Financial absorption in the water, sanitation and hygiene sector

South Africa[1]

WaterAid commissioned Development Finance International (DFI) to carry out analysis of financial absorption in the water, sanitation and hygiene sector in five countries to identify the prevalence of low financial absorption, and help identify key steps and conditions for achieving higher future levels of absorption and effective spending. These studies help shed light on the paradox of under-resourced water, sanitation and hygiene sectors (and the high levels of water and sanitation poverty they cause) in countries where funds are available but unused. The studies highlight the cases of Ethiopia, Mozambique, Rwanda, South Africa and Uganda – all of which have had varying degrees of success in terms of improvements to financial absorption. These countries are also in various stages of decentralisation, which can help to frame lessons for future improvements in other countries. Addressing financial absorption constraints is an important part of the process to strengthen the water, sanitation and hygiene sector and provide a platform for achieving universal access by 2030. The studies, therefore, try also to identify key recommendations on which WaterAid can draw for future actions to improve financial absorption.

List of acronyms

COGTA	Cooperative Governance and Traditional Affairs
DWA	Department of Water Affairs[2]
HLOS	Higher Levels of Service
IGFR	Intergovernmental fiscal relations
LES	Local Equitable Share
LGBER	Local Government Budget and Expenditure Review
MFMA	Municipal Finance Management Act
MIG	Municipal Infrastructure Grant
ODA	Official Development Assistance
WASH	Water, Sanitation and Hygiene
ZAR	South African Rand

1. Introduction and background

1.1. Background to water, sanitation and hygiene in South Africa

With the ending of apartheid, the newly democratically elected Government of South Africa prioritised the provision of basic services, including water supply and sanitation. It has made significant in-roads into delivering water and sanitation services to increasing numbers of the population – although clearly more can and needs to be done.

Ambitious targets were set within a policy framework that included 'free basic water' and 'free basic sanitation' for households with resources below the social grant amount.[3] In 2012, 3.47 million and 1.84 million people benefited from free services for water and sanitation respectively.[4] Initially responsibilities for service provision were driven by central government but in 2003 this responsibility was devolved to local government in line with the constitutional allocation of functions.

Currently, resources for water and sanitation are provided to decentralised organisations charged with providing basic water, sanitation and hygiene (WASH) services. Strong monitoring frameworks have been put in place to track progress against targets set. Although the timeframe for reaching the targets of universal coverage have not been met, major gains in access have been achieved amongst poor communities and those living in rural areas. However, there remain major gaps especially in the poorest and most remote places.

1.2 WASH and the system of Intergovernmental Fiscal Relations

In the context of the South African WASH sector, financial absorption is understood as the extent to which allocated funds are spent for their intended purpose. In other words, the focus is not primarily on whether allocations are adequate or on impact per se, but on trends and challenges in the allocation-expenditure link.

South Africa has a fairly complex system of intergovernmental relations and the question of financial absorption for WASH must be seen in against this backdrop. Briefly, South Africa consists of national, provincial and local spheres of government, with the latter comprising metropolitan municipalities (metros), district and local municipalities.
Constitutionally, municipalities may charge for municipal services, they have been assigned the property tax, and are also entitled to an equitable share of nationally-raised revenue: the local equitable share, or LES.[5] The definitive aspect of the LES is that recipient municipalities have considerable discretion over where to allocate such funds. Given the assignment of these revenue sources, the local sphere in aggregate receives a smaller share of nationally-raised revenue than the provincial sphere (which to date does not benefit from significant revenue sources).

Due to the widely differing economic and financial circumstances of municipalities, the extent to which they are reliant on the LES as a revenue source also varies markedly, with poorer municipalities more heavily reliant on it. Though the LES is a formula-based transfer that has been designed to try to avoid perverse incentives against own revenue efforts (i.e. own revenue efforts do not affect the LES determination), the question of whether local municipalities are doing enough to expand their own revenue sources remains a contentious and important one.

In addition, the South African Intergovernmental Fiscal Relations (IGFR) system makes extensive use of conditional grants, which are transfers from national or provincial departments to municipalities whose purpose and reporting requirements are circumscribed in detail. The main conditional grant to municipalities is the Municipal Infrastructure Grant (MIG). This currently amounts to close to half of total conditional grants to municipalities and which supports the government's aim to expand service delivery and alleviate poverty. The grant "funds the provision of infrastructure for basic services, roads and social infrastructure for poor households in all non-metropolitan municipalities… The municipal infrastructure grant is allocated through a formula with a vertical and horizontal division. The vertical division allocates resources between sectors and the horizontal division takes account of poverty, backlogs, and municipal powers and functions in allocating funds to municipalities. A minimum allocation of ZAR 5 million ensures that a reasonable allocation is made to small municipalities."[6]

In an effort to improve the access of the poorest to WASH, make services more affordable and to reduce inequalities, national allocations to WASH services, which include infrastructure/capital project grants and service provision/operational grants to municipalities, are provided only for basic services. Municipalities are expected to raise the additional funding needed for higher levels of service (HLOS) from their own revenue. However, the leakage of capital funding intended for basic levels of services to HLOS is a growing problem. Free basic water (6,000 litres per household per month) and free basic sanitation are provided to those registered and with incomes below the poverty line in order to try and address equity issues. This is normally done by setting the first tariff block at zero.

