

THABA CHWEU LOCAL MUNICIPALITY

1

PRESENTATION TO FFC PUBLIC HEARINGS ON
4 JUNE 2012





FFC EQUITABLE SHARE ISSUES

2

- My impression is that this hearing has moved from an academic debate to a far more practical approach.
- The opening remarks of Mr. Khumalo referred to practical issues in respect of revenue issues.
- Honorable Nhlengethwa MP indicated the issues around the status of the AG opinions on local Municipalities and mentioned especially Inaccuracy of municipal billing.
- Mr. Palmer gave a comprehensive oversight of the FFC progress so far.

The above feedback is

- extremely meaningful
 - practical
- and absolutely on track
- To solve the issues initially discussed



FFC EQUITABLE SHARE ISSUES

3

- Our contribution to the debate will be of a very basic approach.
- I wish to convey the practical issues every MM and CFO of a low capacity municipality are confronted with every day.
- I was informed that today is not about stating problems, but rather a process of creative thinking and enhancing creative solutions.
- We intend to do exactly that and wish to contribute in a practical manner.



FFC EQUITABLE SHARE ISSUES

4

- Let us analyze some figures from Thaba Chweu Municipality.
- Background
- Prior years section 139 was imposed twice and a aura of no hope was created.
- The brutal turnaround strategy imposed during Nov last year was successful.
- The financials for 2010/11 were completed on 20 Feb 2012
- The financials were audited from 21 Feb 2011 by the AG till last Friday.
- The audit outcome is expected to be a significant improvement from the prior disclaimers.
- The financials revealed some interesting but old and repetitive issues and problems



FFC EQUITABLE SHARE ISSUES

5

THABA CHWEU LOCAL MUNICIPALITY STATEMENT OF FINANCIAL POSITION 30 June 2011

	Note	2011 R	2010 R
ASSETS			
Current assets			
Cash and cash equivalents	1	6 855 924	(31 567 808)
Trade and other receivables from exchange transactions	2	106 377 583	60 383 785
Other receivables from non-exchange transactions	3	36 890 823	4 015 013
Inventories	4	1 530 122	1 850 941
Investments	5	-	723 308
VAT receivable	10	-	4 557 012
Non-current assets			
Investments	6	9 887 784	6 684 766
Property, plant and equipment	39	1 604 120 976	110 810 961
Total assets		1 765 663 212	157 457 978
LIABILITIES			
Current liabilities			
Trade and other payables from exchange transactions	7	66 535 899	44 780 608
Consumer deposits	8	3 246 727	3 163 096
VAT payable	9	3 524 154	-
Current provisions	13	133 310 871	-
Current portion of unspent conditional grants and receipts	11	4 097 558	138 620
Current portion of borrowings	12	-	1 458 200
Non-current liabilities			
Non-current borrowings	12	10 267 392	11 875 436
Short term loan portion	12	507 485	1 878 148
Total liabilities		228 150 085	63 294 108
Net assets		1 537 513 127	94 163 870
NET ASSETS			
Reserves Revaluation of assets		1 604 120 976	41 108 272
Accumulated surplus / (deficit)		(66 607 849)	53 057 598
Total net assets		1 537 513 127	94 163 870



Issue 2
BAD DEBTS
OWN FUNDING



Issue 1
GRAP 17



FFC EQUITABLE SHARE ISSUES

6

- This exercise was an eye opener to all the parties involved.
- Two major issues were recognized
 - ISSUE 1
 - A new GRAP 17 revaluation provision of R 1.5 BN were created in order to reflect the work in progress compilation of the infrastructure asset register.
 - The prior year valuation of R 115 m were written off against accumulated surplus.
 - ISSUE 2
 - A provision for bad debts amounting to R 133 million were made
- What are the implications for Thaba Chweu in respect of the two major issues?



