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FOR EWRD

For a number of years, the South African Cities Network (SACN), through its Well Governed Cities programme, has been reporting on the state and health of finances among its network members. It has also established a promising municipal finance programme that looks beyond South Africa, to the broader South African Development Community region. One of the series of reports produced about its nine member cities is The State of City Finances, the latest of which is for the 2010/2011 financial year.

The SACN has recognised that these reports are often technical and complex documents, not readily understandable to people who do not have financial backgrounds and training or work within municipal finance departments. Therefore, through this document the SACN has endeavored to create a simple and effective method of telling the story of municipal finances as it has emerged from these reports over the years. More importantly, the document sets out to clearly and simply define, explain and illustrate the complex terms and concepts ordinarily used to report on city finance. The hope is that this guide gives the reader an indication of the financial health of the biggest municipalities in the country, both now and in past years. A set of core financial indicators have been used as the basis to build this picture of the municipal financial situation in the cities.

Going forward, the SACN intends to build on this effort, distilling, simplifying and thereby creating greater accessibility of its knowledge outputs. Tools and guides such as this create greater understandability and assist decision and policy-makers to apply the knowledge produced by the SACN. This guide likewise creates a set of indicators that can serve as a broad proxy for municipal financial health. These indicators form part of the SACN broader urban indicators programme, and will be formulated and monitored over time in other areas of SACN research.
WHY THIS GUIDE?

The efficient functioning of cities is vital to South Africa’s social and economic stability and success. Cities have an essential role to play in transforming and developing the country, especially as several cities have larger budgets and populations than some provinces. They are responsible for managing large amounts of money and delivering services that affect millions of people every day. Therefore, municipal officials, councillors, civil activists and others interested and involved in local government have a duty to understand and debate how cities spend their money.

Throughout the developing world, local government is under pressure to provide increased and better services, as more and more people live in cities. South Africa faces the additional challenge of dealing with divided and unequal cities – a legacy of apartheid. Building inclusive cities requires investing in urban developments that will address the widespread poverty, huge inequalities, overstretched (at times inadequate) infrastructure and serious service backlogs, which affect especially the poor.

Only through efficient and sustainable use of financial resources will cities be able to transform into places where all can live and work. And the key to effective local delivery is good financial management.

The SACN has been measuring and reporting on the financial position and performance of South African city governments since 2006. This easy-to-understand guide to city finance was developed using information from the latest SACN State of City Finances Report 2011. The guide provides a framework of nine financial indicators that can be used to analyse and explain the state of city finances and highlights the changes and challenges that cities are experiencing.
## THE 9 SACN CITIES

### Johannesburg

Johannesburg is considered the economic capital of South Africa and is divided into seven administrative regions.

<table>
<thead>
<tr>
<th>Population 2010</th>
<th>Surface area covered</th>
<th>Personnel</th>
<th>Size of economy</th>
<th>GDP 2010 per person</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.775 million</td>
<td>over 1,644 km²</td>
<td>662 staff per 100,000 population; 200 councillors.</td>
<td>R408 billion</td>
<td>R108,894</td>
</tr>
</tbody>
</table>

### Cape Town

Cape Town is home to 66% of the Western Cape's population and the seat of the South African Parliament.

<table>
<thead>
<tr>
<th>Population 2010</th>
<th>Surface area covered</th>
<th>Personnel</th>
<th>Size of economy</th>
<th>GDP 2010 per person</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.499 million</td>
<td>over 2,500 km²</td>
<td>603 staff per 100,000 population; 200 councillors.</td>
<td>R269 billion</td>
<td>R76,932</td>
</tr>
</tbody>
</table>

### eThekwini

The eThekwini metropolitan area stretches from Umkomaas in the south, including tribal areas in Umbumbulu, to Tongaat in the north, moving inland to tribal areas in Ndwedwe, and ends at Cato Ridge in the west.

