ORDINARY COUNCIL MEETING
Thursday, 30 JANUARY 2020

<table>
<thead>
<tr>
<th>ITEM NO</th>
<th>SUBJECT</th>
<th>PAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>13.16</td>
<td>REPORT ON LEASING OF MUNICIPAL PROPERTIES TO STAFF</td>
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</tr>
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<td>13.17</td>
<td>DRAFT CASH MANAGEMENT PLAN</td>
<td>5</td>
</tr>
</tbody>
</table>
REPORT FROM THE DIRECTOR CORPORATE SERVICES

PURPOSE OF THE REPORT

To report to the Municipal Council on the status of staff housing and to request Council to rescind (b) of Resolution No CM47/08/19.

PREVIOUS RESOLUTIONS

CM47/08/19

BACKGROUND

On the 29th August 2019, an item served at the Ordinary Council Meeting on the Status of Leasing of Municipal Property to Municipal Staff. The Municipal Council consequently resolved as follows:

a) That the current situation with regards to leasing needs to be reviewed and a full report submitted to the next Governance and Economic Development meeting on options including possible sale of properties; and
b) Whilst this review is being conducted no further leases or extensions or permission be given to the occupier may be given until the policy has been reviewed.

DISCUSSION

Above-mentioned resolution is enclosed hereto as Annexure “A”. In terms of above resolution, the review of the staff housing policy is currently being conducted and SALGA is also being engaged for their advice as they are also drafting some uniform policies on issues of this nature for municipalities. The department is however inundated with applications for staff housing submitted by officials, newly- and currently appointed. Another risk faced by the municipality is that our Insurance department advised that municipal owned properties are not covered by our insurance if unoccupied for a period of 30 days. This means that should the property be destroyed in a fire, vandalized or subject to theft, said damages will not be covered.

The relevant section from our Insurance document states as follows:

“If any building insured or containing the insured property becomes unoccupied for more than thirty (30) consecutive days, this item is cancelled unless before the occurrence of any DAMAGE, the Insured obtains the written agreement of the Insurers to continue this extension and the property is specified in the Specification. “

In light of above, it is proposed that the Municipal Council considers rescinding resolution CM47/08/19 Status of Lease of Municipal Property to Municipal Staff dated 29 August 2019, in order to prevent possible damage to Council property.
FINANCIAL IMPLICATIONS

Prevention of possible damages
Insurance premiums
Revenue generation

RELEVANT LEGISLATION

MFMA
Insurance Policy
Knysna Municipality’s Provision of Staff Housing Policy

RECOMMENDATION OF THE MUNICIPAL MANAGER

[a] That the report on the leasing of municipal properties to staff be noted;

[b] That the Municipal Council rescinds [b] of resolution CM47/08/19 Status of Lease of Municipal Property to Municipal Staff dated 29 August 2019;

[c] That the provision of the municipality’s Insurance Portfolio, not to cover properties that are vacant for more than 30 days, be noted;

[d] That approval be granted to lease the vacant municipal properties to staff for housing purposes.

APPENDIX / ADDENDUM

Annexure “A” - 29 August 2019 Council Resolution on Staff Leases

File Number: 9/1/1/2
Execution: Director Corporate Services
CM47/08/19  STATUS OF LEASE OF MUNICIPAL PROPERTY TO MUNICIPAL STAFF

UNANIMOUSLY RESOLVED

[a] That the current situation with regards to leasing needs to be reviewed and a full report submitted to the next Governance and Economic Development Committee meeting on options including possible sale of properties; and

[b] Whilst this review is being conducted no further leases or extensions or permission be given to the occupier may be given until the policy has been reviewed.

File Number : 7/1/2/5
Execution : Municipal Manager
Director : Corporate Services
REPORT FROM THE Municipal Manager

PURPOSE OF THE REPORT

To implement immediate cash enhancement procedures and determine a way forward to address the cash flow in the short, medium and long term. The plan is mainly to restore the cash reserves and to maintain a healthy cash flow position to place the Municipality back on a sustainable footing, which will result in an effective and efficient organisation that is financially stable and provide sustainable services to the community.