FFC EQUITABLE SHARE ISSUES

7

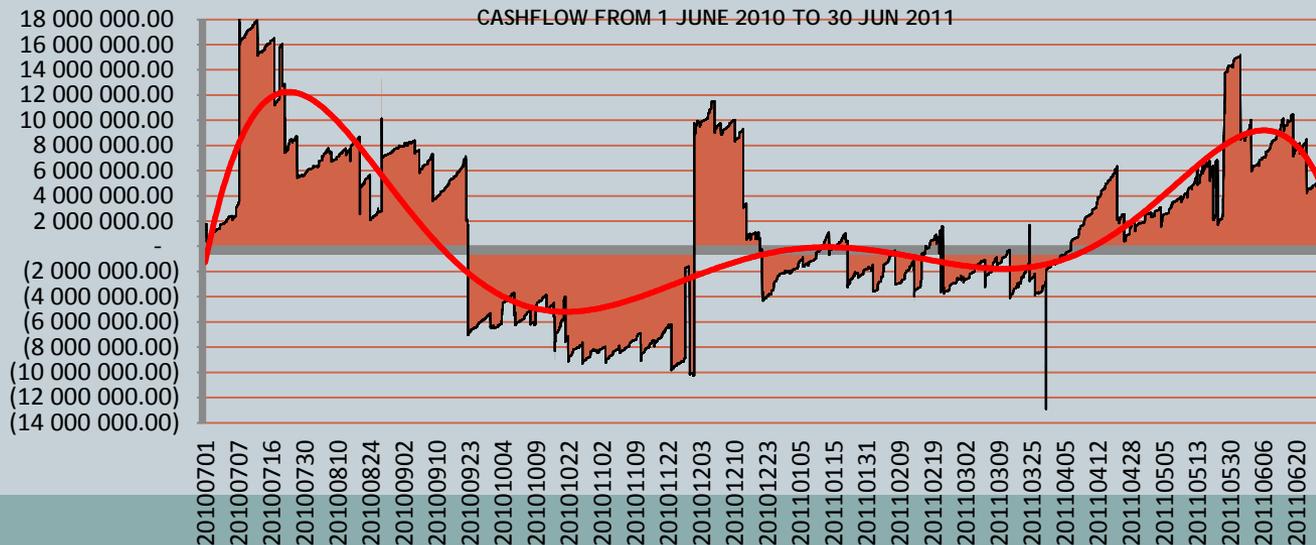
- The Grap 17 issue.
- The value of infrastructure assets were now only fully realized
- On the same hand the useful life of infrastructure are still to be established.
- The jump from the prior year R135 million valuation to R 1,5 Billion was a mental shock.
- Estimated depreciation provision will amount to R 125 million per year.
- No internal funds available from budget to fund the above provision
- No internal funds available from budget for assets repairs and maintenance for the 2012/13 financial year.
- We are scheduled to receive R 32 million for MIG projects. This funds are allocated to “new” capital projects not necessarily aimed at funding the above depreciation.
- The implementation of Grap 17 will allow us to really start to understand the quantum of the capital needs and future estimation of the requirements of maintaining the existing infrastructure.



FFC EQUITABLE SHARE ISSUES

8

- The Grap 17 issue continued
- The IDP indicates a capital project wish list amounting to R 331 million
- The EQS is only sufficient to support operating expenditure
- The MIG grants of R 32m is only allocated to “new” capital projects.
- The MIG grants are absorbed in the cash flow of a struggling municipality and due to cash restrictions will be used to pay salaries and Eskom.
- What’s to be done by the poor CFO with the following actual cashflow?