<table>
<thead>
<tr>
<th>Population 2010</th>
<th>Surface area covered</th>
<th>Personnel</th>
<th>Size of economy</th>
<th>GDP 2010 per person</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.409 million</td>
<td>2,297 km²</td>
<td>534 staff per 100,000 population; 200 councillors.</td>
<td>R266 billion</td>
<td>R77,893</td>
</tr>
</tbody>
</table>

### Tshwane

The Tshwane metro includes Pretoria, Centurion, Laudium, Eersterust, Akasia and Soshanguve, surrounding areas of Atteridgeville, Crocodile River, Ga-Rankuwa, Mabopane, Winterveldt, Hammanskraal, Temba, Mamelodi and Metsweding.

<table>
<thead>
<tr>
<th>Population 2010</th>
<th>Surface area covered</th>
<th>Personnel</th>
<th>Size of economy</th>
<th>GDP 2010 per person</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.775 million</td>
<td>over 1,644 km²</td>
<td>522 staff per 100,000 population; 210 councillors.</td>
<td>R233 billion</td>
<td>R98,688</td>
</tr>
</tbody>
</table>

### Ekurhuleni

Ekurhuleni Metro Municipality comprises nine towns of the former East Rand: Greater Alberton, Benoni, Germiston, Springs, Kempton Park, Edenvale, Nigel, Brakpan and Boksburg.

<table>
<thead>
<tr>
<th>Population 2010</th>
<th>Surface area covered</th>
<th>Personnel</th>
<th>Size of economy</th>
<th>GDP 2010 per person</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.027 million</td>
<td>over 1,924 km²</td>
<td>522 staff per 100,000 population; 192 councillors.</td>
<td>R163 billion</td>
<td>R53,819</td>
</tr>
</tbody>
</table>
THE 9 SACN CITIES

Nelson Mandela Bay

The Nelson Mandela Metro Municipality includes the city of Port Elizabeth and the neighbouring towns of Uitenhage and Despatch.

<table>
<thead>
<tr>
<th>Population 2010</th>
<th>Surface area covered</th>
<th>Personnel:</th>
<th>Size of economy</th>
<th>GDP 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.139 million</td>
<td>over 1,958 km²</td>
<td>579 municipal staff per 100,000 population.</td>
<td>GDP 2010</td>
<td>R83 billion</td>
</tr>
<tr>
<td></td>
<td></td>
<td>120 councillors</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

GDP 2010 per person
R72,861

Mangaung

The municipality of Mangaung includes the judicial capital of Bloemfontein, as well as the towns of Botshabelo and Thabanechu and a large rural area.

<table>
<thead>
<tr>
<th>Population 2010</th>
<th>Surface area covered</th>
<th>Personnel:</th>
<th>Size of economy</th>
<th>GDP 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.791 million</td>
<td>6,283 km²</td>
<td>468 municipal staff per 100,000 population.</td>
<td>GDP 2010</td>
<td>R41 billion</td>
</tr>
<tr>
<td></td>
<td></td>
<td>151 councillors</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

GDP 2010 per person
R51,648

Buffalo City

The municipality of Buffalo City is situated in the Eastern Cape province, in the Amatole District, and encompasses East London, King William's Town and Bhisho.

<table>
<thead>
<tr>
<th>Population 2010</th>
<th>Surface area covered</th>
<th>Personnel:</th>
<th>Size of economy</th>
<th>GDP 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.761 million</td>
<td>2,460 km²</td>
<td>657 municipal staff per 100,000 population.</td>
<td>GDP 2010</td>
<td>R45 billion</td>
</tr>
<tr>
<td></td>
<td></td>
<td>75 councillors</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

GDP 2010 per person
R59,673

Msunduzi

Msunduzi municipality includes Pietermaritzburg, the capital city of KwaZulu-Natal province.

