13 November 2018

To: Municipal Finance Recovery Services
MFMA Unit
Office of the Accountant General
Per: E-mail (MFMA@treasury.gov.za)

Dear Sirs,

ORGANISATION UNDOING TAX ABUSES' COMMENTS ON THE EMFULENI LOCAL MUNICIPALITY'S DRAFT FINANCIAL RECOVERY PLAN 2018
OUR REF: LG/EDFRP/11/03
YOUR REF: UNKNOWN

1. The Organisation Undoing Tax Abuse (OUTA) is a proudly South African non-profit civil action organisation, comprising of and supported by people who are passionate about improving the prosperity of our nation. OUTA Local was established to challenge the abuse of authority at municipal level and in particular the abuse of taxpayers' money in Local Government and more particularly in Municipalities by establishing a local branch to assist and represent the local community where requested.

2. OUTA-Emfuleni is a properly established community-based civil rights organisation with a constitution and which acts on behalf of the community in consultation with its supporters.

3. Kindly take note that OUTA-Emfuleni will be partaking in the community participation processes as envisaged in sections 16 and 17 of the Local Government: Municipal Systems Act[1] as a "*community organisation*".

4. From the outset we would like to reserve our rights in respect of the possible non-compliance of the Municipal Recovery Service (MRS) to adhere to the prescribed legislative requirements in respect of community participation as required by the Local Government: Municipal Finance Management Act[2]. In light of the latter we reiterate our submissions made in earlier correspondence.

[1] Local Government: Municipal Systems Act, 2000, hereinafter referred to as the Municipal Systems Act.
[2] Local Government: Municipal Finance Management Act, 2003, hereinafter referred to as the MFMA.

Due to the short notice and the refusal by the MFRS to extend the period for comments, OUTA would like to place on record that we could not obtain comprehensive input from our supporters, and we will continue with the consultation process after submission.

5. The comments below are submitted in terms of section 141(1)(c)(ii)(bb) of the MFMA –

6. Introduction:

6.1. To successfully draft a Financial Recovery Plan, it is essential to establish and understand the following considerations-

- Identify and understand the root causes of the problems in Emfuleni;
- Determine the appropriateness of the Institutional composition; and
- Ensure that the plan adequately addresses the problems and that the team assigned to implement this plan has the requisite skills to execute; and
- The plan must be based on the SMART Principle. Specific, Measurable, Achievable, Resources and Timeframes; and
- The plan must be formulated and executed according to recognized project management standards.

7. Review:

7.1. OUTA conducted a high-level review of the salient features of the Draft Financial Recovery Plan in accordance with the key factors as described above.

7.2. In addition to the root causes under section 4 of the draft Recovery Plan, OUTA further submits that the following areas are additional causes of the problems experienced in Emfuleni:

7.2.1. Lack of National CoGTA & Treasury oversight and action;

7.2.2. Lack of Provincial CoGTA & Treasury oversight and intervention;

7.2.3. The poor management and maladministration of the municipality;

7.2.4. Councillors representing political parties not acting in terms of the councillors' code of conduct;

7.2.5. ESKOM and Rand Water not enforcing Section 41 of the MFMA;

7.2.6. Cadre deployment is rife, political appointments have not served the communities and are in direct contravention of Section 152 (1) (a) of The Constitution, which reads; to provide democratic and accountable government for local communities;

7.2.7. Lack of sufficient public participation; and

7.2.8. Lack of accountability in the conduct of managers and officials and the failures that led to the status quo.

8. Outcomes due to the lack of intervention:

8.1. The consequences of maladministration have been identified and reported on as follows-

- Revenue loss of R1Billion
- 93% Debtors Impairment or R4.2Billion
- Inability to collect outstanding Debtors
- Poor Financial Management
- Current Liabilities exceed Current Assets by R1.35Billion
- Infrastructure failure due to lack of maintenance and the requisite skills to address the problems
- Deficit of R768Million as at 30th June 2017
- Section 56 managers: All posts are currently acting. Senior vacant posts- Head of Revenue Services, Head of Customer Care, Chief Audit Executive, Head of Operations, Chief Director: Utilities and Special Projects, Manager Electricity, Manager Debtors, Manager: Revenue Management and Manager: Fleet Management
- The Annual Financial Statements refer as follows – approved posts 6274, 2868 filled 54.80% vacancy. The Financial Recovery Plan refers as follows - approved posts 6314, 2600 filled- 59% vacancy rate. There is inconsistency in the reporting.