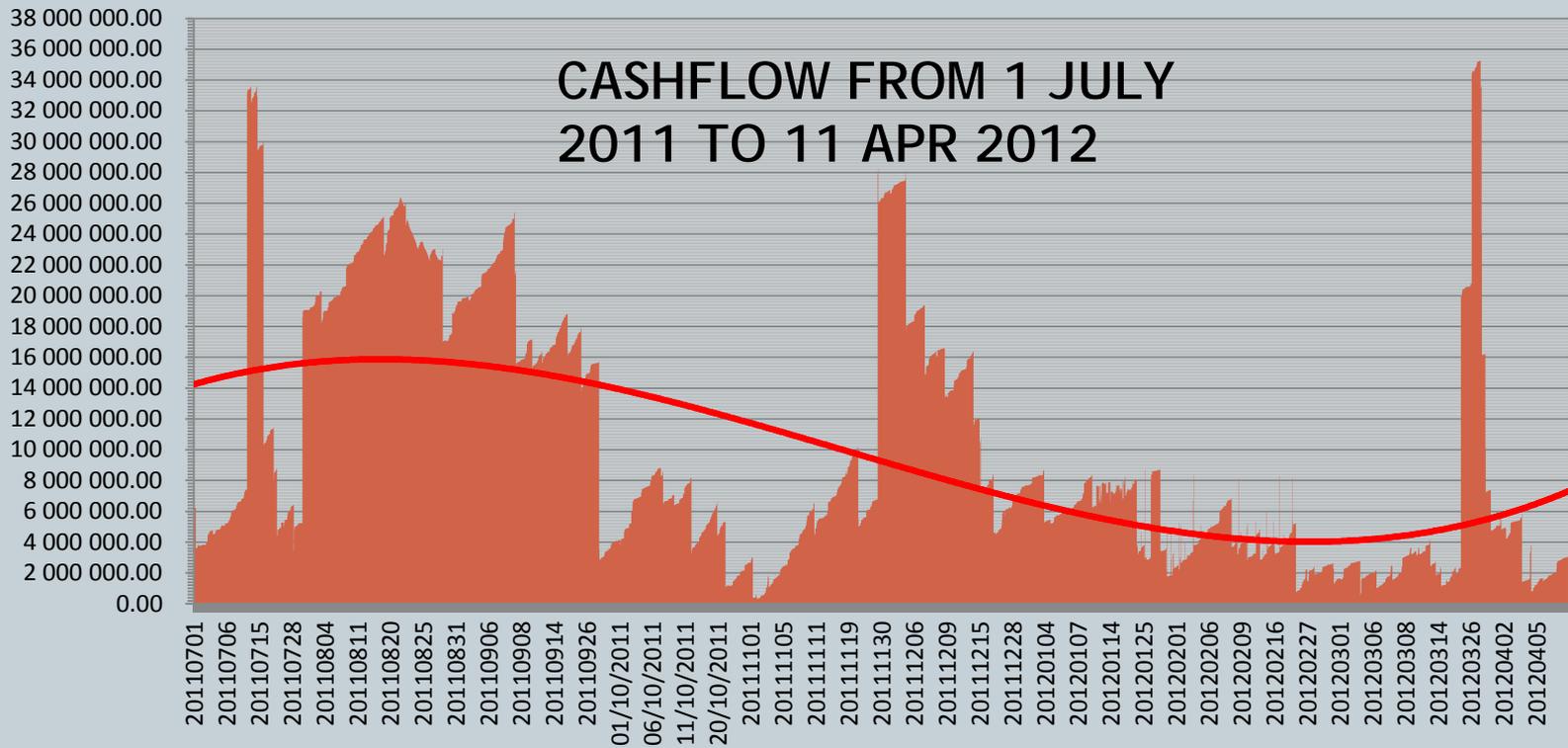




FFC EQUITABLE SHARE ISSUES

9

- It should rather look like this:





FFC EQUITABLE SHARE ISSUES

10

The GRAP 17 issue

Conclusion

- In order to do the accounting entry of R 1.5 BN infrastructure assets and a required R 112 m per year depreciation provision
 - Were a consequence of implementing GRAP 17.
 - Gave Thaba Chweu the first insight to the future replacement value and useful life of infrastructure
 - Will enable us in phase 2 to cost the quantum, date and cost of replacing existing infrastructure.
 - The exercise cost for this issue is running at R 2,2 m.
 - Phase 2 will be an expected cost of another R3,2 M
 - In total R 5,2 m from own funds are required for us to understand the basics of our deteriorating infrastructure
 - This could possibly be funded from the LGFM grant



FFC EQUITABLE SHARE ISSUES

11

- Issue 1 is the high level issues discussed today
 - and is a problem seeking external intervention
 - by amending the EQS formula in the manner and direction we are discussing today.
 - Funding is required to exhaust all the avenues of GRAP 17 in order to establish a National Infrastructure asset register indicating the total demands and needs of useful life , quantum of the date and time of possible replacement of the National infrastructure.



FFC EQUITABLE SHARE ISSUES

12

- Issue 2 is a introspective issue
 - And is a problem requiring municipal intervention with overlap of external intervention.
- Let us now consider issue 2 the provision of bad debts .
- Let us review Thaba Chweu draft financial statement of position again