<table>
<thead>
<tr>
<th>Population 2010</th>
<th>Surface area covered</th>
<th>Personnel:</th>
<th>Size of economy</th>
<th>GDP 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.648 million</td>
<td>633 km²</td>
<td>509 municipal staff per 100,000 population.</td>
<td>GDP 2010</td>
<td>R25 billion</td>
</tr>
<tr>
<td></td>
<td></td>
<td>70 councillors</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

GDP 2010 per person
R38,493

All 9 Cities

<table>
<thead>
<tr>
<th>Population 2010</th>
<th>Percentage of national population</th>
<th>Personnel</th>
<th>Size of economy</th>
<th>Percentage of national GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>19.41 million</td>
<td>39%</td>
<td>more than 111,800 permanent employees</td>
<td>GDP 2010</td>
<td>63%</td>
</tr>
</tbody>
</table>

GDP 2010 per person
R7,286
**DESCRIPTION OF 9 INDICATORS**

An *indicator* is an instrument that gives you information and is useful for measuring progress and direction.

The following nine financial indicators are a guide to the state of city finance. They are not intended to give a complete picture, but to help explain the trends in city finance over the past five years, and to show how the nine cities are managing their money and planning for their longer-term development.

<table>
<thead>
<tr>
<th>Indicator 1</th>
<th>Indicator 2</th>
<th>Indicator 3</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>REVENUE PROFILE:</strong> where the money comes from to pay for the city’s operations and capital investment.</td>
<td><strong>SPENDING PROFILE:</strong> what the city spends its money on, for both day-to-day running costs and capital expenditure.</td>
<td><strong>OPERATING SURPLUS:</strong> money left over after all bills have been paid.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Indicator 4</th>
<th>Indicator 5</th>
<th>Indicator 6</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>DEBTORS:</strong> money owed to the city by households, businesses, government departments and other organisations.</td>
<td><strong>REMUNERATION COSTS AS % of OPERATING EXPENDITURE:</strong> total costs of staff salaries and benefits (including councillors)</td>
<td><strong>FUNDING OF CAPITAL EXPENDITURE:</strong> where the money comes from to invest in capital projects.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Indicator 7</th>
<th>Indicator 8</th>
<th>Indicator 9</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CAPITAL EXPENDITURE (CAPEX) AS A PERCENTAGE OF EXPENDITURE:</strong> the amount of money spent on developing the city.</td>
<td><strong>LIABILITIES:</strong> the amount borrowed by the city to fund capital expenditure.</td>
<td><strong>CASH POSITION:</strong> number of months of cash available to pay for expenditure that the city is committed to.</td>
</tr>
</tbody>
</table>
Revenues across the cities are increasing, with grant revenues rising faster than any other source of revenue.

Spending is increasing on bulk purchases (electricity and water). However, after peaking in 2009, capital expenditure reduced in 2010.

In recent years, City operating surpluses have shown a downward trend, as operating margins have been squeezed by real increases in bulk purchases and remuneration costs. Nevertheless, most cities are managing to generate operating surpluses of around 15%–20%.

Debtors reflect generally improved financial management. Gross debtor days have declined mainly due to rising city income, while net debtor days have been maintained at sustainable levels.

Remuneration costs show an upward trend, accelerating sharply from 2008. During the period 2004–2010, remuneration costs accounted for around 24% of total expenditure.

The proportion of capital expenditure (capex) funded through own resources has declined.

Capital expenditure (capex) has decreased after increasing rapidly from 2005 to 2009 in anticipation of the 2010 FIFA World Cup™.

Cities’ liabilities increased rapidly in the three years to 2010, as cities borrowed to fund capital projects. The level of indebtedness varies among the cities, from 1% to over 50% of operating income.

Most cities have experienced a weakening cash position and by the end of 2010 had cash available to cover only around one month of operating expenditure.
The three cities with the largest population are Johannesburg, Cape Town and eThekwin.  
* Johannesburg’s economy is significantly the largest, while Cape Town and eThekwin tie second.  
* Tshwane’s economy is relatively large compared to its population, as its local GDP per person is close to that of Johannesburg.  
* Mangaung has a GDP per resident that is about equal to the national average figure of R1,555.  
* Msunduzi has a lower GDP per resident than the national average of R1,555.