- Many employees lack required competency skills in Financial and SCM as prescribed
- No Contract Management
- Poor SCM practices
- R642Million in Unauthorised Expenditure of which 64% relate to Cash items
- R60m in Fruitless and Wasteful Expenditure
- R262m in Contingent Liabilities – this figure should read R272 million as per 2016/17 financial statements
- The municipality owes Eskom R606million and Rand Water R419m (which should be included in the R1.3Billion owed to creditors)
- 43% Electricity Losses and 40% Water Losses
- There is a funding shortfall of R73m for Operations and an amount of R1.79Billion is required for Capex which has not been factored into the Budget and would need Commitment from various stakeholders.

8.2. Impact of Root Causes

- Excessive salaries paid to unqualified staff
- Inadequate funds to maintain infrastructure services
- Inadequate capital to replace, upgrade and expand infrastructure
- Inadequate skills mix to maintain infrastructure life cycle
- Infrastructure integrity beyond restoration
- Infrastructure capacity inadequate to service losses and demand
- Absent metering and/or inaccurate metering
- Incomplete billing system which leads to the lack of revenue generation
- Lack of sustainable service delivery
- Deteriorating infrastructure
- Threat to health and safety of communities
- Obstacle to local economic development and investment
- Community unrest and growing inequality
- Pollution and degradation of the natural environment

8.3. The Municipal Financial Recovery Service unit proposes the following Medium-Term Intervention Plan:

- 5% reduction in employee costs
- 5% reduction in contracted services
- 5%, 7.5% and 5% per annum Increases in R&M
- 1% increase in services revenue
- 7.5% reduction in bulk purchases cost- water and electricity
- Potential borrowing of R450m for 2019/20 and further R450m in 2020/21 ring-fenced for revenue generating capital investments over 3 years and repayable over 5 years.

9. Our Findings:

9.1. Despite the Recovery Plan and report being very detailed, it does not identify actionable solutions which will bring the community of Emfuleni relief.

9.2. The information and detail should be sufficient to draw up an effective Recovery Plan, however there are some instances where outdated financial information has been analysed, and this may not provide the plan with the current and relevant information required for a successful financial recovery plan.

9.3. Although the Recovery Plan does not conform to the required prescripts, it falls short of being an effective and implementable plan for reasons spelt out below-

9.3.1. There is no clear project management plan to ensure executable projects with actions, adequate workforce and critical skills and reasonable timeframes.

9.3.2. There is no clear strategy on how the skills shortages and vacancies will be filled. The Root Causes to these weaknesses are not illustrated. Until and unless these weaknesses are adequately addressed, the Recovery Plan will be redundant, and the status quo will continue.

9.3.3. The Plan makes use of different financial periods which creates inconsistency in comparative analysis.

9.3.4. The plan does not make provision for material adjustments for the 2017/18 financial position as this may impact on the funding requirement.

9.3.5. The plan contains several calculation errors because they were not based on the Audited Financial statements and in turn will have an impact on the funding calculations. As an example, page 59 refers to unaccounted electricity losses of 396,624,431(KWh) instead of 319,449,836 (KWh) for the year 2016/17 which has an impact on the recalculated revenue losses for 2016/17. The same type of error appears on page 62 relating to the recalculated water losses for 2016/17.

9.3.6. With regards to the highlighted points in (5) above, it seems that this was a cut and paste exercise.

9.3.7. The Impairment value of R4.2Billion is grossly understated by R1,1 Billion, which should read R5.3Billion being the non-exchange debtors omitted. This Impairment is equal to 81% of the annual revenue and has a significant and detrimental impact on the financial stability and liquidity of the institution and is a direct contributing factor in the inability of Emfuleni Local Municipality to pay ESKOM, Rand Water and other creditors as well as the inability to carry out repairs and maintenance on infrastructure. Consideration should be given to writing off the provision for impairment of R5.3 Billion and to reduce the debtors to fair value as per accepted generally recognized accounting practice (GRAP). It is not just or reasonable to let the liabilities of the municipality (caused by the municipality) become the liability on the communities that pay for these services on a monthly basis.

