited Outcome
Transport Assets	-	-	-	21,819
Machinery and Equipment	-	49,400	2,939	91,567
Furniture and Office Equipment	-	3,803	3,884	6,718
Computer Equipment	-	-	-	2,917
Intangible Assets	823	-	135	1,312
Other Assets	6,158	-	-	-
Community Assets	30,756	44,802	61,225	40,181

Financial years

Community Assets, Other Assets, Intangible Assets, Computer Equipment, Furniture and Office Equipment, Machinery and Equipment, Transport Assets

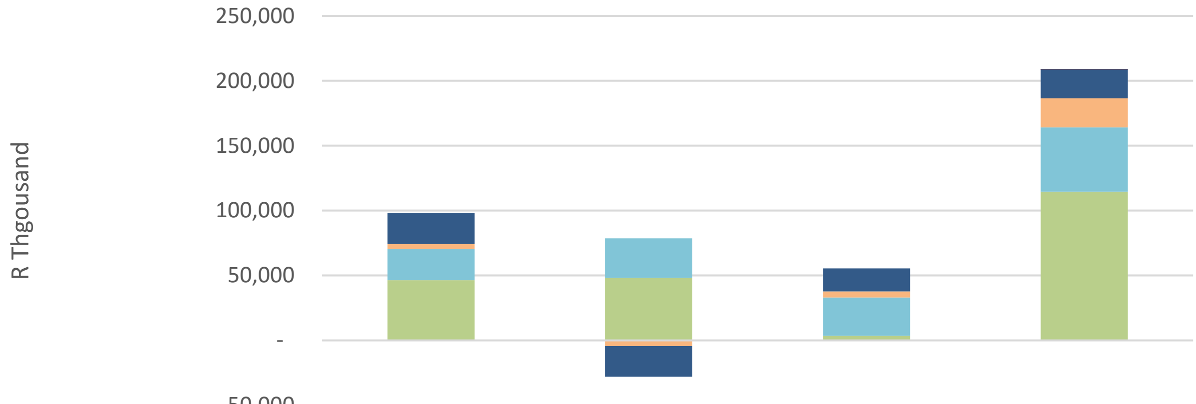
Table 5: Revenue vs Total Capital Expenditure & Repairs and maintenance (Budget audited outcome)



	2013/14 Audited Outcome	2014/15 Audited Outcome	2015/16 Audited Outcome	2016/17 Audited Outcome
TOTAL CAPITAL EXPENDITURE - Asset class	180,417	287,995	240,880	253,376
Repairs and Maintenance by Asset Class	98,322	50,726	55,385	209,009
Total Revenue	4,639,759	4,911,630	5,276,218	5,590,176

The total capital expenditure as a percentage of the total audited revenue of the municipality is very small - only 4.5% of revenue in 2017; 4.6% in 2016; 5.9% in 2015 and 3.9% in 2014. Refer Table 5. That indicates that around 95% of the revenue of the municipality is used on administrational expenditure.

Table 6 - Repairs and maintenance on infrastructure - Audited outcome (budget)

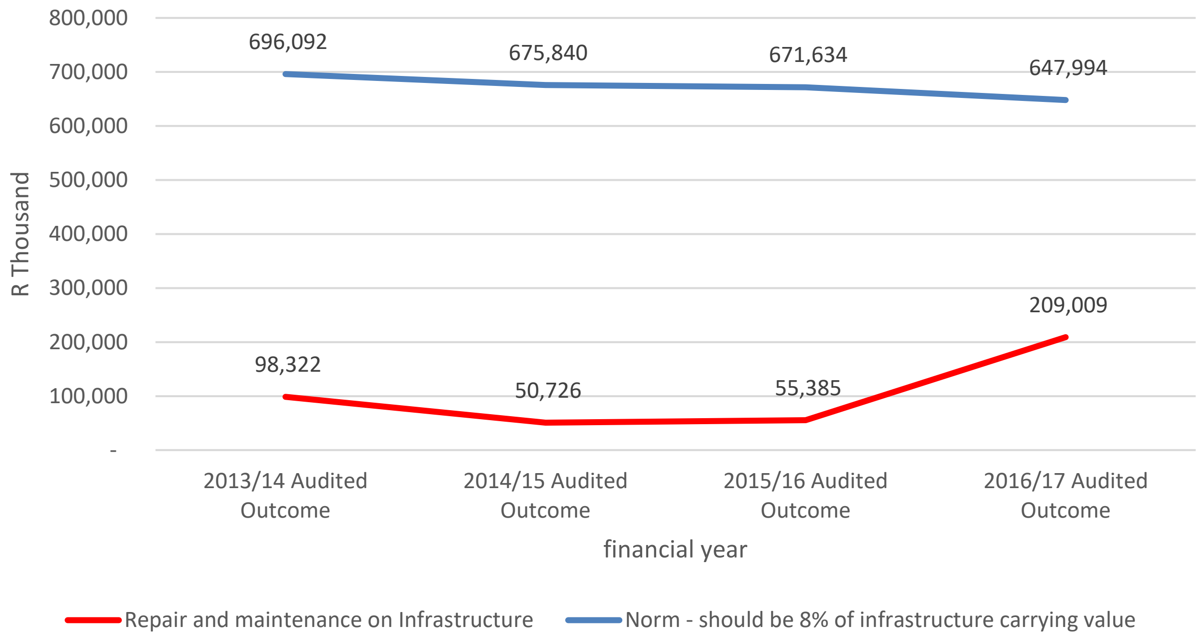


	2013/14 Audited Outcome	2014/15 Audited Outcome	2015/16 Audited Outcome	2016/17 Audited Outcome
Solid Waste Infrastructure		-	-	77
Sanitation Infrastructure	24,182	-23,573	17,737	22,395
Water Supply Infrastructure	3,755	-4,442	4,608	22,429
Electrical Infrastructure	24,019	30,616	29,578	49,407
Storm water Infrastructure		-	-	-
Roads Infrastructure	46,362	48,125	3,462	114,701