Did you know?  
South Africa’s nine largest cities collectively account for over 60% of national economic product and 40% of the national population.
WHAT IS CITY FINANCE?

City finance consists of the revenue (income) and expenditure (costs) decisions of local governments. Like households, cities need to budget for annual income and expenditure. In addition to drawing up budgets for the coming year, city governments account for the spending that has occurred in the current year by publishing management accounts. They also draw up financial statements for the previous year’s expenditure and income, which are audited. The data in this booklet is drawn from these audited financial statements.

There are two types of budget:

- **Operating budget**, which deals with the day-to-day (short-term, i.e. less than a year) costs and income to deliver municipal services to all communities.
- **Capital budget**, which deals with the once-off costs of developing or improving something that the city owns, such as buildings or infrastructure.

The difference between the operating and capital budgets

The purchase of a car is a useful way to explain the difference between the operating and capital budgets. The car is paid for out of the capital budget because the expected life of the car is greater than a year. However, the costs of fuel and repairs are operating expenditure because they are short term.

The car example also explains how capital and operating budgets are mutually dependent and so must be considered together. If you haven’t enough money in your operating budget to pay for fuel and servicing, it is pointless buying a car using funds from your capital budget. What good is a car if you can’t afford to run and repair it?

Similarly, a city needs to include enough money in its operating budget to cover on going repair and maintenance costs of projects paid for out of its capital budget. For example a new sewage plant (paid from the capital budget) requires regular maintenance (from operating budget).

A budget is a financial plan that summarises the activities planned by the city for the coming year. It sets out how much these activities will cost and where the money will come from to pay for the expenses.
Cities must find their operating or capital expenditure separately. Just as a bank loan through a bond should only be used to buy a capital asset (such as a house) and not to cover household expenses, so too cities cannot legally spend their capital money on operating expenses. However, they can and should spend their operating revenue on capital items – assuming there is money left over after paying all the bills.

For instance, a city can use a capital grant to pay for a new road. However, ongoing repairs and maintenance must come from operating income.

In other words, cities cannot solve short-term budget problems by selling long-term assets (e.g. roads and pipes) that are critical for service delivery. That would be like selling your house to pay for groceries – although you would have money to buy bread and milk, you wouldn’t have a roof over your head.

**What is operating revenue?**

This revenue is used to pay for the costs of running a city. It consists of ‘own revenue’, or money that the city generates itself through taxes and services charges, and money received from central government in the form of operating grants.

**What is operating expenditure?**

These are the costs associated with running a city and providing services. The benefit is short-term, as the services will be used up within a year. Operating costs are split between personnel, bulk services and ‘other’.
What is capital revenue?

This revenue is the money available to pay for capital projects. A capital project may be a new construction, expansion, renovation or replacement of an existing facility or infrastructure (e.g. water and sewer pipes or streetlights) or a long-term purchase or investment (e.g. land or buildings) that will be a city asset (i.e. owned by the city) for more than a year. The main sources of capital revenue are own revenue (operating surplus, cash reserves and borrowing) and government grants.

What is capital expenditure?

These costs are largely based on longer-term planning decisions around development of the city’s infrastructure and built environment. To count as a capital expenditure, the asset has to be improved, not just put back in good order. Capital expenditures are split between infrastructure, land and buildings, community assets and other assets.
In 2010 total city revenues were R103.7 billion compared to R75.9 billion in 2005. The graphs below present the total revenue by source and by city on a per resident basis, to make inter-city comparison easier.

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Revenue (Per Capita)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td></td>
</tr>
</tbody>
</table>

City revenues have been increasing at a rapid rate since 2005, growing by an average real increase of 7.3% per year and by 11.4% in 2010 alone. However, not all cities are experiencing the same kind of revenue increases.