The principal strategic objective of the plan is thus more of a turnaround strategy where the focus is to identify key priority areas and to set out specific interventions with projects and strategies that will address the key issues that gave rise to the problems identified.

Previous resolutions

N/A.

BACKGROUND

Based on figures contained in the October and November 2019 MFMA section 71 reports released in November and December 2019 respectively it became apparent that there was a significant issue developing in regards to the municipal cash flow. As can be seen from the table below extracted from the various July to December reports the months of October, November and December 2019 reflect the rapidity of the decline in cash and cash equivalents.

<table>
<thead>
<tr>
<th>R thousands</th>
<th>Cash/cash equivalents at the month/year end:</th>
</tr>
</thead>
<tbody>
<tr>
<td>SC9 Section 71</td>
<td>July</td>
</tr>
<tr>
<td>Original Budget</td>
<td>111,866</td>
</tr>
<tr>
<td>July</td>
<td>57,912</td>
</tr>
<tr>
<td>August</td>
<td>57,912</td>
</tr>
<tr>
<td>September</td>
<td>57,912</td>
</tr>
<tr>
<td>October</td>
<td>57,912</td>
</tr>
<tr>
<td>November</td>
<td>57,912</td>
</tr>
<tr>
<td>December</td>
<td>57,912</td>
</tr>
</tbody>
</table>

Table legend

- Original budget figures
- Actuals
- Budgeted figures contend in reports
- Deficit budgeted figures contend in reports
- Actual deficit

_________________________________________________________________
The table indicates that the July section 71 report indicated probable cash flow challenges by the end of the financial year. Several reports contained remedial actions and recommendations in regards to addressing the expected shortfalls. The shortfall is mainly due to the unfunded working capital. The remedial actions and recommendations focused on debtor control, grant funding, loan drawdowns and evaluation of expenditure. However, by the time that the majority of remedial actions and recommendations were made, the cash flow issue was imminent.

**TENDENCY TOWARDS FINANCIAL DISTRESS**

Knysna Municipality’s current financial cash flow difficulties were evident back in 2014. For the purpose of this plan and to determine a turnaround strategy, it would serve no purpose to go further than a five-year period of analyzing to determine where the problems started and what caused them. Therefore the period 2014/15 to 2018/19 is used as an analyzing basis.

To define the cash flow problem, the midyear budget assessment table C7 is used as an important indicator to assess the past six (6) months actual figures and to forecast the expected 12 months.
From the information in the above table, it is indicated that as at 31 December 2019, the municipality had a cash deficit of almost R10 million and a forecasted cash surplus of only R13 million at year end.

With the analysis of the above, it was found that there was over projected of the forecasted cash to be generated from operating activities, in the sense that the collection rate on debtors used is higher than the actual tendency indicated, with the result that the predicted cash flow at year end would not be in a surplus but a cash deficit of almost R64 million.

Preliminary assessment of the root causes of cash flow challenges

The following factors have contributed to the financial cash flow challenges experienced by the municipality:

- Historically senior managerial positions were vacant for a very long time and that had weakened the municipality’s institutional and administrative capacities.

- Increase in capital expenditure which is funded from own revenue (CRR). The municipality has used its own revenue as bridging finance to fund grant funded projects, thereby depleting the available cash.
The municipality did not adjust its capital and operating expenditures to be in line with income received. The projected income was too ambitious and it could not be collected.

The socio-economic profile of the municipality, high levels of unemployment and a high percentage of indigent customers have placed a further strain on municipal resources and the ability to function as a going concern.

The tariff structure applied by the municipality has not been cost-reflective thereby under recovering on the cost of service rendering and allowing infrastructure to deteriorate.