Financial Year

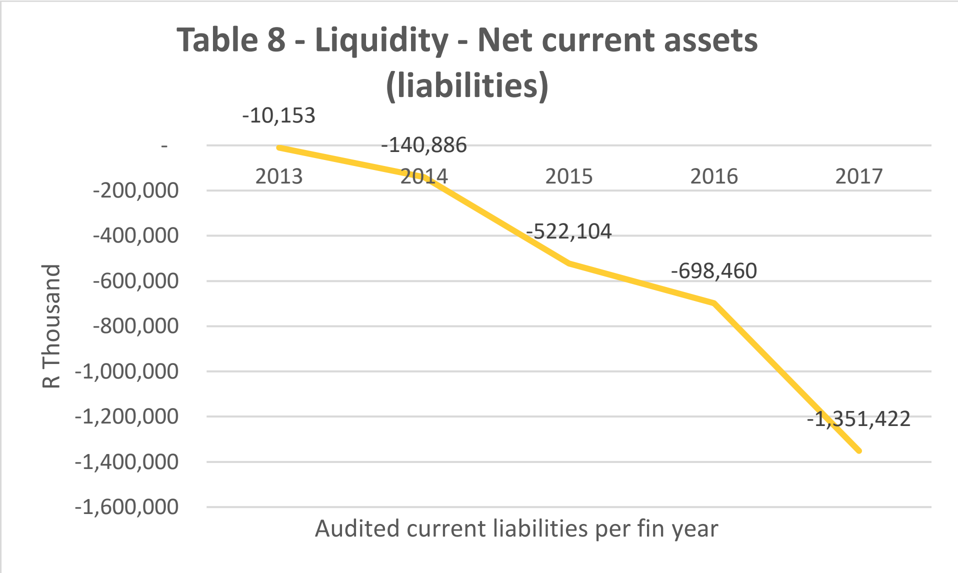
Roads Infrastructure Storm water Infrastructure Electrical Infrastructure
Water Supply Infrastructure Sanitation Infrastructure Solid Waste Infrastructure

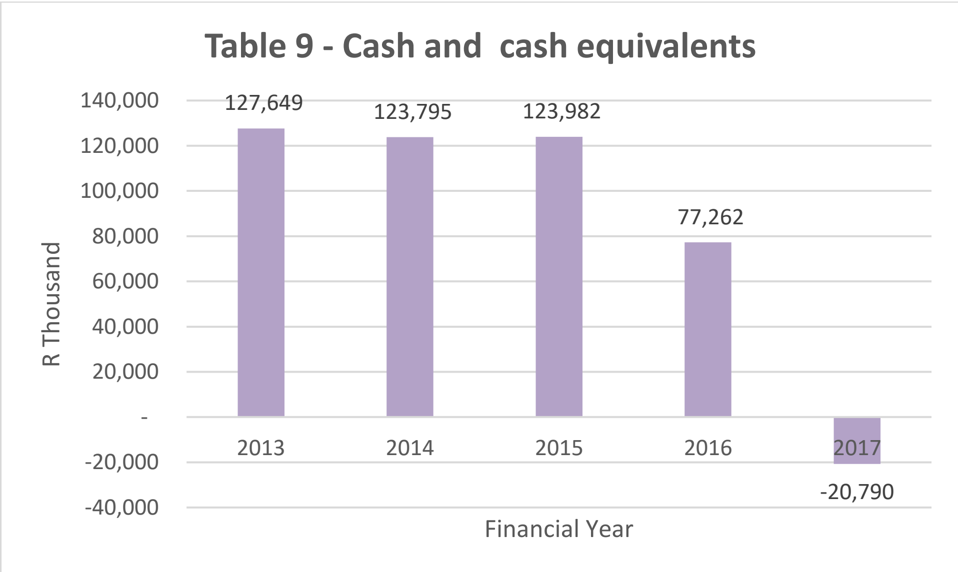
Table 7 - Repairs and maintenance on infrastructure - Audited outcome (budget) versus norm of 8% on value of infrastructure



ELM infrastructure is in very poor condition, unable to ensure sufficient basic services, especially relating to sanitation. The recommended maintenance and repairs standard is 8% of value of assets (without a backlog as applicable to ELM). In 2017, infrastructure carrying value is R8.1 billion – the recommended value for maintenance and repairs should therefore be R648 million (8%) in 2017, not R209 million (2.6%). (The previous years are even worse relating to money spent on maintenance) – Refer Table 7.

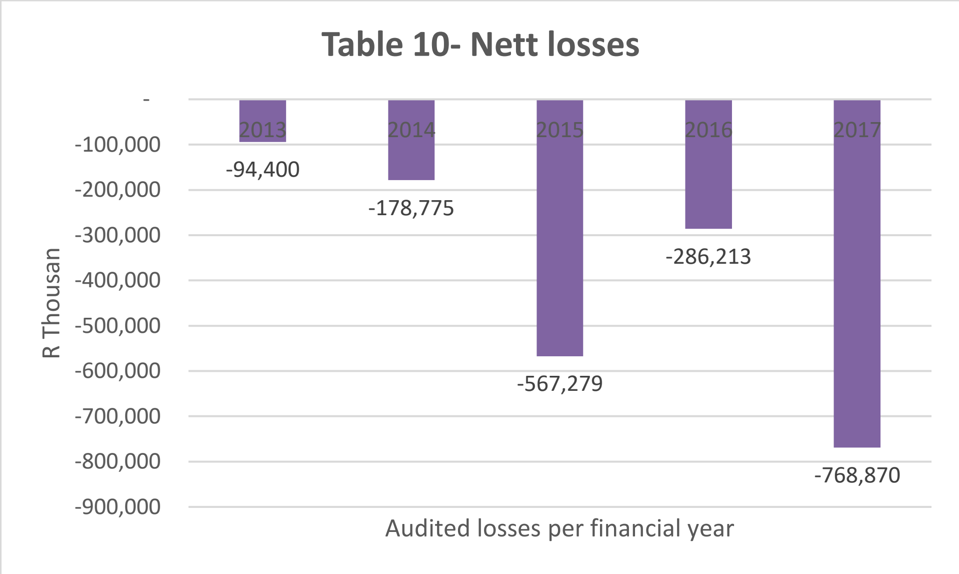
3. Liquidity; nett losses; borrowing, provisions; creditors and contingencies





The municipality's operations resulted in losses during the past five years. The trend of losses materially increased each year from R94 million in 2014 to R769 million in

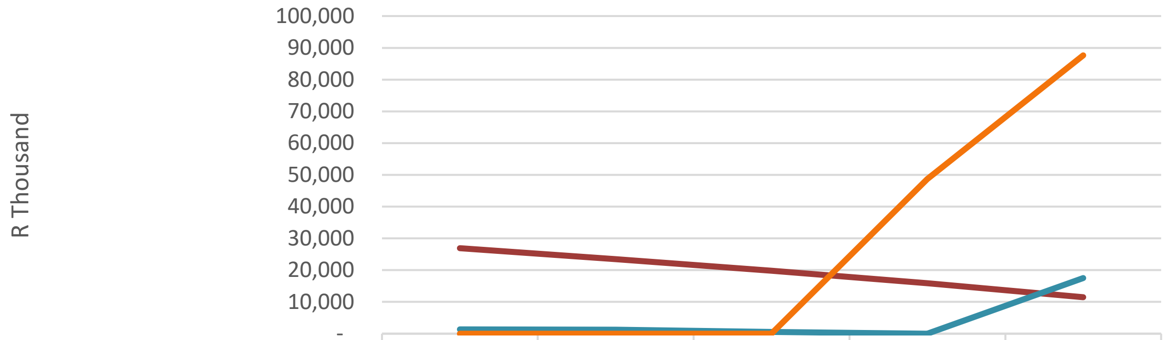
2017 (Refer Table 10). That is further proof of mal-administration, poor planning and lack of internal controls.