A programme is also underway to provide unserved (largely rural poor) people with at least an interim level of service. Certain grants are specifically intended for the poor or for informal settlements. The Municipal Water Infrastructure Grant (MWIG) was introduced in 2013/14 to accelerate the delivery of clean water to communities that do not have access to basic water services. "The grant, administered by the Department of Water Affairs, provides funding for various projects, including the construction of new infrastructure and the refurbishment and extension of existing water schemes…In areas where municipalities have the capacity to implement projects themselves, funds will be transferred through a direct grant. In other areas, the Department of Water Affairs will implement projects on behalf of municipalities through an indirect grant."[7]

1.3 Institutional relations and players in WASH

The main actors in the water services sector are the national department of Water Affairs, the water boards and municipalities. Drawing from the sector description in the 2011 Local Government Budget and Expenditure Review (LGBER): "The Department of Water Affairs plays the role of sector leader and is responsible for policy development, regulation, monitoring and support functions... The Water boards act as intermediaries to distribute raw and potable water across vast distances to multiple users (the regional water supply schemes). Water boards are primarily responsible for bulk water provision, but some water boards also provide retail and reticulation services…The provision of water services is a municipal competence in terms of Part B of schedule 4 of the Constitution. However, not all municipalities are authorised to provide this function. The two-tiered local government system requires that powers and functions be divided between category B and C municipalities to avoid duplication and coordination problems. An asymmetric approach has been followed in relation to water and sanitation, where all category A (metros) municipalities are authorised, category B (local) municipalities are authorised in certain instances and category C (district) municipalities in others."[8]

Within this framework, municipalities are responsible for the provision of water services, with their water operating budgets typically going to bulk water purchase costs, repairs and maintenance, and personnel costs, and their capital budgets requiring an appropriate balance between water infrastructure extension aimed at addressing historical backlogs and infrastructure extension aimed at facilitating economic development.

For the purpose of assessing financial absorption, a number of factors need to be kept in mind. The categories used in the Municipal Finance Management Act (MFMA) section 71 reports[9] (the main data source for this study) distinguish between water operating revenue and expenditure, and between water capital revenue and expenditure.

In the municipal budgeting and planning process, the municipality needs to ensure that its revenue estimates are credible, based on the mix of revenues that are likely to occur, and that its expenditure plans are aligned realistically with this.

This appears to be a problem for many municipalities. The revenue for water services, on the operating side will come mainly from water tariffs and from a share of the LES allocated to the water function. The LES commitment, therefore, is a secure, predictable funding source for municipalities, and for smaller municipalities with a limited revenue base it constitutes a key revenue source. On the other hand, budgeting for and collecting water tariff revenues is currently subject to a number of challenges. These include charging for water services below the cost of delivery, poor billing practices, and an extensive debtors' book. This latter factor may reflect both resistance to water charges on the part of users (in turn related to dissatisfaction with services, the perception that water should be free and so on) and also possibly a reluctance on the municipality's part to pursue debt collection more assertively, particularly where a reliance on the LES has come to shape how the municipality thinks about its future revenue.

The water capital budget is funded from sources in the municipality's own revenue stream (whether from water or other services) as well as from the Municipal Infrastructure Grant (MIG) and Municipal Water Infrastructure Grant (MWIG) where applicable. Again, and as discussed later, in many municipalities there is insufficient provision for capital expansion beyond addressing backlogs in historically under-serviced areas through the MIG and MWIG.

1.4 Availability of data for the study

South African budgeting has rightly been hailed for its commitment to transparency. In particular, the fact that municipal financial information is made publicly available constitutes an invaluable resource for this study. Municipalities are required, by Section 71 of the MFMA, to submit monthly expenditure and revenue reports to the mayor and the provincial treasury, and these reports are provided in various forms on the website of the National Treasury. They constitute the main source of information for the analysis provided below. The National Treasury also releases various summary reports on the state of local finances.

Since this data is provided in-year rather than retrospectively, it is unaudited. As such, the possibility must be considered, given poor auditing outcomes for the local sphere, that some of the data may be subject to revision. However, by and large the data contained in the Section 71 reports is regarded here as credible, and certainly so for the purposes of a national overview of local WASH absorption.

At present, data in Section 71 reports does not allow disaggregation in terms of the various components of water services; thus, for example, budgeting and spending on the sanitation function cannot be determined in a disaggregated way. A balance will always have to be struck between comprehensiveness and ease of use of data; it is suggested, however, that some disaggregation of water services data would be possible without leading to information-collecting and reporting overload.

Finally, for some time, the National Treasury released the useful Local Government Budgets and Expenditure Review, which provided, for the main local functions, financial, policy and service delivery summaries. This publication was, for unclear reasons, discontinued in 2011 and leaves a gap.