- Much of the increase is powered by higher service charges and capital and operating grants, rather than tax revenues. Property taxes have been stagnant in real terms.
- Operating grants (mainly the equitable share) jumped substantially in 2007, as they incorporated the RSC replacement grants and (later) the share of the fuel levy.
- Capital grants increased sharply from 2007 as a result of investments in transport and for the 2010 FIFA World Cup™. Despite this dramatic increase, national government grants to cities represent only about 10% of total revenue. The majority of grants are conditional grants, which have specific objectives.
- Mangaung’s decline in revenue in 2007 was the result of the establishment of Centlec (a city entity to manage electricity), which meant that the service charge component of the city’s revenue decreased substantially. Msunduzi and Buffalo City also experienced a drop in revenue in 2007.

The revenue from grants is rising faster than that of any other revenue source, which is a concern. A greater reliance on grants has the potential to increase revenue uncertainty and reduce a city’s accountability to the local population.

Did you know?

In 2006 the cities lost a significant source of revenue when the RSC levy was removed. The RSC levy had been a form of local business tax for nearly 20 years and was replaced first by a grant and later by a share of the national fuel levy. Under new legislation (Municipal Fiscal Powers and Functions), municipalities have the right to establish new taxes, and some cities are considering the introduction of a new business tax.
Over the period 2005–2010, the nine cities spent a total of R590 billion, of which R110 billion was capital investment, R123 billion was for the purchase of bulk supplies, R139 billion went on staff remuneration and R217 billion was spent on other expenditure, which includes provision for bad debts, repairs & maintenance, depreciation, interest, and other operating and non-operating expenses. The graphs here present the total spending by source and by city on a per resident basis, to make inter-city comparison easier.

Did you know?

In 2008/09 the nine SACN cities accounted for 71% of all local government operating expenditure. In other words, the remaining 274 municipalities in South Africa collectively spent 29% of all local government budgets.

Different types of expenditure have different effects on the city. Spending on infrastructure ideally improves the city’s revenue base and therefore the city’s economy. Spending on free basic services contributes to reducing service delivery backlogs and improves the greater social good of the city.
**Operating surplus** is the money left over after all the operating expenditures have been paid. A city’s operating surplus is used to fund capital expenditure.

The operating surplus is like the extra cash in your pocket after you have paid for all your necessities that you can use to extend your house by, for instance, building a new room or landscaping the garden. In the same way, a city may use its operating surplus to develop the transport infrastructure, plant trees or build a new library.

City governments should maintain a substantial surplus of operating revenues over operating expenditures. This is to be able to fund the cost of new, expanded and refurbished infrastructure and services.

A stable operating surplus enables the city to plan its longer-term development. The operating surplus is an important part of ‘own revenues’, which give cities autonomy and leeway to decide on where and how to spend their capital revenues.

**Did you know?**

Despite a downward trend in recent years, many cities are managing to maintain operating surpluses of 15%–20%, which appears to be a reasonable range.
Four cities are managing to generate operating surpluses of more than 20% of operating revenues; three cities show medium-term declines in overall operational viability:

- Johannesburg’s operating surplus stayed at around 30% for four years to 2008 but then collapsed to below 15% in 2009. Since then, it has risen to around 20% in 2010. Cape Town had surpluses of around 30% until 2007, after which it slipped down to 20%. eThekwini managed above 25% up until 2008, slipping to 15% by 2010. Buffalo City shows the greatest stability of all cities, maintaining an operating surplus of at least 25% and improving in 2010 (unlike the other cities).

- The 2009 international financial crisis clearly affected cities, in particular Johannesburg, Cape Town, Nelson Mandela Bay and Tshwane.

- Mangaung’s improved operating surplus reflects the removal of electricity services from city finances in 2009.