The municipality will struggle to get funding from financial institutions with such poor financial performances as indicated in the decreasing loan balances over the past five years, despite its desperate need to provide infrastructure and services. Furthermore, the bank overdraft has increased in the last two years. (Refer Table 11). In addition, the municipality is not in compliance with Section 45 (4) of the MFMA that determines that a municipality must pay off short term debt within the financial year and cannot renew or refinance short-term debt.

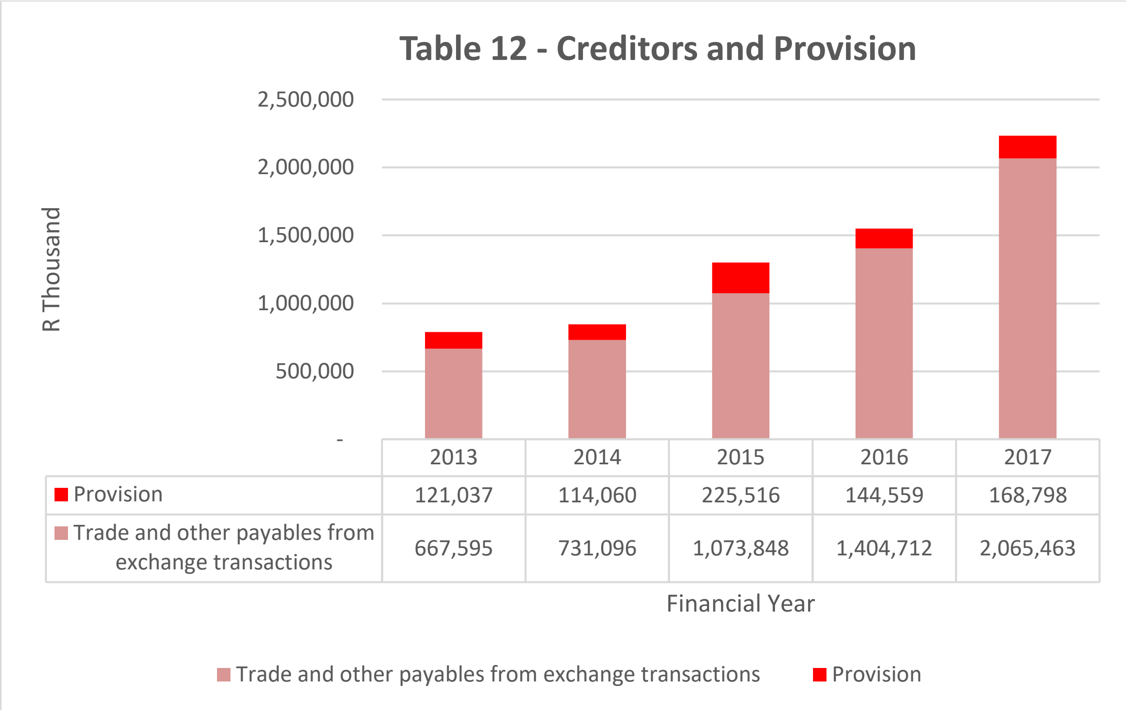
Table 11

Borrowing, financial lease payments & bank overdraft



	2013	2014	2015	2016	2017
Total loans and bonds	26,921	23,485	19,828	15,894	11,488
Minimum lease payments due	1,388	1,289	539	-	17,520
Bank overdraft	-	-	-	48,667	87,630

Note 2 of the 2017 financial statements declares that the municipality obtained an overdraft facility of R150 million from Standard Bank. The terms of condition of the facility: R50 million is repayable on 30 Nov 2016; another R50 million on 31 March 2017 and the balance repayable on 30 June 2017. The aforesaid conditions on the overdraft agreement were revised to settle the whole amount by the end of June 2017 due to cashflow constraints. As at the end of the financial year (30 June 2017), an amount of R87 million remained unsettled- another default by ELM.

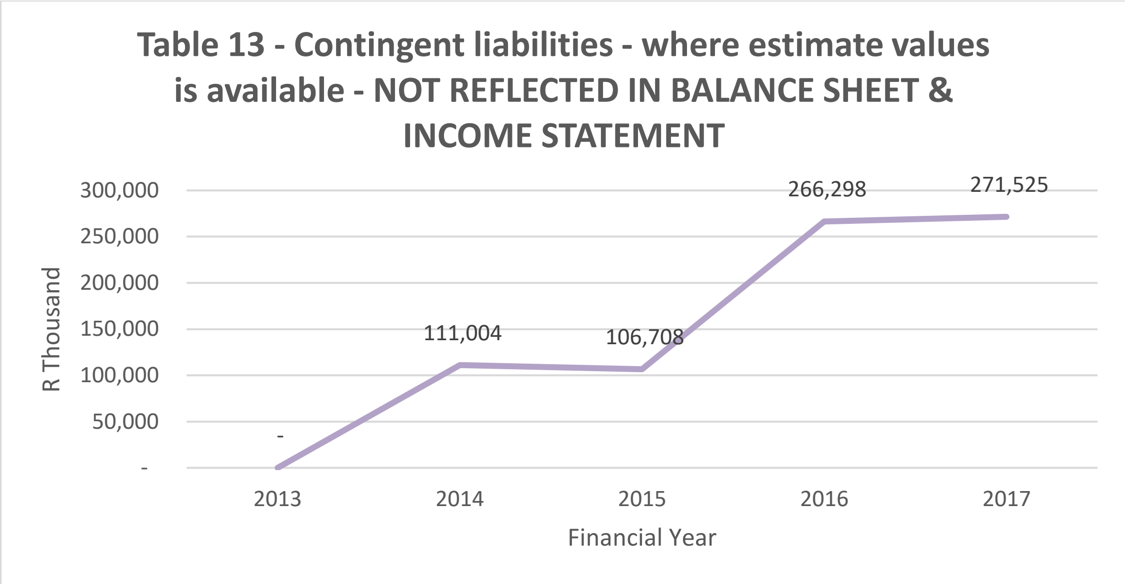


	2013	2014	2015	2016	2017
Provision	121,037	114,060	225,516	144,559	168,798
Trade and other payables from exchange transactions	667,595	731,096	1,073,848	1,404,712	2,065,463

The creditors and provisions increased to material values over the past 5 years to more than R2.2 billion in 2017. (refer Table 12). The fact that outstanding creditors increased each year, further indicates that the municipality is unable to pay its creditors within 30 days as stipulated by the MFMA, section 65(2)(e).