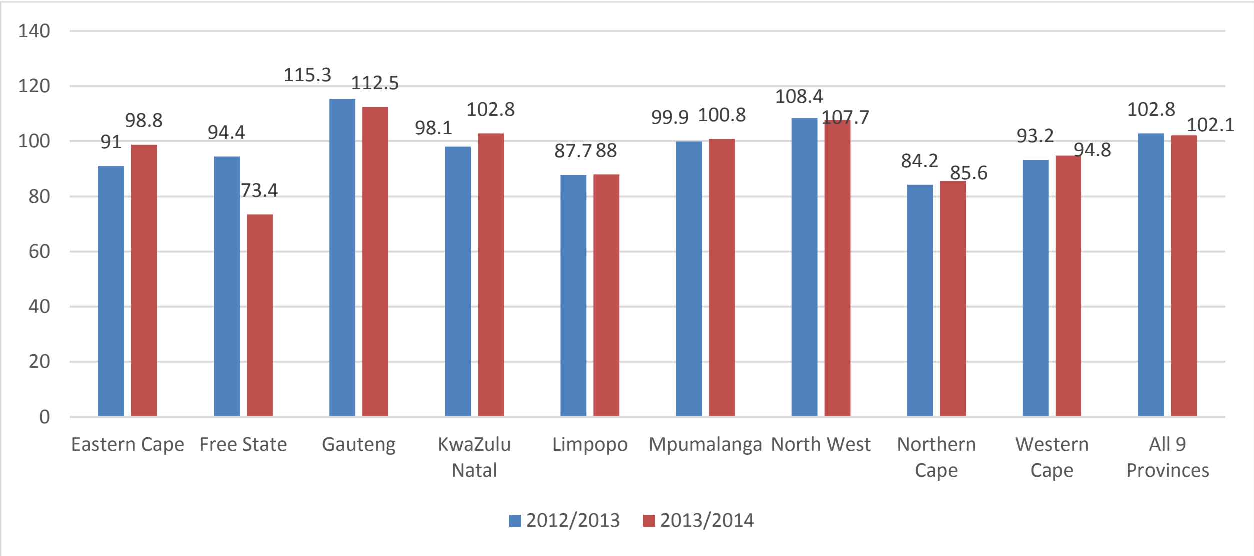
2. Financial absorption trends in water operating and capital expenditure, 2012/13 and 2013/14

Figure 1 provides, nationally and for all nine provinces, the share of the adjusted water operating budget actually spent in 2012/13 and 2013/14. The figure uses data for all municipalities: metros, district and local municipalities.

Though the national averages look fairly healthy, at 102.8% and 102.1% for the two years, a number of concerns can be identified even from this broad perspective. Most obvious is that performance by province is fairly uneven, with underspending quite high in some provinces. Thus, for example, the Free State averaged less than 80% in 2013/14, Limpopo around 87% in both years, and Northern Cape 84% and 85% in 2012/13 and 2013/14 respectively.

However, national and provincial average absorption rates may appear deceptively rosy, for at least two reasons. First, they include metro spending: the metros form a large part of water services in many provinces and tend to perform better than district and local municipalities. Second, the average absorption presented here may in some or many instances represents the interaction of high over- and underspending in different municipalities, neither of which is desirable. The latter of course represents poor absorption narrowly understood, whilst the former may point to problems in financial control and planning.

Figure 1: Expenditure as a share of adjusted water operating budget, 2012/13 and 2013/14, all municipalities



Source: MFMA Section 71 reports.

To get a more nuanced sense of these challenges at local and district level, we take out metros from the picture and further categorise municipal water operating budget expenditure as follows:

- Serious underspending: < 60% of budget
- Moderate underspending: 60%-80% of budget
- Moderate overspending: 120%-140% of budget
- Serious overspending: > 140% of budget

Table 1 accordingly shows the results for 2013/14 for all local and district municipalities that have the water services function assigned to them. These results suggest a continuing challenge with water operating budgets in many local and district municipalities. Indeed, in 2013/14 more than half of all these municipalities (57%) did not have spending outcomes that were within 20% of their adjusted budget. A full 45% of these municipalities spent less than 80% of their water operating budgets in this year.

Table 1: Adjusted water operating budget over- and underspending, metros excluded

Province	Serious under-spending	Moderate under-spending	Serious over-spending	Moderate over-spending	No serious/ moderate under- or overspending
Eastern Cape	5	5	2	1	6
Free State	8	7	1	1	1
Gauteng		1		1	5
KwaZulu Natal		2	2	2	8
Limpopo	4	2			5
Mpumalanga	4	2	1	2	9
North West	6	3	1	3	4
Northern Cape	8	8	2		9
Western Cape	2	3			19
Total	**37**	**33**	**9**	**10**	**66**
Percentage of total	24%	21%	6%	7%	43%

Source: Section 71 reports, author's own calculations.

The results suggest continued absorption problems, and are particularly concerning given that operating budgets, all else being equal, are 'easier' to spend than capital budgets, where issues of adequate medium-term planning, capacity, procurement processes tend to loom much larger.

As described above, municipal capital spending can be financed from a number of sources, though a useful broad distinction is between conditional infrastructure and related grants and own revenue sources assigned to capital expenditure. The reality for most South African municipalities, with the exception of some of the metros, is that they are unable or unwilling to fund capital spending from internally-generated sources – that is, in the case of water, from surpluses on water tariffs or surpluses from other trading services. The reliance thus remains heavily on the MIG in particular.

Furthermore, there appears to be a tendency for the amounts of internally-generated funds budgeted for capital expenditure to be quite optimistic, or indeed unrealistic. In other words, capital expenditure premised on internally-generated funds tends to be shelved or reduced in-year when revenue collection fails to meet the projections from which budgeted expenditure derives, as Table 2 suggests for 2013/14.
Poor budgeting for own revenue to be allocated to capital expenditure must be considered as one reason for poor financial absorption on capital budgets, but by no means the only one. In other words, in some instances municipalities will provide for

a water capital budget that cannot be achieved because internal funds are not sufficient to complement transfers. However, aside from this budgeting and capital revenue problem, under-spending of *secured* funds is also fairly pervasive, as we discuss below, by considering performance both for the total water capital budget and against the MIG and the MWIG.