ANALYSING THE STATEMENT OF FINANCIAL POSITION

The following Tables are an indication of financial deterioration

**Current Ratio**

**Table 1: Ratio of Current Assets vs Current Liabilities (Current Ratio) R (million)**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Assets</td>
<td>170.8</td>
<td>205.4</td>
<td>253.0</td>
<td>243.5</td>
<td>276.72</td>
</tr>
<tr>
<td>Current Liabilities</td>
<td>110.0</td>
<td>127.7</td>
<td>152.3</td>
<td>166.9</td>
<td>221.89</td>
</tr>
<tr>
<td>Asset Surplus</td>
<td>60.8</td>
<td>77.7</td>
<td>100.7</td>
<td>76.6</td>
<td>54.83</td>
</tr>
<tr>
<td>Ratio</td>
<td>1.55:1</td>
<td>1.61:1</td>
<td>1.66:1</td>
<td>1.46:1</td>
<td>1.24:1</td>
</tr>
</tbody>
</table>

Source: Audited Annual Financial Statements

The Ratio is used to assess the Municipality’s ability to pay back its Short-term Liabilities (Debt and Payables) with its Short-term Assets (Cash, Inventory, Receivables). The national norm as set by National Treasury (circular 71 of January, 2014) is a ratio of at least 1.5:1.

From the above information in table 1, it is evident that the municipality has a slight improvement in the ratio between 2015 to 2017 followed by a sharp decline from 2018 and it dropped to an alarming 1.24:1 during 2019.

This declining trend continuing during the current financial year, and it is very clear from the declining trend that the municipality is approaching a period where the municipalities immediate available cash and cash equivalents would not be available to settle accounts payable within the legally prescribed period of 30 days should corrective measurements not implemented to prevent the declining trend to continue.

When the current ratio is further analysed to determine the municipalities liquidity, (cash available in a short period of time), the situation worsened and is there more reason for concern, as indicated in table 2 below.
Liquidity

Table 2: Ratio of Liquid Assets vs Current Liabilities

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and cash equivalents</td>
<td>60.898</td>
<td>75.566</td>
<td>108.212</td>
<td>79.877</td>
<td>71.709</td>
</tr>
<tr>
<td>Vat receivable</td>
<td>.317</td>
<td>5.989</td>
<td>10.285</td>
<td>27.346</td>
<td>19.744</td>
</tr>
<tr>
<td>Payables(creditors)</td>
<td>63.014</td>
<td>89.775</td>
<td>135.835</td>
<td>122.204</td>
<td>122.228</td>
</tr>
<tr>
<td>Unspent Grants</td>
<td>54.678</td>
<td>73.672</td>
<td>93.616</td>
<td>91.771</td>
<td>112.842</td>
</tr>
<tr>
<td>Cash Surplus</td>
<td>11.393</td>
<td>8.329</td>
<td>4.897</td>
<td>10.315</td>
<td>32.585</td>
</tr>
<tr>
<td>Ratio</td>
<td>(3.057)</td>
<td>7.774</td>
<td>37.322</td>
<td>20.118</td>
<td>(23.199)</td>
</tr>
</tbody>
</table>

Source: Audited Annual Financial Statements

In terms of the Generally Recognized Accounting Practice (GRAP) standards to which the municipality is legally obligated to report the financial transactions in their Financial Statements, it is a requirement that all the municipalities’ reserves must be cash-backed.

The municipalities reserve funds since 2014/2015 are as follows:

Table 3: Reserves

<table>
<thead>
<tr>
<th>R(million)</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>To 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital replacement</td>
<td>25.000</td>
<td>5.000</td>
<td>19.869</td>
<td>40.500</td>
<td>45.500</td>
</tr>
<tr>
<td>Employee retirement</td>
<td>7.850</td>
<td>6.408</td>
<td>9.575</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Non- Current Prov.</td>
<td>4.274</td>
<td>4.738</td>
<td>5.758</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Valuation Roll</td>
<td>1.648</td>
<td>1.648</td>
<td>1.648</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Re- Valuation</td>
<td>46.219</td>
<td>46.015</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total</td>
<td>84.991</td>
<td>63.810</td>
<td>36.850</td>
<td>40.500</td>
<td>45.500</td>
</tr>
</tbody>
</table>

Source: Audited Annual Financial Statements

Looking at the above information as reflected in tables 1 and 2, it is evident that although the reserve was funded at year end, it is an unrealistic reflection of the real cash situation when the municipalities other short-term responsibilities are taken into consideration.