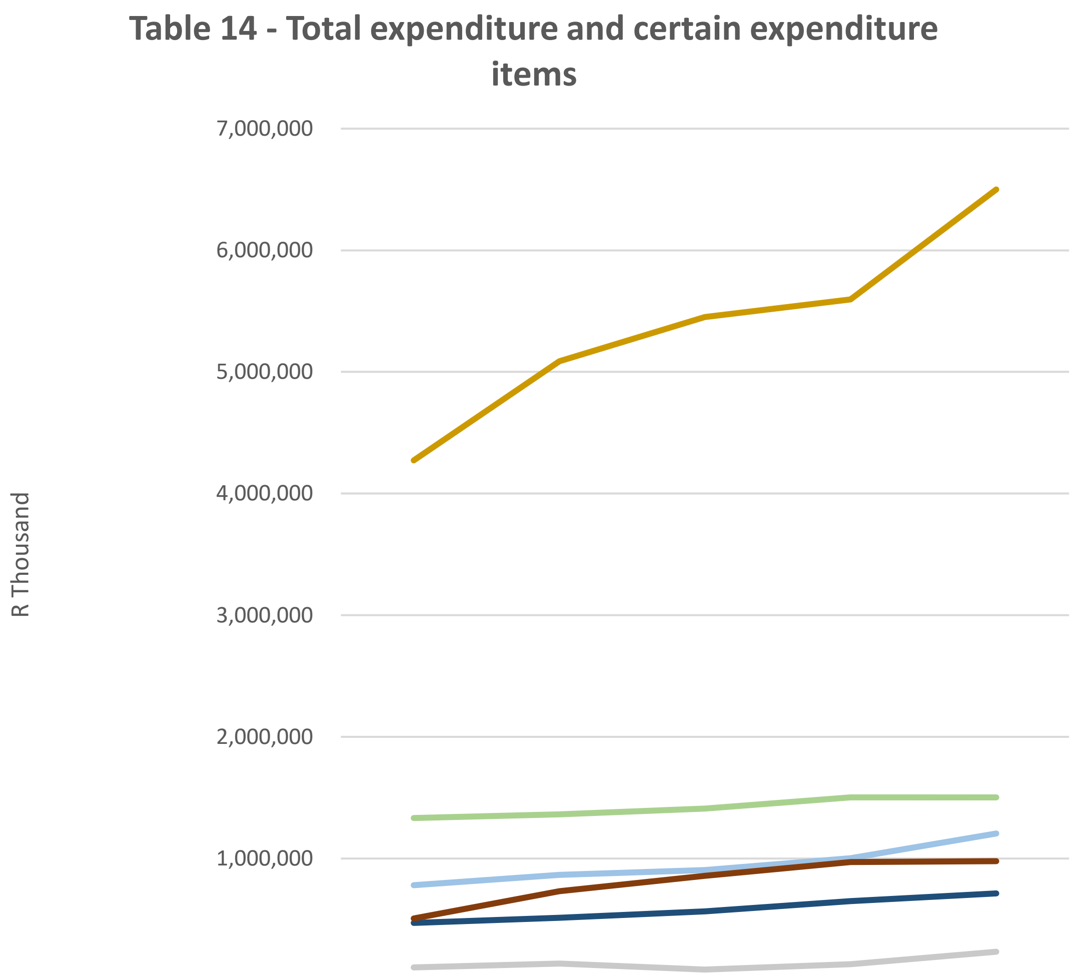
ELM made a provision of R169 million in 2017 for environmental rehabilitation of R154 million and for legal proceedings of R15 million.

In addition, the financial statements reflect contingent liabilities (where estimate values are available) of another R272 million in 2017. It includes civil claims of R266 million and insurance claims of R5.5 million. This value is not included in creditors and no provision have been made as it is still under conciliation, arbitration and review at labour court. Contingencies excludes labour related claims where values are unknown. (Refer Table 13).



Over the past five years (and more), the municipality lacked liquidity, by incurring losses every year (Table 8 and 10) and the creditors increased significantly. It is a clear indication that the municipality is dysfunctional and cannot continue as a going concern. Furthermore, the municipality is struggling to obtain loans, due to the un-creditworthiness of the municipality

4. Expenditure – High value expenditure items



	2013	2014	2015	2016	2017
Total Expenditure	4,272,991	5,087,493	5,450,318	5,595,117	6,499,998
Remuneration	780,984	866,872	904,973	1,002,428	1,205,850
Repairs and maintenance	104,669	137,957	87,359	130,914	233,883
Bulk purchases: Electricity	1,332,970	1,362,267	1,411,616	1,502,075	1,502,596
Bulk purchases: Water	470,700	513,253	565,768	650,297	713,411
General Expenses	507,507	730,872	857,729	971,340	978,294