Table 2: Percentage of forecast internally-generated revenue for capital expenditure actually collected, 2013/14

Province	%
Eastern Cape	54.3%
Free State	65.7%
Gauteng	85.2%
KZN	69.2%
Limpopo	42.3%
Mpumalanga	67.2%
Northern Cape	48.3%
North West	73.4%
Western Cape	77.7%

Source: Section 71 reports; author's own calculations

Considering first the total water capital budget, i.e. where grants and other revenue sources allocated to water capital spending are included, the results by province given in Table 3 suggest continuing and significant challenges.

Table 3: Water capital budget expenditure by province, 2013/14 (ZAR millions)

	Actual expenditure as share of adjusted budget	Under- or overspending
Eastern Cape	83.3%	390.7
Free State	74.3%	172.5
Gauteng	133.8%	(386.7)
KZN	81.3%	632.7
Limpopo	64.3%	818.4
Mpumalanga	67.2%	269.5
Northern Cape	73.8%	107.0
North West	45.5%	503.2
Western Cape	85.1%	129.2

Source: Section 7 reports; author's own calculations

These results tend to confirm the *prima facie* conclusion that financial absorption for capital water budget spending is even poorer than in the case of operating budgets. The total underspending on water capital budgets that occurred in 2013/14 was approximately ZAR 3 billion[10], a large amount by any standards. Excluding Gauteng, for the eight underspending provinces the simple unweighted average for water capital budget financial absorption was only 72%. These results reflect low financial absorption and – as already discussed – the fact that the component of municipal capital spending on water (which is premised on own revenue being allocated to water capital expenditure) tends not to materialise. We now consider trends in conditional grants, the MIG and the MWIG more closely, in order to isolate this more narrow understanding of financial absorption from the issue of budgeting for own capital revenue.

In general, considering conditional grant expenditure by municipalities, there is still room for improvement, with a number of provinces still underspending conditional grants to a significant degree. Though total municipal conditional grant expenditure as a share of the adjusted budget amounted to 90.2% nationally in 2013/14, this ratio again disguises the fact that both under- and overspending occurred in many provinces. In other words, as a net figure it bundles together over- and underspending on different conditional grants.

Table 4 focuses exclusively on underspending and gives total conditional grants underspending as share of adjusted value by province, as well as the Rand value of underspending, for 2013/14. Clearly substantial underspending still occurs, with a total underspend for all nine provinces of ZAR 3.3 billion, and with a number of provinces experiencing serious difficulties.

Table 4: Conditional grant underspending, 2013/14, by province

	Underspending as % of adjusted budget	Rand '000 value of underspending
Eastern Cape	7.5	308 335
Free State	9.3	126 946
Gauteng	7.3	239 562
KwaZulu Natal	13.2	672 589
Limpopo	21.8	788 767
Mpumalanga	18.8	392 919
Nothern Cape	10.8	258 926
North West	16.4	122 184
Western Cape	15.7	384 547
Average	13.1	3 294 776

Source: Section 71 reports; author's own calculations

In relation to the MIG and the MWIG, for 2013/14 MIG spending was at 95.7% of the adjusted budget total, entailing a net underspend of ZAR 610.3 million. In the case of the MWIG, however, which is focused on poorer, more rural municipalities, infrastructure grant performance is weaker, and quite low, at 68.4% of the adjusted budget.

The results provided below for the MIG and the MWIG require some further explanation in terms of how the National Treasury reports on them. For each grant, a 'total available' is given, which refers to the funds that are in principle set aside for the municipality in the financial year. This amount however differs in many instances from the actual expenditure (i.e. the actual transferred amount) by the national department, and also from grant expenditure by the municipality itself. Municipal expenditure in some instances exceeds the nationally transferred amount and in other instances is less than it.

These different totals relate largely to the discretion of the national department to withhold funds where municipalities have not provided adequate planning, reporting, and where, in the view of the National Minister, sufficient capacity did not exist to spend funds well. A briefing to the Standing Committee on Public Accounts (SCOPA) by National Treasury and the Department of Water Affairs (DWA) gives a more concrete sense of challenges in this regard:

"As at January 2014, the report on the Municipal Water Infrastructure Grant (MWIG) noted 70% spending. Spending on the infrastructure projects was at 69%. In relation to MWIG, the Department had transferred funding in two quarters to the municipalities. The Department entered into an agreement with municipalities to submit monthly progress reports as well as a business plan. However, DWA was currently experiencing challenges in terms of the MWIG allocation transfers, because of late submission of project plans from the municipalities, and late submission also of the reports… another reason for withholding the transfers was that, in the case of the 49% transfers made to the municipalities, only 18% had been spent, and it was a risky exercise to continuously transfer funds where there was no capacity to spend. The Department had projects that needed to be fast-tracked to ensure that water would reach communities. It was thus engaging with the municipalities and encouraging them to review their business plans. DWA recognised that withholding of money did not get the projects done, so it was critically important to reach a stage where it could transfer the money to the projects that needed to progress." [11]

Table 5: 2013/14 MIG and MWIG spending performance by province

ZAR ' 000s	Total available	Transferred by COGTA	Expenditure by municipality	Expenditure as share of MIG total available
MIG				
Eastern Cape	2 952 906	2 830 683	3 071 244	104%
Free State	968 682	960 061	1 019 024	105%
Gauteng	456 461	419 308	422 490	93%
KwaZulu Natal	3 193 259	3 092 219	3 190 490	100%
Limpopo	2 650 889	1 853 526	2 135 103	81%
Mpumalanga	1 565 716	1 326 781	1 433 858	92%
Northern Cape	499 123	381 585	430 698	86%
North West	1 481 743	1 349 735	1 483 796	100%
Western Cape	455 688	438 047	427 439	94%
MWIG				
Eastern Cape	86 788	78 263	85 524	99%
Free State	20 795	4 239	153	0.7%
Gauteng	N/A	N/A	N/A	