9.3.8. The Plan does not illustrate a clear strategy on how the Debtors collection will be improved to achieve the 95% requirement. There is no clear indication as to how all consumers of electricity, water and other services will be metered and billed. In the private sector the Debtors Collection index is expressed as a % of the total outstanding debtors and not as a % of Billing. By expressing it as a % of Billing, it ignores the Outstanding Debtors and probable cause of the high Impairment.

9.3.9. Item 1.8 in the DFRP clearly states that implementation of the recovery plan is the responsibility of the Municipal Manager and the management team. Given the enormity, scope and complexity of the execution, this cannot be implemented successfully since management must still attend to the day to day running of the municipality. The lack of commitment shown to date by the current Executive and administration is a major cause of concern.

9.3.10. There exists a significant and remarkable difference in managing a turn-around or recovery plan to the usual management of a municipality. This requires a different approach and understanding. It must be considered and treated as a Special Project requiring Project Management skills, planning and execution.

9.3.11. No Project Management Plan is suggested nor included to guarantee that the entire Plan is correctly planned, to ensure that the municipality has all the required resources and personnel, that all critical vacancies are filled and that the specialised Infrastructure skills are available and on board. In the absence of a dedicated Project Management Plan and Manager, the Recovery Plan will not succeed.

9.3.12. We submit that human resources in the form of a project manager can be utilised by the Municipal Financial Recovery Service to assist in the proposer planning and implementation of the Recovery plan as made provision for in section 142(1)(a)(v) of the MFMA.

9.3.13. The implementation reporting required by legislation[3], to the Provincial Treasury, should be strictly governed and planned. We submit that stringent reporting timelines and guidelines are required.

9.3.14. No strategy exists on how the serious deficits and losses will be averted and how the required surplus will be achieved

9.3.15. The proposed reduction in cost % above do not reflect how these were calculated and arrived at. However, the proposed remuneration costs of 20-40% of operating expenditure is contrary to the proposed 5% reduction in personal costs. We believe that remuneration and staff costs should not be more than 25% of the operating expenditure.

[3] Section 146 of the MFMA.

9.3.16. No detailed calculations exist to illustrate how the proposed reduction % are arrived at in the Proposed Medium-Term Intervention as referenced in Item 1.6 and therefore cannot be independently verified nor relied upon.

9.3.17. The proposed borrowings of the 2x R450million are not supported by a funding model necessary for this type of requirement nor is the application of funds shown. The liabilities towards ESKOM and Rand Water alone exceed these amounts. We don't believe that taking on more debt is wise, though we do understand that it will cost a significant amount to address the issues in the municipality. The fact remains that the municipality is already insolvent and will not be able to settle any new debt. The proposed borrowing of 2x R450million is certainly not sufficient for the immediate needs of the municipality. Where will the funds come from? How will the commitment be met? A more responsible avenue would be to sell non-essential assets to generate the funds needed to address the issues.

9.3.18. It was found that 'Infrastructure Integrity is beyond restoration." This would probably include the infrastructure maintenance backlog, replacement and any new development. It is also reported that R1.79 Billion is required for CAPEX. The proposed FRP provided for 2.56% in repairs & maintenance in 2020/21 which will not meet the required standard of 8%. However, the Plan does not seem to illustrate how this funding will be done as no funding model exists nor does a business plan exist for raising this capital requirement. The balance sheet is too weak to support a funding requirement of this nature.

9.3.19. The Analysis done on pages 24 and 25 as part of the FRP compares the ratio analysis % norms for Financial Performance categories and Financial Position categories to the **Projected Ratios Before** the Financial Recovery Plan and the **Projected After** Financial Recovery Plan.

9.4. It would appear that the **Projected After** figures do not Improve the position nor achieve desired turn around and therefore results in non-effective planning.