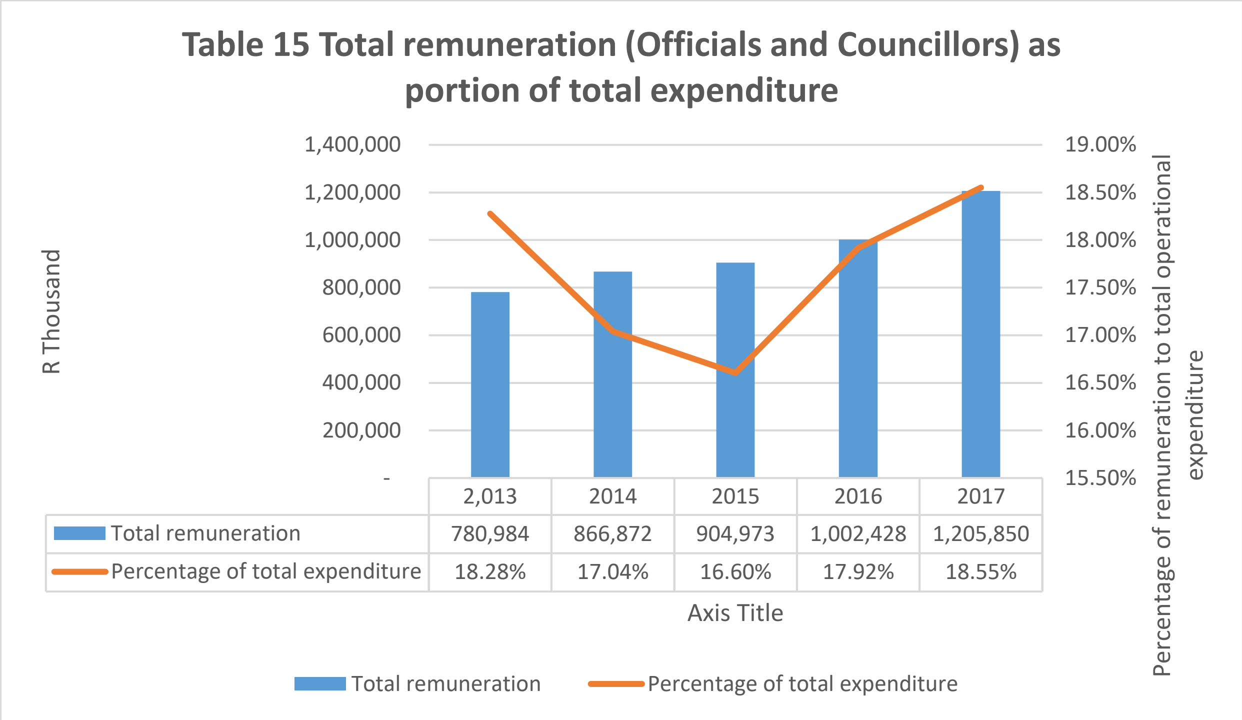
Finanacial Year

Total Expenditure — Remuneration — Repairs and maintenance — Bulk purchases: Electricity — Bulk purchases: Water — General Expenses

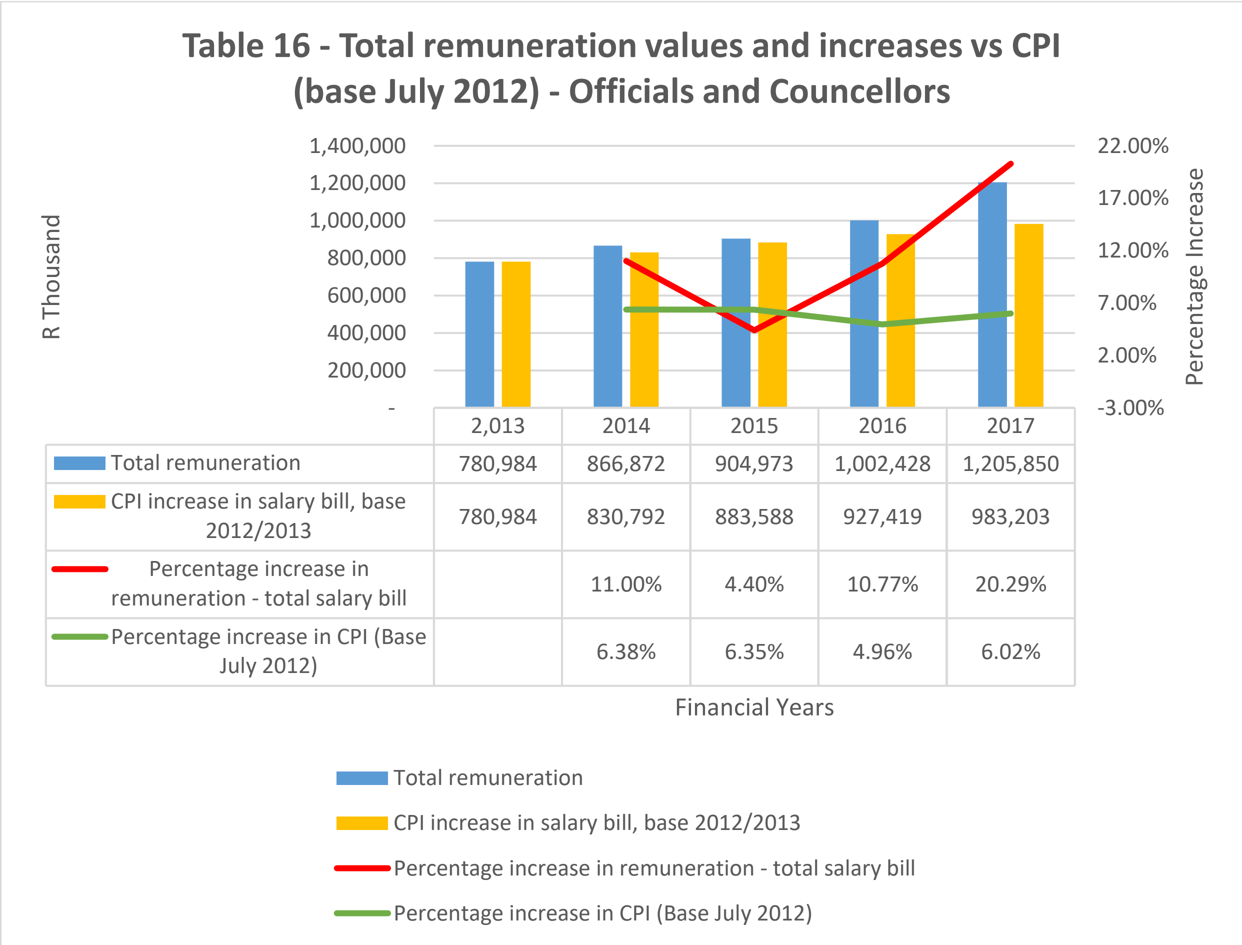
The percentage of the following expenditure on total expenditure in 2017 is:

- Remuneration: 18,6%
- Repairs and maintenance: 3.6%
- Bulk purchases – Electricity 23.1%
- Bulk purchases – Water 11%

- General expenses – 15.1%



	2,013	2014	2015	2016	2017
Total remuneration	780,984	866,872	904,973	1,002,428	1,205,850
Percentage of total expenditure	18.28%	17.04%	16.60%	17.92%	18.55%



	2,013	2014	2015	2016	2017
Total remuneration	780,984	866,872	904,973	1,002,428	1,205,850
CPI increase in salary bill, base 2012/2013	780,984	830,792	883,588	927,419	983,203
Percentage increase in remuneration - total salary bill		11.00%	4.40%	10.77%	20.29%
Percentage increase in CPI (Base July 2012)		6.38%	6.35%	4.96%	6.02%

Emfuleni Local Municipality total operational expenditure in 2017 is R6.5 billion (Refer Table 14)

A major priority of the municipality relating to its expenditure is employee and councillor remuneration that is 18.55% of total expenditure in 2017. Comparing the R1.2 billion spent on remuneration against R234 million, or 3.6% of total expenditure spent on repairs and maintenance and R252 million, or 3.9% spent on upgrading and new capital expenditure (property, plant and