KwaZulu Natal	267 463	170 146	165 381	62%
Limpopo	93 473	80 853	71 030	76%
Mpumalanga	89 468	38 339	63 216	71%
Northern Cape	16 371	15 775	15 775	96%
North West	28 617	23 653	10 644	37%
Western Cape	NA	NA	NA	

Source: Section 71 reports; author's own calculations

MIG performance appears broadly adequate, though again it can be assumed that provincial averages disguise variations in particular municipalities. Conversely, MWIG expenditure clearly suggests ongoing challenges, as the SCOPA briefing confirms, with both large transfers being withheld, as in the case of the Free State, KwaZulu-Natal and Mpumalanga, and underspending on funds actually transferred (Free State and North West).

2.1 Donor funding to the South African WASH sector

For the period 2013/14, the relevant Annual Report of the DWA notes that no donor funds were received by the Department for the WASH sector.[12]

South Africa does, however, receive donor funding for the sector through Official Development Assistance (ODA), private and multi-lateral channels, aimed mainly at NGOs and civil society. It is difficult, however, to track the scope, purpose and especially the absorption rates for such flows. South Africa does not systematically track and report on donor funding entering the country but that does not run through government.

The Organisation for Economic Co-operation and Development (OECD) database on aid flows from member countries provides some indication of the scope and purpose of such flows, however. Table 6 shows, in 2014 (millions of US$), the total ODA committed for water supply and sanitation for the period 2005 to 2013.

Table 6: ODA to water supply and sanitation in South Africa, US$ millions

2005	2006	2007	2008	2009	2010	2011	2012	2013
20,35	71,39	167,31	7,59	7,7	2,86	147,84	9,68	3,85

Source: OECD Creditor Reporting System

Taking the 2013 number of $3.85 million, the OECD database suggests that typically ODA funding to the sector is in the form of quite small, 'project-based' grants and technical assistance. Average grant size, for this year, was around $167 000; indeed, three larger grants, two of about $1.3 million, and one of $1.1 million, accounted for the lion's share of ODA flows to the sector.

3. General and water-related municipal challenges

South Africa's local government sphere has been the object of concern, scrutiny and intervention for an extended period of time, and service delivery protests in many municipalities have become a fact of life. Not all the factors that contribute to citizen frustration are under the control of municipalities themselves, of course, though much of the evidence suggests that municipal governance, leadership and capacity challenges do play a key role.

Audit results for the local sphere have continued to remain disappointing. Table 6 shows audit results for municipalities and municipal entities for 2012/13; almost half of audited entities were unable to achieve a financially unqualified finding, and the large share of entities obtaining a disclaimer remains a concern.

Table 6: 2012/13 Audit results for municipalities and municipal entities

Assessment	Number
Clean (Financially unqualified with no findings)	30
Financially unqualified with findings	138
Qualified	84
Adverse	8
Disclaimer	59

The Auditor-General report also notes a number of related challenges, of which we highlight non-compliance with laws and regulations and irregular expenditure here: "In the current year, 90% of auditees had findings on non-compliance with laws and regulations, many of which related to the area of supply chain management. Irregular expenditure was reported at 265 auditees (83%), mainly due to the lack of basic controls and inadequate implementation of appropriate consequences where there has been poor performance or transgressions. The value of these controls cannot be emphasised enough as they are an important mechanism to narrow the space for widespread abuse of the public resources that are required to provide services to citizens… As a result of significant breakdown in controls, municipalities and entities entered into transactions that were not carried out in accordance with regulations and other prescripts. We have classified these as irregular expenditure, which totalled R 11,6 billion for the period under review. We have ascertained through audit test that R 8 billion of this amount represents goods and services that were received despite the normal processes governing procurement not being followed. The balance of R3,6 billion is at risk due to lack of supporting documentation, and we were therefore unable to confirm whether goods and services were received or not."[13]

In their most recent 80/20 report,[14] whilst noting the significant progress in access to basic services in democratic South Africa, the Institute of Race Relations (IRR) identifies three 'main systemic issues' which they regard as root causes for the problems currently facing local government. These are:

- political appointments;
- lack of capacity, and
- lack of accountability.

Similarly, National Treasury notes in its LGBER that "…while there are many examples of councils, mayors and municipal managers striving to provide effective leadership and making progress with strengthening governance, there are instances where serious governance shortcomings remain. The systems that are under greatest pressure are procurement, billing and revenue collection, staff appointments and the planning and zoning functions".[15]

The same publication then goes on to note a number of areas where critical attention is required:

- **Quality of leadership and governance***.* Effective leadership and good governance contribute enormously to ensuring a municipality makes positive progress in delivering services and extending infrastructure. To improve the capacity of municipalities to perform their functions, there is an urgent need to stabilise the senior management cadre of municipalities. Appropriate technical skills need to be in place.
- **The municipal budget must be funded in accordance with the legal requirements set out in the Municipal Finance Management Act** *(2003).* If a municipal budget is unfunded, it is not a credible budget – either the revenue projections are unrealistic, the operating expenditures are too high, or the capital budget is too ambitious. In most instances there are problems in all three areas.
- **Municipalities must pay greater attention to maintaining their existing assets***.* Systems of asset management and levels of spending on repairs and maintenance need to be improved. To assist in financing this spending it is important that tariffs for the trading services are cost-reflective, incorporating all the input costs associated with the production of those services.
- **Municipalities need to revisit how they fund their capital budgets***.* Generally, national capital grants are intended to finance the rollout of infrastructure for addressing service delivery backlogs and extending access to basic services. Municipalities are still expected to fund the ongoing development and extension of infrastructure related to the economic and trading services for which they are responsible. To do so, municipalities need to examine the balance between their operating budgets and capital budgets, and ensure they structure their operating budgets so as to generate the surpluses required to fund infrastructure.
- **More inputs are also required from national government to contribute to the improvement of municipal capacity***.* The following technical functions require particular attention: sewerage and water treatment plant operators, road maintenance supervisors, health inspectors and planning and project managers.[16]

Clearly these inter-related challenges impact on the delivery of water services, and some of them are also relevant to the narrower issue of financial absorption as one dimension of the challenge many municipalities face. The LGBER includes a chapter on water which provides some useful further context: “While there have been substantial improvements in the rollout of water services infrastructure and the rendering of free basic water and sanitation, the sector does face some challenges going forward as implementation capacity remains a constraint.”[17]

In considering the skills shortage in the water services sector, the National Treasury finally notes: “The water sector is currently experiencing a severe shortage of critical skills – qualified engineers, water scientists, technicians and artisans. This poses a risk to the sector’s continued capacity to provide water services effectively. Research indicates that the civil engineering capacity (expressed as civil engineering professionals per 100 000 people) in local government is too low to deliver, operate and maintain local government infrastructure in a sustainable manner. Whereas in 1994, there were 20 engineers per 100 000 people, this has now dropped to three per 100 000 people, a ratio that is clearly indicative of a crisis.”[18]

Some of these issues can be regarded as inherent in the water service challenge, some require national and provincial coordination, and some point to failures that need to be addressed on the part of municipalities themselves. To explore and make concrete the way in which financial absorption interacts with these challenges and the manner in which water services are sustainably and effectively delivered, the next section considers two case studies: Makana in Eastern Cape and Mossel Bay in Western Cape.

4. Two local case studies: Makana and Mossel Bay

4.1. Makana, Grahamstown

Makana is a municipality in Eastern Cape with a population, according to the 2011 census, of 89,000, a poverty rate of 43.6% and an average household income of ZAR 89 694. More than 85% of households have access to water through piped tap water in their dwelling or yard, 10.5% make use of a communal stand, and 4.3% have no access.[19]

Makana is emblematic of a weakly-led and managed municipality that faces both a cash-flow and a service delivery crisis. For some time the municipality had been receiving support from the Eastern Cape provincial government under the provisions of Section 154 (1) of the Constitution, which requires that they “must support and strengthen the capacity of municipalities to manage their own affairs, to exercise their powers and perform their functions”. Despite this support, however, the municipality was placed under administration, under Section 139 (1) (b) of the South African Constitution, in August 2014.

Makana has a particularly poor audit record, and indeed audit findings for Makana were not included in the consolidated Auditor-General report on local audit outcomes for 2012/13 because the audit was not complete by the legislated date. In the four financial years preceding this low point, Makana received a disclaimer opinion with findings for the three years 2009/10-2011/12, and an adverse audit opinion with findings for 2008/09.

Considering its performance in water operating and capital budget expenditure, Makana spent 97.5% of its operating water budget in 2012/13, and 178.5% of its water operating budget in 2013/14. In the latter case, its initial budget allocation was adjusted downward from the initial appropriation of ZAR 44.6 million to ZAR 23.2 million, but the municipality ended up spending ZAR 41.5 million.

In 2013/14 Makana spent only 61.9% of its water capital budget. The municipality managed to collect only 12.9% of the ZAR 44.7 million it set down in its adjusted budget as coming from internally-generated funds for capital expenditure. Of equal if not greater concern is the fact that, as admitted by the Mayor in 2014, around 72% of MIG revenue was used to fund the operational budget in 2013/14. As a result of concerns around irregular expenditure, LES payments were withheld for Makana in 2013/14, preceding its being put under administration.

In a useful analysis of the Makana budget and its governance context, Rhodes University's Public Service Accountability Monitor (PSAM) notes: "The service delivery crisis within Makana Municipality had been well documented in recent times by the media with stories pointing to financial, water provision and maintenance and infrastructure challenges engulfing the municipality."

Drawing further on the PSAM paper, a number of challenges contributed to a dysfunctional municipality, facing an arduous turnaround requirement.

The PSAM paper adds valuable context and perspective, noting: "The water crisis, human resource and revenue management challenges are all symptoms of, and an indirect consequence of, the main problem, that of poor and unrealistic budgeting which has led to the current crisis in the municipality. In a nutshell the Makana municipality budget lacks credibility."[20]

A particularly prominent aspect of the problem has been the low revenue collection rate for municipal services, which has struggled to attain 60% of budgeted amounts in recent years and has declined in real terms. This has also generated, aside from failures to extend services, problems with decaying infrastructure as a result of inadequate repairs and maintenance provisions.