FFC EQUITABLE SHARE ISSUES

13

THABA CHWEU LOCAL MUNICIPALITY STATEMENT OF FINANCIAL POSITION 30 June 2011

	Note	2011 R	2010 R
ASSETS			
Current assets			
Cash and cash equivalents	1	6 855 924	(31 567 808)
Trade and other receivables from exchange transactions	2	106 377 583	60 383 785
Other receivables from non-exchange transactions	3	36 890 823	4 015 013
Inventories	4	1 530 122	1 850 941
Investments	5	-	723 308
VAT receivable	10	-	4 557 012
Non-current assets			
Investments	6	9 887 784	6 684 766
Property, plant and equipment	39	1 604 120 976	110 810 961
Total assets		1 765 663 212	157 457 978
LIABILITIES			
Current liabilities			
Trade and other payables from exchange transactions	7	66 535 899	44 780 608
Consumer deposits	8	3 246 727	3 163 096
VAT payable	9	3 524 154	-
Current provisions	13	133 310 871	-
Current portion of unspent conditional grants and receipts	11	4 097 558	138 620
Current portion of borrowings	12	-	1 458 200
Non-current liabilities			
Non-current borrowings	12	10 267 392	11 875 436
Short term loan portion	12	507 485	1 878 148
Total liabilities		228 150 085	63 294 108
Net assets		1 537 513 127	94 163 870
NET ASSETS			
Reserves Revaluation of assets		1 604 120 976	41 108 272
Accumulated surplus / (deficit)		(66 607 849)	53 057 598
Total net assets		1 537 513 127	94 163 870



Issue 2
BAD DEBTS
OWN FUNDING



Issue 1
GRAP 17



FFC EQUITABLE SHARE ISSUES

14

- The breakdown of the R 133 m is the following:

Provision for rehabilitation of landfill sites	3
Provision bad debts parked amounts	82 501 558
Provision for bad debts	41 083 741
Provision for leave	6 923 488
provision for staff bonus	2 919 550
Total Non-Current Provisions	133 428 340

- The parked amounts of R 82 m was the result of a disaster in the system which we prefer not to discuss now
- The provision for bad debts is a provision providing writing of all debts beyond 60 days and longer outstanding.
- Whichever way you look at it is R 83 million



FFC EQUITABLE SHARE ISSUES

15

- Whichever way you look at it is R 83 million down the drain.
 - Why ?



FFC EQUITABLE SHARE ISSUES

16

- The breakdown of sale of services are the following

Sale of electricity	67 973 432
Sale of water	25 593 320
Refuse removal	8 766 424
Sewerage and sanitation charges	8 567 042
Total Service Charges	110 900 217

- The single most problematic issue of revenue collection is the collection of the sale of electricity.
- Why
 - Eskom is relentless in collecting their dues.
 - Illegal connections and bridging of meters is a national sport.
 - (the going rate for bridging a meter is a bottle of Klipdrift).
 - With conventional meter system (prevalent in all low capacity Municipalities) our debt collection is a disaster.



FFC EQUITABLE SHARE ISSUES

17

- A typical conventional metering system

	The Client Process	Eskom
Day 1	Meter reader reads the meter incorrectly.	
Day 7		Demand payment for prior month
Day 15	The incorrect reading is entered on the system	
Day 24	The incorrect reading is billed	
Day 28	The incorrect account is sent to the external sourced printers	
Day 34	The incorrect account is sent to the client	
Day 36	The client receives the account. (If not dumped by the postman in the river)	Demand payment for prior month
Day 48	The client queries the incorrect account.	
Day 55	The issue is still unresolved	
Day 89	The client's electricity is cut off	Demand payment for prior month
Day 89	The client complains again about the wrong reading	



FFC EQUITABLE SHARE ISSUES

18

- A typical pre paid system

	The Client Process	Eskom	The Municipality
Day 1	The client buys upfront		Generates cash up front
Day 7		Demand payment for prior month	Pay ESKOM
Day 15	The client buys upfront		Generates cash up front
Day 24	The client buys upfront		Generates cash up front
Day 28	The client buys upfront		Generates cash up front
Day 34	The client buys upfront		Generates cash up front
Day 36	The client buys upfront	Demand payment for prior month	Pay Eskom
Day 48	The client buys upfront		Generates cash up front
Day 55	The client buys upfront		Generates cash up front
Day 89	The client buys upfront	Demand payment for prior month	Pay Eskom
Day 89	The client buys upfront		Generates cash up front