- Periods of internal crisis and subsequent recovery can be seen for Ekurhuleni (2006–2010) and Nelson Mandela Bay (2007–2009),

- The medium-term financial problems that occurred in Msunduzi (2008–2010) are also evident.
A **debtor** is someone who owes money. For a city, this can be either individual households, businesses, government departments or other organisations. To compare debtors across cities, the **gross** and **net debtor days** are calculated by dividing the money owed (gross or net debtors) by the billed revenue x 365 days. This gives the average number of days of uncollected billed income (i.e. owed to the city).

**Gross debtors** is the total amount owed to the municipality for services and taxes (e.g. electricity, water, rates). If gross debtors is growing, the municipality is continuing to invoice for services and taxes but failing to collect all the money.

**Net debtors** take into account invoices that the city does not expect to be paid. In other words, they are the amount owed to the city after allowing for bad and doubtful debts. Net debtors is important because if they are too high, the implication is that the city government is spending more than it will receive in cash.

Therefore, net debtors, not gross debtors, should be considered the realistically collectible figure.

Like organisations or households, cities that are well-managed make reliable income estimates in their budget. An important part of these estimates is accurate bad debt provision, which is illustrated here by net debtor days. If a budget is unrealistic and assumes that more people will pay their debts than actually do, the city will find itself unable to fulfil the promises made.

It’s like a household basing its budget (and spending) on twelve pay cheques in the year but only receiving ten months’ pay (in other words two months unpaid or 60 debtors days); the household will struggle to pay for all the planned expenditure. However, if a household assumes and spends as though only ten cheques will arrive, cash flow problems are avoided. Although money to pay for certain services and infrastructure will be lacking, the overdraft will not get worse.

**The money owed, or debtors, is revenue that the municipality does not yet have to spend on infrastructure development and service delivery. Therefore, the lower a city’s debtors are, the more money is available to improve the living conditions of its citizens, especially the poor.**

**Gross debtor days indicate the city’s effectiveness in billing, debt collection, and credit control. Net debtor days indicate the city’s approach to and effectiveness in budgeting, financial, cash and risk management.**

**Did you know?**

Uncontrolled debtors can cripple a city’s cash flow, affecting its ability to deliver basic services and to upgrade, maintain and develop infrastructure. A reasonable and achievable range for net debtor days appears to be 60–90 days.
Gross and net debtor days are used to compare debtors across cities.

- The medium-term decline in gross-debtor days in many cities is the result of an increase in revenue invoiced rather than a decline in debtors.
- **Johannesburg, Ekurhuleni and Mangaung** have very high gross debtors. **Johannesburg** experienced a steady decline between 2005 and 2009, sticking at around 231 days in 2010 (about 7½ months). **Ekurhuleni** has followed a similar pattern. **Mangaung**’s performance on gross debtors is currently the worst among the cities.
- **Cape Town, eThekwini, Tshwane and Nelson Mandela Bay** have been on an improving trend over at least the last three years, but **Buffalo City** and **Msunduzi** are more fragile.
- The overall position with net debtors is more reassuring than gross debtors. Net debtor days are under 60 days for **Johannesburg, Ekurhuleni and Msunduzi** and under 90 days for **eThekwini, Nelson Mandela Bay** and **Mangaung**. Only **Buffalo City, Tshwane** and **Cape Town** have net debtor days higher than 90 days.
- Affordability issues (such as the effects of increased electricity costs) are likely to show up first in an increase in gross debtor days.
Remuneration is the cost of paying for the thousands of people responsible for the running city governments. It includes the salaries and wages of full-time, part-time, contract and temporary municipal employees and Councillors.

Remuneration costs have shown an upward trend and accelerated sharply from 2008. Between 2008 and 2010, staff remuneration costs per resident increased by 18%. Nevertheless, over the period 2004–2010, remuneration costs as a proportion of total expenditure has accounted for around 24% of the total expenditure. Personnel and bulk purchases account for a similar proportion of operating expenditure. The ratio of personnel costs to operating expenditure has not changed much because costs of both bulk purchases and personnel have risen rapidly in recent years.