Human resource challenges have also loomed prominently, with key positions being filled in 'acting' capacities for longer than the six months permitted by the Municipal Systems Act, inadequate qualifications for key positions, absence of performance agreements, and a high vacancy rate. The PSAM report notes: "Makana municipality needs to urgently address the challenges in its human resource management system and this requires improved oversight by the municipal council. Of key importance in the immediate future is filling the positions of Municipal Manager and Chief Financial Officer (CFO). These are integral positions in the financial, administrative and organisational leadership of a municipality. One of the reasons

that could explain why Makana municipality has faced financial challenges is the lack of a permanent CFO and Municipal Manager in addition to the poor budgeting and planning processes."[21]
Further governance and leadership-related challenges that have compromised delivery and financial sustainability in Makana include poor controls on expenditure, late intervention by the provincial government, and a tendency on the part of the municipality to obfuscate the true issue, for example referring to a 'water crisis' when what has really been at stake is a governance crisis.

4.2 Mossel Bay

Mossel Bay has a population of almost identical size to Makana (89,000) but a substantially lower poverty rate (24.3%) and higher average household income (ZAR 117 216). Water access is also better, with 95% of households receiving piped water in their dwelling or yard, 3% via a communal stand, and 2% reporting no access.

Mossel Bay has consistently performed well against financial and service delivery indicators. It is one of the top 10 performing municipalities in the 80/20 report, and was identified by National Treasury as one of the three financially healthiest municipalities in the country at the end of 2013. Its audit record is also exemplary: 2011/12 and 2012/13 were unqualified with no findings; the three years before that achieved unqualified audits with findings.

Concerning the water budgets, 82.4% of the operating budget and 82.5% of the capital budget were spent in 2013/14. Particularly noteworthy however have been the trends in internally-generated funds for capital expenditure: in 2013/14 a high target of ZAR 71.6 million was set, amounting to a budget where 60% of capital funding was to be funded from internally-generated funds. The outcome was ZAR 66.7 million, or 93% of this projection. The success here is two-fold: first a strikingly high share of own funds relative to the size of the municipality, and second *accuracy* in estimates which provides stability to the overall budget framework and the municipal cash flow.

In addition, what is particularly striking about the Mossel Bay results is the close convergence of budget revenue projections and revenue outcomes across all service revenue sources. In a number of instances collections were larger than budgeted for, and as a result, the deficit of ZAR 17.5 million forecast in the adjusted budget became a surplus of ZAR 82.3 million.

In assessing the reasons for success it is important to note those factors, positive in Mossel Bay's case, that are beyond the municipality's control: average income for those living in Mossel Bay is substantially higher than for those living in Makana. At the same time these factors are not enough to explain Mossel Bay's good financial performance: there are numerous instances in South Africa of municipalities which have not succeeded despite similar or better objective circumstances.

The 2014 Annual Report for Mossel Bay gives the following reasons for the municipality's financial health: "One of the most important contributors to a municipality's financial health is how well its ratepayers and customers pay their municipal accounts. Without adequate revenue, not even the most basic services can be rendered properly, nor can infrastructure such as roads and electricity, water and sewerage networks be maintained or upgraded. It is a tribute to the integrity and sense of responsibility of Mossel Bay's ratepayers and users of municipal services that a revenue collection rate of 97.5% of budget could be achieved in 2013/2014 despite the difficult economic conditions. Unemployment is high in Mossel Bay and the town has many poor people as well as a large retiree population who are affected more than anyone else by the adverse economic climate. These results are the outcome of good financial management and indicative of a good culture of payment in Mossel Bay, despite difficult economic times. Our Ward Councillors as well as Ward Committees should also receive credit for helping to instil a culture of payment in our community, and I would like to thank them for their support in this regard."[22]

In broader terms, the municipality appears to have succeeded in getting the basics right and progressively extending the scope of its work. Basics here include, for example, public accountability and participation: according to the Annual Report, "21 public Integrated Development Plan (IDP) engagement sessions were held across all 14 wards in the year under review" [23] as well as an effective and comprehensive use of the ward committee system. In brief, a virtuous circle has been maintained between municipality and citizens, which in turn contributes positively to the 'payment culture' of the municipality.

5. Conclusions and recommendations

South Africa has made significant progress in respect of the extension of basic service provision, including access to water services. However, the local sphere remains beset with a range of challenges that have increasingly generated service delivery protests.

Some of the reasons have been discussed already, and these feed into the recommendations that follow in this section. It needs to be understood, however, that the challenges confronting the sphere are a complex and inter-related mix of political, governance and financial management issues. It also needs to be acknowledged that many local municipalities confront real challenges relating to their revenue base, the scope of the LES, and their ability to extend services into rural areas and across large distances. As noted in the case studies, however, there is ample room for improvement in those factors that are under municipal control and/or amenable to more effective intergovernmental cooperation. Fundamentally, it is a matter of deepening or re-establishing, in many municipalities, the social contract between government and citizens. Or, alternatively, a matter of establishing a virtuous circle where, for example, service delivery improvements yield higher service collection rates as compliance improves, which in turn generates more resources for delivery.

1. Municipalities need to ensure that billing is accurate, fair and that collection rates improve. Attributing problems here to a ‘culture of non-payment’ is disingenuous since it ignores frustrations with the quality of service, as well as with quality of billing: too often, it would seem, service billing amounts appear arbitrary, or characterised by sudden, unexplained leaps, for example where a cash-flow crisis looms for the municipality.

2. Budgeting needs to be aspirational but also realistic in terms of both own revenue projections and spending: too often both are too optimistic, and the result is frustration, delays, and an undermining of municipal credibility with further implications for the ‘social contract’ and service fee collection rates.