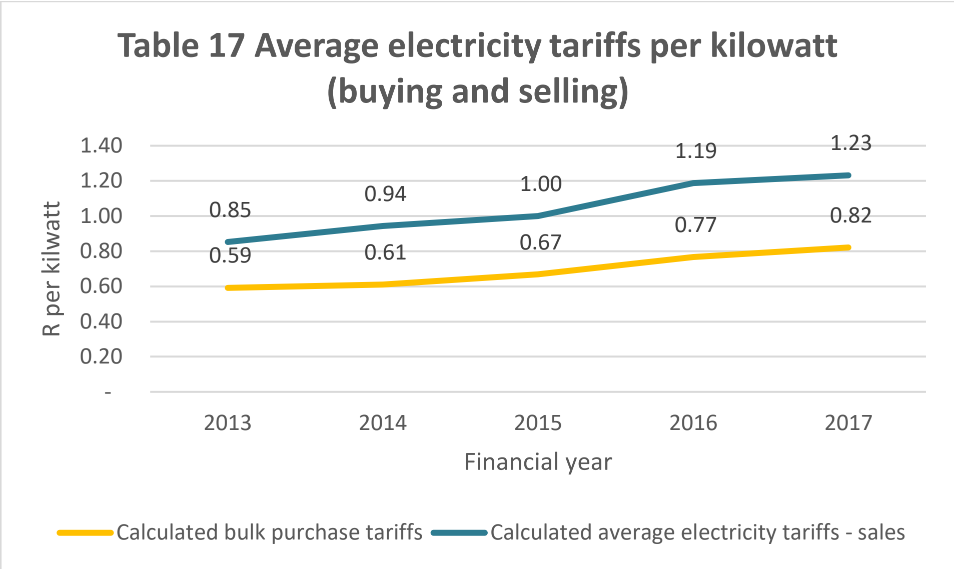
equipment) in 2017. The salary portion relating to total revenue is even worse, as the municipality is operating at a huge operating deficit of R910 million in 2017. The salary bill is 21.6% of total revenue (R5.6 billion) in 2017.

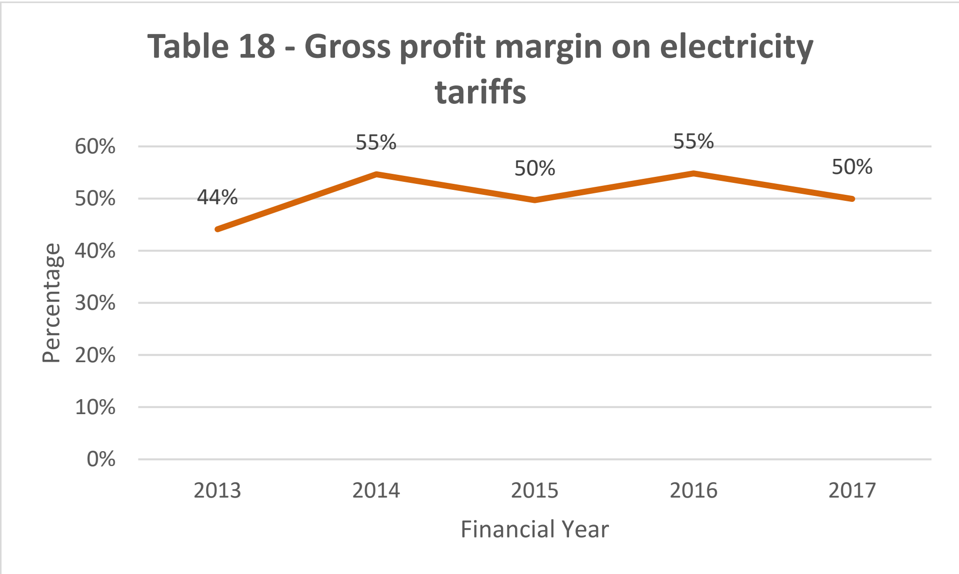
A municipal manager earning more than R2.2 million (2017 salary and benefit scale), and a head of department earning between R1.6 million and R2 million should be highly qualified with good municipal experience, not bankrupting and plundering a municipality to total dysfunctionality. The role SALGA, the trade unions and/or the municipality played in authorising the extra-ordinary high remuneration levels of municipal officials should be investigated, as it plays a large role in making municipalities unaffordable and contribute to the uncompetitive business environment in South-Africa.

The total remuneration bill of the municipality increased from R781 million (2012/13 to R1.21 billion (2016/17) in a five-year period – refer Table 16. If increases over that five-year period were limited to CPI, the total remuneration for 2016/17 would have been R223 million less – only R983 million instead of R1.21 billion in 2016/17 – refer Table 16). It should have saved the Council R355 million in that five-year period.

If the total remuneration increases for officials and councillors were limited to CPI since 2005/6 when the total remuneration bill was R321 million, the total remuneration for 2016/17 would have been only R620 million. It would have saved the community enormously over that 11-year period if salary increases were restricted to CPI, with the same numbers of officials and councillors. If the required skills and capacity were also in place, combined with efficient, economical and affordable services, (including Eskom, Rand Water, other SOE's and government departments and other municipalities) it would have resulted in much lower and more affordable rates and taxes, investment from private sector, more employment, less indigent subsidies and impairment of debtors. Our country would not have been in a recession with critical high unemployment; VAT increases and investment shortages.

5. Water and electricity tariffs





The electricity tariff increases (Table 17) for sales in the five-year period starting from July 2012 to July 2016 was 44.7%. The municipality's buying tariffs from Eskom increased by 39%. South-Africa consumer price index (CPI) in the same period was 25.9%. Both Eskom and Emfuleni Local municipality electricity tariffs were significant above the inflation rate, contributing to the unaffordability of electricity. The uniform financial ratios and norms set revenue growth equal to CPI.

We were not able to calculate the water tariff sales, as the water inventory levels (dams and reservoirs) were unknown. The municipality's buying tariffs from Rand Water increased with 33.4%, both far above the CPI of 25.9% over the five-year period, contributing to the unaffordability of water.