High personnel costs could imply a bloated bureaucracy. Yet, declining personnel costs may not necessarily indicate a ‘lean and mean’ city, but rather that the city is losing (relatively highly paid) skills.
Capital projects (capex) are funded mainly by own resources (reserves, current operating surpluses and borrowing) and government grants. The main categories of government capital grants have been: Municipal Infrastructure Grant (MIG), transport infrastructure grants and grants for investments associated with the 2010 FIFA World Cup™.

Did you know?

Over-reliance on capital grants can lead to 'serial asset replacement' and degradation of existing assets – such as where a new road is built (using grant money) but not maintained because the expectation is that in a few years time another grant will become available to build a road to replace the now degraded road.

Cities should ideally fund most, if not all, of their capex from own resources.
Capex, or capital expenditure, is the amount of money spent on developing the city. To count as a capital expenditure, money must be spent on either a new asset or on improving or refurbishing an asset. Money spent on simply keeping an asset in good order falls under operating expenditure.

Capex is like the money you spend on upgrading your household’s standards of living, such as purchasing household appliances (e.g. a washing machine) or renovating and improving the house (e.g. replacing windows or building a garage).

Similarly, capex is the money that the city invests in long-term economic and social infrastructure. Capital expenditures are split between infrastructure (e.g. roads, solid waste recycling stations, electricity substations and cables, water pipes and sewage treatment plants), land and buildings, community assets (e.g. community halls, clinics, or stadia) and other assets (e.g. a new system to control traffic lights; or an upgraded IT system).

Cities are growing as a result of their own organic growth and in-migration from other areas. Every year increasing numbers of people and businesses, make more use of city infrastructure and services. The city’s capital investment needs to provide for this growth and development.

Did you know?

By 2020 the nine cities will have to provide for over 22 million people, nearly 3 million more than in 2010.
The nine cities spent a total of R119.1 billion on capital expenditure between 2004 and 2010.
Capital expenditure increased rapidly from 2005 to 2009 in anticipation of the 2010 FIFA World Cup™ and then dropped back in 2010.
Nelson Mandela Bay bucked the trend and increased its real capital expenditure as a percentage of total spending in 2010.
eThekwini increased real capital expenditure in 2010, although capital expenditure as a percentage of total spending decreased.
Liabilities are the debts that a person or an organisation owes. A city government has long-term liabilities (money borrowed to fund capital expenditure) and short-term liabilities (which are payable within a year).

A household’s liabilities or debts are also long term (e.g. the bond on your house) or short term (e.g. credit card debt). The amount of money that you can borrow depends on your income, and loans can be expensive when interest rates are high.

Similarly, borrowing money from banks and other financial institutions can be an expensive way for cities to finance the capital budget when interest rates are high. However, borrowing also enables cities to implement capital plans more quickly. It’s like choosing to take out a bond in order to live in a house now, rather than saving up for years and paying cash for the house.

A city with excessive debt will be unable to borrow further money, as it will not have enough money to repay the debt from its existing income. As a consequence, the city will have to cut capital spending (put off planned developments) or raise taxes and service charges.

Credit ratings are the assessment of the credit worthiness of an individual, corporation, institution or place: the higher the credit rating, the lower the risk of default (not repaying the debt fully and on time) and so the lower the ‘risk premium’ charged by the lender, which means lower interest rates. In other words, a city with a high credit rating pays less for borrowing money, which means it can do more with its money. A city with a lower rating is still able to borrow but will pay a higher interest rate and so have less money to spend.
Borrowing by city governments rose slowly until 2006 but increased rapidly in the three years leading to 2010 (by 58% or R13.2 billion). The largest cities were responsible for the bulk of the borrowing.