FFC EQUITABLE SHARE ISSUES

19

- **A typical pre paid system leverage finance example**

Impact of replacing conventional meters with pre paid meters Project value R 2 million

		meters quantity	UNITS	INCOME PER UNIT PER MONTH	TREND	CURRENT SCENARIO	ADJUSTED IMPACT AFTER PROJECT 5555	
	PROJ 5555	3500						
ITEM 1	CURRENT	Prepaid meters status quo as is and does not change this scenario	6137	R 174.43	1 YEAR	JUL 2010 TO JUNE 2011	R 12 845 722.92	R 12 845 722.92
ITEM 2	CURRENT	Conventional meters scenario up to Dec 2010 whereafter it will be partially replaced with pre paid meters	6500	R 400.00	6 MONTHS	JUL 2010 TO DEC 2010	R 12 480 000.00	R 12 480 000.00
ITEM 3	PROJ 5555	Replacing bridged meters free of charge for succesfull amnesty applicants	150	R 0.00	ONCE OFF	JAN 2010 TO JUNE 2011	NO EFFECT	NO EFFECT
ITEM 4	PROJ 5555	Replacing bridged meters free of charge succesfull amnesty applicants income stream now expected	150	R 212.38	6 MONTHS	JAN 2010 TO JUNE 2011	NO EFFECT	R 191 142.00
ITEM 5	PROJ 5555	Replacing bridged meters @cost recovery for non amnesty applicants	1050	R 1 100.00	ONCE OFF	JAN 2010 TO JUNE 2011	NO EFFECT	R 1 155 000.00
ITEM 6	PROJ 5555	Replacing bridged meters @ cost recovery income stream now expected	1050	R 150.00	6 MONTHS	JAN 2010 TO JUNE 2011	NO EFFECT	R 945 000.00
ITEM 7	PROJ 5555	Installing pre paid meters in RDP houses	300	R 0.00	ONCE OFF	JAN 2010 TO JUNE 2011	NO EFFECT	NO EFFECT
ITEM 8	PROJ 5555	Installing pre paid meters in RDP houses income stream now expected	300	R 150.00	6 MONTHS	JAN 2010 TO JUNE 2011	NO EFFECT	R 270 000.00
ITEM 9	PROJ 5555	Replacing conventional meters with prepaid meters @special cost	2000	R 500.00	ONCE OFF	JAN 2010 TO JUNE 2011	NO EFFECT	R 1 000 000.00
ITEM 10	PROJ 5555	Replacing conventional meters @ cost recovery income stream now expected	2000	R 212.38	6 MONTHS	JAN 2010 TO JUNE 2011	NO EFFECT	R 2 548 560.00
ITEM 11	CURRENT	Remainder of conventional meters now still conventional income stream expected	4500	R 400.00		JAN 2010 TO JUNE 2011	R 8 640 000.00	NO EFFECT
ITEM 12	PROJ 5555	Remainder of conventional meters now prepaid income stream expected	4500	R 400.00		JUL 2010 TO JUNE 2011	NO EFFECT	R 10 800 000.00
							R 33 965 722.92	R 42 235 424.92
								-R 8 269 702.00
								GAIN ON REVENUE



FFC EQUITABLE SHARE ISSUES

20

- The prior slide indicates
 - the leverage financing benefit of investing R 2 million
 - With a R 8.2 m income stream revenue generated.
- The benefits of a total conversion to pre paid system both electricity and water will be
 - Better manage able with dedicated on line reports with preferably remote sensing and reading.
 - If a blanket approach of installing pre paid for all will solve all the data cleansing challenges which is a on going issue for ever
 - The advantage of receiving cash up front nearly three months in advance for pre paid is calculated at a 4.2 leverage benefit in cash flows.
 - If the system is managed in conjunction with a internal Municipal Finance task team reacting on daily careful management of exception reports the benefits are tremendous.



FFC EQUITABLE SHARE ISSUES

21

- In conclusion we plead that
 - ISSUE 1
 - GRAP 17 be effectively expanded to a national level
 - ✦ That the actual useful life of all assets per municipalities be consolidated
 - ✦ and that the national infrastructure rate of decay and replacement cost not only be determined for the Republic as a whole
 - ✦ But also be determined per municipality in order to determine the cost of maintaining existing infrastructure.
 - ✦ We only consider the repair and maintenance of infrastructure and not even talking about new capital projects
 - ISSUE 2
 - ✦ That a pre paid metering project be launched on a test basis and that the pilot project be done in Emakhazeni and Thaba Chweu.
 - ✦ That the benefits of the leverage financing be then be quantified and rolled out as a small start.



FFC EQUITABLE SHARE ISSUES

22

Thank You