Category	
Repairs & Maintenance	Does not improve position
Debtors Management	Not sufficient to improve position
Current Ratio	2 more years of Distress
Capital Costs	No plan to renegotiate or Restructure
Debt/Revenue	Not achieving Turn around
Net Surplus	Not achieving Turn around
Elec distribution losses	Not achieving Turn around
Creditors payment	Not achieving Turn around

9.5. The Plan lacks a Change Management strategy which is critical in bringing about a systematic change in responsibility and objectives that would result in achieving the required financial and functional outcomes.

9.6. **Annexure A**: illustrates the declining trends in the financial position and performance of the municipality over a 5-year period which should have been detected and the necessary corrective action should have been taken by Treasury and CoGTA in previous years to ensure accountability and to stop the decline which has led to a dysfunctional and insolvent municipality.

10. Recommendations:

10.1. The successful implementation requires the appointment by Provincial CoGTA of an experienced and skilled Project Manager independent of the municipal management

10.2. The implementation should be based on sound Project Management principles.

10.3. The Project Manager should draw up the Project plan based on the requirements, resources, costing, funding and timeframes.

10.4. It would be preferable to form a Project Steering Committee comprising of all interested and affected parties to ensure good oversight.

10.5. The Steering Committee should also have the ability to unblock bottlenecks and a dispute resolution mechanism.

10.6. OUTA recommends that the Financial Recovery Plan be updated to take into account the financial information contained in the 2017/18 Annual Financial Statements, in order to be more relevant and current.

10.7. The municipality is clearly not in a stable financial position to afford raising the required funding and repayment costs. It would therefore require a rethink and National Treasury must make the funding available from emergency reserves.

10.8. Should this suggestion not be considered, the municipality will run the risk of being Liquidated and the proceeds from the sale of non-essential assets will be used to pay off the creditors.

10.9. The municipality must avoid passing on the recovery costs to its consumers and inhabitants, which has the potential to lead to instability.

10.10. The Gauteng Province issued the Municipality with an intention to intervene in terms of Section 139(1)(b) and 139(5)(a) of the Constitution.

10.11. The Provincial CoGTA should clarify this inconsistency and ensure full compliance.

10.12. The short term needs of the community have not been taken into consideration.

10.13. OUTA requests an opportunity to develop and present a Municipal Financial Recovery Plan for Emfuleni Local Municipality that can be used as a blueprint for other dysfunctional municipalities.

11. Conclusion:

11.1. The plan is not sufficient in its composition to be a formal Plan ready for execution.

11.2. The significant omission is the Funding Model which is essential in securing the required Funding, a Business Plan for Application of funds and Strategy on obtaining the skills to fill the critical vacancies which unless filled, will compromise the turn-around plan.

11.3. An undertaking of such magnitude can only be successfully executed with skilled Project Management planning and execution. The Infrastructure Integrity which is Beyond Restoration requires a well-developed implementation Strategy and management.

11.4. Furthermore, a degree of blame can also be apportioned on the Provincial departments of Treasury and CoGTA and to a lesser extent National Treasury for their failure in their respective oversight obligations. Chapters 6 and 7 of the Constitution provides for measures to support and strengthen the capacity of municipalities to manage their own affairs, to exercise their powers and to perform their functions.

11.5. Municipalities submit their monthly and quarterly reports to these departments to allow for oversight.

11.6. National Treasury is required to review the draft Budgets and advise where needed. It is clear that the budgets submitted were not achievable and compromised, which should have been detected by Treasury and Provincial Treasury.

11.7. It is our stated view that the Turn-around required will only be achieved with external funding intervention from National Treasury as the municipality cannot afford any borrowing which will have a negative impact on the delivery of services to the community.

11.8. Furthermore, any delay in the implementation will increase the risks of community resistance and /or probable litigation for possible Liquidation of the municipality.

12. Kindly contact writer should you have any questions or concerns.

13. We trust you find above in order and extend our willingness to participate in an open discussion on our comments and submissions should you require same.

Regards,

Michael Holenstein
Manager: OUTA Local Division
michael.holenstein@outa.co.za