- **eThekwini** and **Johannesburg** are the two most heavily indebted cities, with long-term liabilities equal to over 50% of their operating income.
- **Cape Town** and **Tshwane** carry similar debt-to-income ratios (about 40%) and appear to be on a long-term upward trend.
- **Nelson Mandela Bay** and **Msunduzi** also increased their long-term debt-to-revenue ratio in 2010.
- **Buffalo City** has reduced its long-term liabilities from 40% of operating income in 2007 to 25% in 2010.
- **Mangaung**, whose borrowing is traditionally minimal, continues to reduce its real long-term liabilities, which were only 1% of operating income in 2010.

**Did you know?**

Cape Town, Ekurhuleni and eThekwini have been the cities with the most consistently high credit ratings over the last five years.
The city’s *cash position* is the number of months of cash available to pay for expenditure that the city is committed to.

Similarly, a household needs to have enough cash to pay its bills for the coming month. These may include bond repayments (or rentals), instalments on car and other loans, groceries, school fees, medical insurance etc.

**Did you know?**

A city’s cash flow also depends on its ability to collect revenue and to predict accurately key expenditures and revenues.

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To operate effectively, cities need liquidity, which means having sufficient cash available to meet their financial commitments. Employees, bulk and other suppliers, service providers and contractors must all be paid in cash.
Several city governments have seen their year-end cash position weaken since 2005. By the end of 2010 most cities had cash available to cover only around one month of operating expenditure.

- **Johannesburg** and **Mangaung** dropped to two weeks.
- **Ekurhuleni** has dropped to around one month.
- **Nelson Mandela Bay** has gone from as high as five months, in 2007 and 2008 to one month in 2010.
- **Tshwane** remains consistent, operating with about one month’s worth of cash.
- **Buffalo City** had above three months cash available, rising to six months in 2009 before dropping to two months in 2010.
- **Cape Town** is consistent, at less than three months of cash every year.
# Guide to the State of City Finances

## Auditing Local Government

A government is obliged to account to taxpayers for its management of public funds and services and to ensure that government programmes are managed in a way that represents value for money.

The Auditor-General acts on behalf of taxpayers as an ‘independent auditor’ that audits and reports on the activities of all government institutions, including municipalities. Through auditing, the Auditor-General contributes to strengthening South Africa’s democracy by ensuring government accountability and improving the effectiveness and efficiency of the public sector. All reports are made public, which is essential for transparency and accountability, the guiding principles of the Office of the Auditor-General.

In these reports, the Auditor-General must express an opinion on whether or not the financial statements fairly represent the actual financial position of the institution.

If the financial statements are in order, the Auditor-General’s report will state ‘financial unqualified’ either with no or with other findings. Other findings usually relates to municipalities not making progress on findings made in previous years.

If the Auditor-General finds that the financial statements are not in order, the opinion expressed may be:

- **Qualified** when financial information is misstated or incomplete, but is not pervasive (spread throughout the institution) or significant enough to require an adverse or disclaimer opinion.
- **Adverse** when the financial information presented is incomplete, inconsistent, incorrect, misleading or misstated
- **Disclaimer** when the financial information is insufficient for the auditor to express an opinion

In all three cases, the auditor states the areas that have given rise to the financial qualifications. These may relate to capital assets, current assets, liabilities, revenue, expenditure, or unauthorised, irregular and fruitless/wasteful expenditure.

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010</th>
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<tbody>
<tr>
<td>A</td>
<td>Johannesburg</td>
<td>Cape Town</td>
</tr>
<tr>
<td>B</td>
<td>Cape Town</td>
<td>Ekurhuleni eThekwinl Nelson Mandela Bay</td>
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<tr>
<td>C</td>
<td>Buffalo City</td>
<td>Msunduzi</td>
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<tr>
<td>D</td>
<td>Tshwane</td>
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<tr>
<td>E</td>
<td>Mangaung</td>
<td>Mangaung Buffalo City</td>
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<tr>
<td>N</td>
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**KEY:**

- **A** - Financial unqualified with no findings
- **B** - Financially unqualified with findings
- **C** - Qualified
- **D** - Disclaimer
- **E** - Adverse
- **N** - Audit not finalised at legislated date