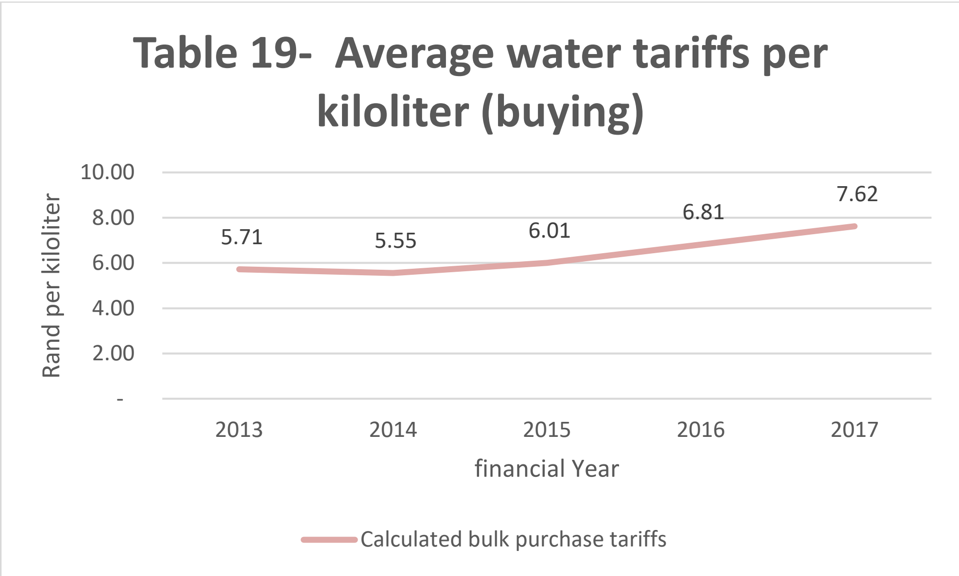


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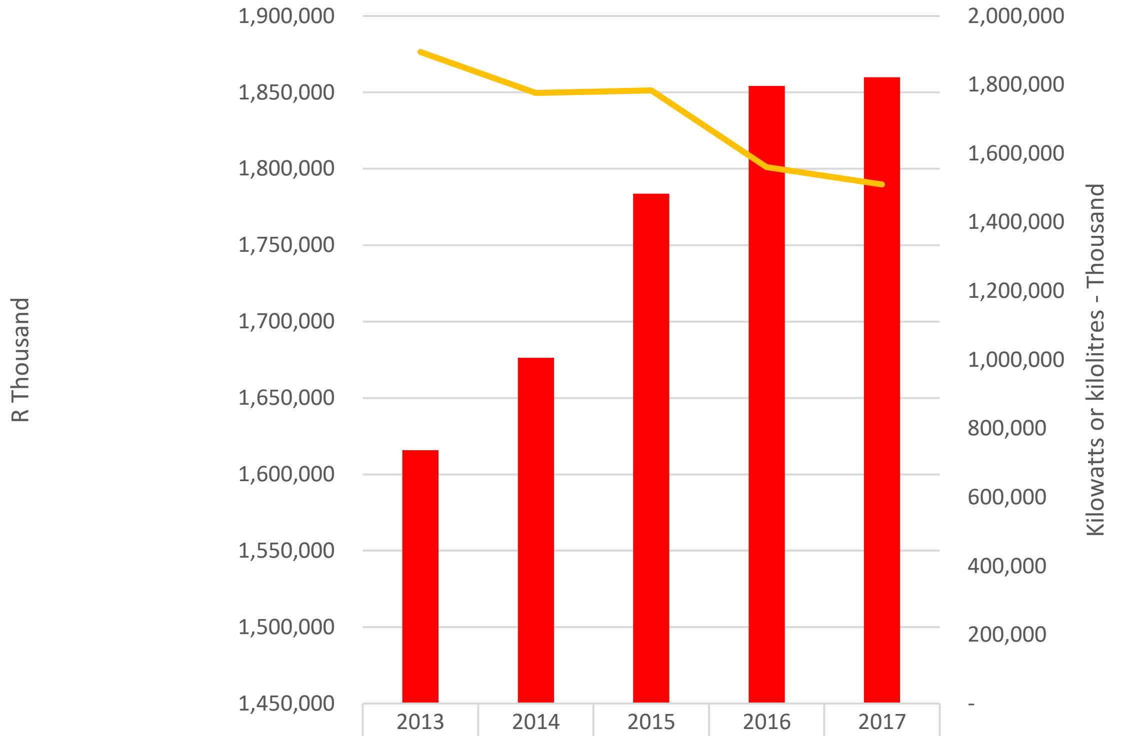
Table 20 - Billing: Electricity and water revenue and consumption



	2013	2014	2015	2016	2017
- Sale of electricity	1,615,708	1,676,333	1,783,609	1,854,285	1,859,841
- Electricity: Calculated sales (thousand kilowatts)	1,895,243	1,776,665	1,783,607	1,560,477	1,510,083

Financial Years

- Sale of electricity   - Electricity: Calculated sales (thousand kilowatts)

It is interesting that the billed electricity consumption has decreased from 1,9 billion kilowatts to 1.5 billion kilowatts, although the rand value has increased from R1.6 billion to R1.9 billion rand in same five-year period ended 30 June 2017 – refer Table 20. Could it be that the electricity is not billed correctly and validly, and/or is the decrease in billed electricity consumption the result of the economy, and/or because of alternative and private electricity power generation from consumers, like solar power, and/or electricity previously provided by municipality and now by Eskom?

Average water and electricity tariffs are not properly monitored by COGTA; National and Provincial Treasury, as they could not assist us with the average rates and taxes municipalities charged their consumers. That leads to municipalities charging the public excessive rates and taxes with their complex and differentiated rates and tax tariffs, and nobody ensure that the total tariffs are in line with inflation. Municipal tariffs should be simplified and standardized and the calculation of tariffs should be transparent. Ideally, the municipalities should be monitored and evaluated for average consumption versus estimate consumption (budget) for residential; business, industrial and agricultural consumption on a monthly or quarterly base. Such a database should be regularly published to enable the investor to make informed investment decisions and to enable healthy competition between the municipalities, based on most affordable services.

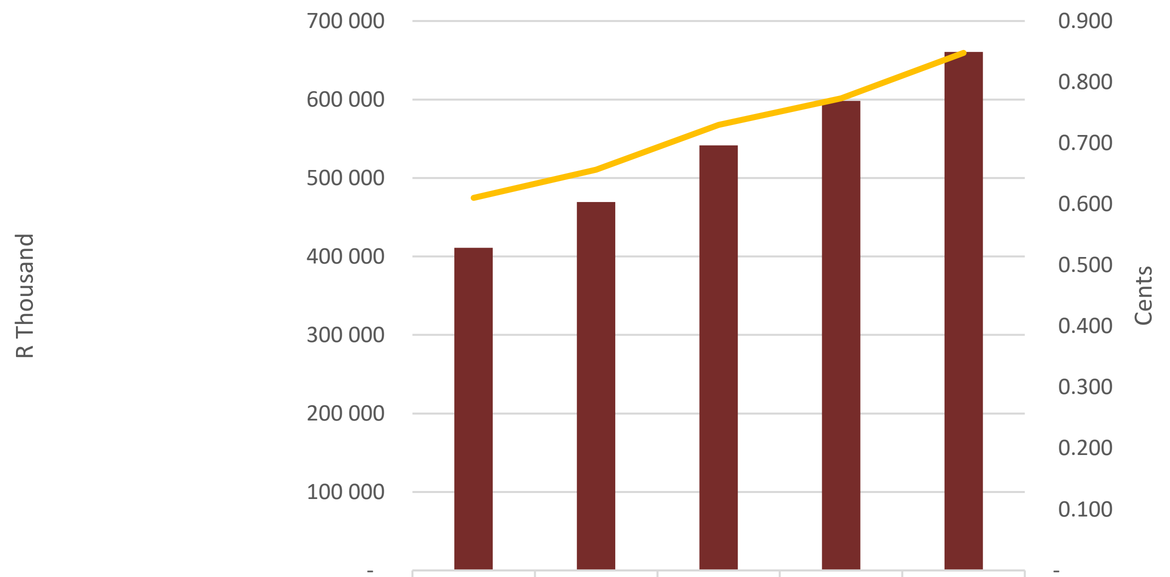
6. Assessment rates

Emfuleni estimate municipal **population** slightly increased from 735,128 (2013) to 762,816 (2017) people, that is an increase of only 3.77% over the 5-year period.