3. Many municipalities struggle with the technical capacity required to deliver municipal services, as reflected in the shortage of engineers for example. This is a responsibility of the national sphere of government, over the medium- and longer-term, but more innovative and decisive forms of support need to be found for smaller municipalities in the short-term. Whilst acknowledging the reality of this challenge it also needs to be recognised that ‘capacity’ issues are too often invoked as a catch-all excuse for delivery failures, when other factors may be equally or more significant. The Auditor-General notes in this regard: “We again raise concerns about the management of vacancies which resulted in prolonged acting periods. Of particular importance is that at year-end the position of chief financial officer was vacant at 27% of auditees, and 31% did not have a head of supply chain management unit. The average time that municipal managers, chief executive officers, chief financial officers and heads of supply chain management unit occupied their positions was just under two years, which is a reflection of instability at these levels. The competencies of these key officials were also not yet at the level prescribed by municipal regulations on minimum competencies at around a third of the auditees. Some auditees did not assess the competencies, as they are required to do by the regulations. There were still weaknesses in the performance management of senior management, such as performance contracts not being in place.”[24]

4. The deepening of accountability, and the effective oversight of municipal planning and implementation is a key requirement for establishing virtuous circles. More effective community participation is required, that goes beyond protests into constructive engagement. This is of course easier said than done, and in smaller municipalities the scope of civil society intermediation in fostering accountability is also likely to be limited. A key aspect of deepening accountability must however be associated with ending the excessive politicisation of municipal management: too many political appointments occur. Two main problems arise from this: first appointees often lack the skills and experience for their job, and second their accountability may well be first to their political party and only second to the communities they have been employed to serve. The Auditor-General report on local audit outcomes refers to: “A slow response by political leadership (mayors and councils) to our message of embracing their responsibility to guide and direct the development and performance of a strong system of internal controls at the auditees.

This includes improving their oversight function, demonstrating effective and ethical leadership, strengthening the municipal public accounts committees and insisting on credible and regular reports on the finances and activities of their municipalities." The report goes on to note: "a lack of consequences for poor performance and transgressions in local government. This is evident from the inadequate response to the high levels of unauthorised, irregular as well as fruitless and wasteful expenditure… and the weaknesses in performance management, which include a lack of performance contracts."[25]

5. Getting the basics right. The MFMA and the suite of other legislation relating to the local sphere impose fairly demanding requirements on municipalities, and these are a challenge to the systems and capacity of smaller municipalities in particular. At the same time, there is ample scope for doing better in getting the basics right. The Auditor-General notes: "… significant weaknesses in the financial and performance management controls need urgent attention as these basic controls and disciplines will ensure that errors, omissions and non-compliance are prevented, detected and corrected timeously. The controls include: preparation of regular, accurate and complete financial and performance reports; review and monitoring of compliance with legislation; proper record keeping and document control; controls over daily and monthly processing and reconciliation of transactions."[26]

References

[1] This report was written by Len Verwey, Resource Person from South Africa, on behalf of DFI. The report had inputs and edits carried out by Jo Walker of DFI and Angela Burton, John Garrett, Rebecca Heald and Wen Hoe of WaterAid.

[2] This is now called the Department of Water and Sanitation.

[3] The social grant is a form of social protection aimed at the poorest and most vulnerable in South Africa and is approximately $1 per day.

[4] Investing in Water and Sanitation: Increasing Access, Reducing Inequalities. Report for the Sanitation and Water for All (SWA) High-Level Meeting (HLM) 2014. Available here: http://www.who.int/water_sanitation_health/glaas/2013/14063_SWA_GLAAS_Highlights.pdf

[5] For more in this see http://www.treasury.gov.za/documents/mtbps/1997/5.pdf

[6] Explanatory Memorandum to the Division of Revenue, National Treasury, 2014, page 39.

[7] Ibid, page 41.

[8] Local Government Budget and Expenditure Review, National Treasury, 2011, page 129.

[9] MFMA Section 71 requires the municipal accounting officer to submit monthly reports to the mayor and the provincial treasury on actual revenue, borrowing and expenditure, as well as explanations for material variances. Section 71 reports are available on the website of the National Treasury in consolidated and disaggregated forms, www.treasury.gov.za.

[10] This is equivalent to c. Euro 223 million.

[11] Available at: http://www.pmg.org.za/report/20140211-water-delivery-challenges-department-water-affairs-national-treasury-briefings-in-presence-minister-water.

[12] 2013/14 Annual Report, Department of Water Affairs, page 127.

[13] Consolidated General Report on the Audit Outcomes of Local Government, AGSA, p. 19.

[14] The 80/20 Report: Local Government in 80 Indicators Over 20 Years, 2014, Institute of Race Relations.

[15] Local Government Budget and Expenditure Review, National Treasury, 2011, page 3.

[16] Adapted from Local Government Budget and Expenditure Review, National Treasury, 2011, page 3.

[17] Ibid page 130.

[18] Ibid page 137.

[19] 80/20 report, IRR, pages 38-40.
[20] Public Service Accountability Monitor, Rhodes University, Makana Budget Analysis, p.7.
[21] Ibid page 14.
[22] Mossel Bay Municipality Annual Report *2014*, page 8.
[23] Ibid page 37.
[24] Op. cit., AGSA, page 27.
[25] Op. cit., AGSA, page 28.
[26] Ibid.

Cover photo: Boys using groundwater supply, Madibogo North-West.