The property valuations roll has increased from R67.3 billion to R77.9 billion in above 5-year period, despite poor property market conditions since 2009. (Refer Table 23) That is a cumulative increase of 15.7% in property values from 2013 to 2017. In addition to higher property valuations, the property rates also increased from 0.61 Cents to 0.848 Cents in same period – that is an increase of 39% on rates, compared with an increase in consumer price index (CPI) of only 25.89%. - Refer Table 21 and Table 22). The revenue from assessment rates increased from R411 million to R661 million – a total increase of 61% over the five-year period.

These much higher than inflation assessment rate increases over the last five years (and longer period) has negatively influenced the affordability of the taxes, with insufficient and zero services provided by the municipality.

Table 21 - Assessment Rates revenue & average earnings on property values

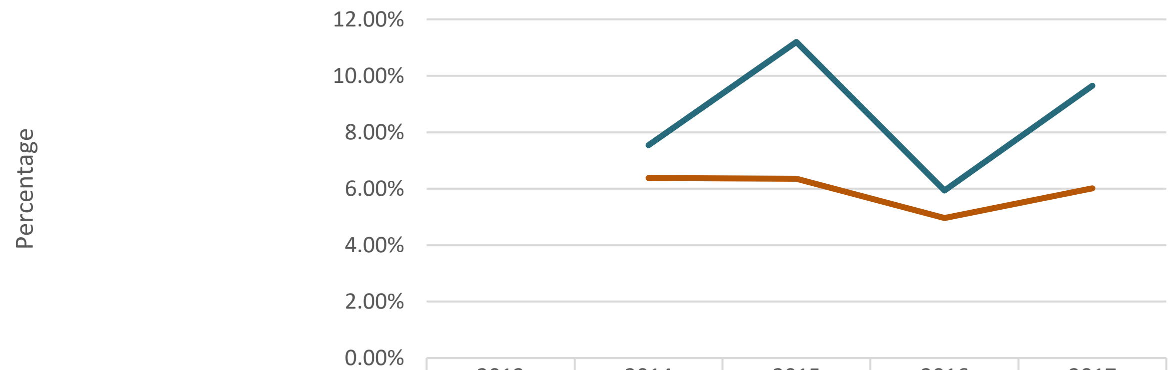


	2013	2014	2015	2016	2017
Property Rates - revenue	410 974	469 447	541 509	598 394	660 533
Average property rate earned on value of properties (Cents)	0.610	0.656	0.730	0.773	0.848

Axis Title

Property Rates - revenue   Average property rate earned on value of properties (Cents)

Table 22 - Increase in property rates vs CPI

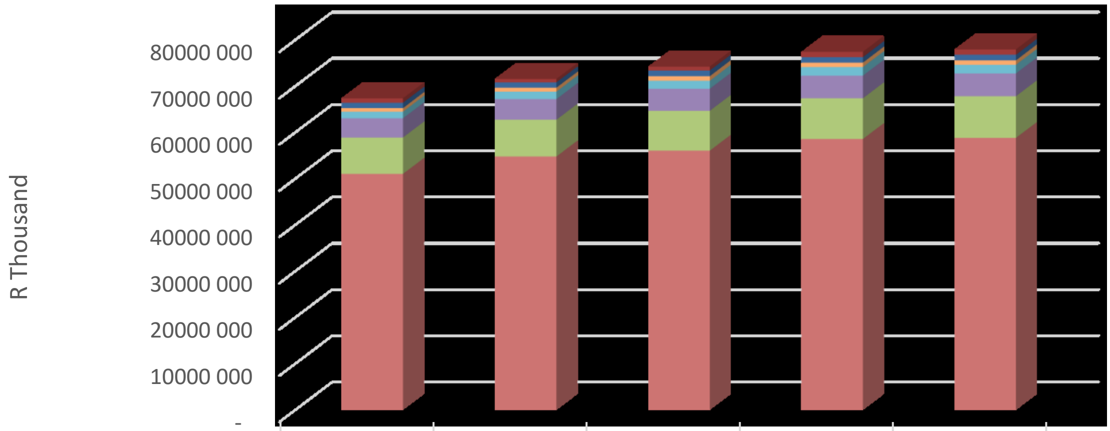


	2013	2014	2015	2016	2017
Average increase in property rates on value of properties		7.54%	11.20%	5.94%	9.65%
Percentage annual increase in CPI (Base July 2012)		6.38%	6.35%	4.96%	6.02%

Financial Year

Average increase in property rates on value of properties
Percentage annual increase in CPI (Base July 2012)

Table 23 - Property Valuations



	2013	2014	2015	2016	2017
Other	953 258	728 328	838 050	1136 759	1155 347
Agriculture	1155 720	1159 774	1219 705	1191 000	1193 190
Municipal	771 274	840 267	985 266	964 935	964 140
State owned properties	1424 691	1617 396	1741 416	1865 916	1865 043
Industrial	4166 515	4456 845	4772 871	4884 855	4931 311
Business	7852 592	7967 196	8614 047	8807 205	9013 048
Residential	51011 173	54750 838	56019 605	58540 794	58788 074

Financial Year

Residential Business Industrial State owned properties Municipal Agriculture Other

7. Closing Comments

The poor administration of Emfuleni Local Municipality (and the insufficient monitoring and intervention from Treasury and COGTA) over at least the past five years and the serious going-concern issues that have resulted in long outstanding creditors and provisions (Table 12) of around R2 billion and contingencies of around R300 million in 2017 (Table 13) despite Provincial Treasury Established Support Team in collaboration with Sedibeng District Municipality and Emfuleni Local Municipality to address amongst others cash flow and service delivery challenges (refer going-concern note 42 of the 2017 and note 43 of 2016 financial statements) had led to a dysfunctional municipality that cannot pay its outstanding debt, nor deliver basic services.

Section 2(d) of the Municipal Systems Act define a municipality that "*has a separate legal personality which excludes liability on the part of its community for the actions of the municipality*." That clearly makes the actions of Eskom and Rand Water to disrupt the municipality’s services not in compliance with the Systems Act. Furthermore, the recovery plan should not obtain additional internal funding and external loans to repay the creditors.