Since 2017, the municipality has changed their Reserve Policies to only has a Capital Replacement Reserve, due to the lack of cash and cash equivalents, but it was only a partial solution to a bigger problem because, with the cash shortfall as indicated in table 2, of R23 million, the R45 million Reserve (which must be cash-backed in terms of GRAP), less the repayment of Receivables of approximately R50 million would constitute to a total cash deficit of roughly R18 million as on 30 June 2019.

This trend would worsen during the current (2019/2020) financial year due to the budgeted capital expenditure financed from own funds, (which is explained under capital expenditure below). If the spending trend is not managed, the municipality would be in a situation where some of the creditors could not be paid within the legally prescribed timeframe, in the very near future, which would lead to a ripple effect of financial chaos and a collapse of effective
service delivery, which unfortunately is now already surfacing in the 2019/2020 midyear budget assessment figures.

In terms of National Treasury’s norms for Liquidity Management (Cash/Cost Coverage) a range between 1 to 3 months is acceptable. If the ratio is below the norm, the municipality would be vulnerable and at a higher risk to meet its obligations and its financial commitments could be compromised.

During the 2018/2019 financial year, the municipality’s ratio was only 19.2 days and in terms of the 2019/2020 budget figures, it worsened to an alarming 7.95 days. Which is way below the norm of at least 30 days.

The Long-Term Investment amounted to R34 million is excluded due the fact that it is pledged as a guarantee on an external loan taken up.

**Capital Expenditure**

**Table 4: Capital Expenditure**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans</td>
<td>15.400</td>
<td>.180</td>
<td>36.573</td>
<td>27.737</td>
<td>60.238</td>
</tr>
<tr>
<td>Grants</td>
<td>30.963</td>
<td>54.005</td>
<td>59.952</td>
<td>64.820</td>
<td>49.865</td>
</tr>
<tr>
<td>Own Funding</td>
<td>15.310</td>
<td>35.626</td>
<td>-</td>
<td>37.109</td>
<td>39.564</td>
</tr>
<tr>
<td>Total Capital Expenditure</td>
<td>61.773</td>
<td>89.811</td>
<td>96.525</td>
<td>129.666</td>
<td>149.667</td>
</tr>
</tbody>
</table>

*Source: Audited Annual Financial Statements*

From the content of table 4 above, the municipality has spent R127.609 million of their accumulated cash reserves the past 5 years on capital projects.

Although National Treasury’s norm for Capital Expenditure to Total Expenditure (Opex plus Capex) is a ratio between 10% and 20%, Knysna Municipality’s prior year capital expenditure was within the parameters with 14.36 %. However, in terms of the 2019/20 budget, capital projects amounted to a total of R263.78 million of which an enormous amount of R102.46 million is budgeted to be financed from the cash reserves. This constitutes a ratio of 21.5 % which is only marginally above the norm, but which is totally beyond the municipality’s ability in terms of available cash reserves which would then be exhausted. The fact of the matter is that the municipality just doesn’t have the reserves to finance the capital expenditure as budgeted.

The continuation of capital financing from the cash reserves must be very carefully reconsidered with future budgets and even the current year’s adjustment budget as this would be a very important element as a turnaround measurement and remedy to rectify the cash flow problem.
**Borrowing**

<table>
<thead>
<tr>
<th>Table 5: Debt (Total Borrowing) to Total Operating Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt</td>
</tr>
<tr>
<td>Operating Revenue</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>%</td>
</tr>
</tbody>
</table>

*Source: Audited Annual Financial Statements*

National Treasury’s norm is 45%.

The purpose of this ratio is to determine if the municipality has the ability to generate sufficient revenue to repay long-term liabilities. In other words, this indicates the affordability to borrow.

From the above, it is indicative that the municipality is almost 50% below the norm, which is an indication that the municipality must rather borrow money for capital projects instead of financing capital expenditure from own funds because the municipality has the capacity to take increase funding from borrowing.

To motivate this further the following ratio is also indicative of the municipality’s capacity to borrow as indicated in table 6 below.

<table>
<thead>
<tr>
<th>Table 6: Capital cost / Total Operating Expenditure (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest</td>
</tr>
<tr>
<td>Operating Expenditure</td>
</tr>
<tr>
<td>%</td>
</tr>
</tbody>
</table>

*Source: Audited Annual Financial Statements*

National Treasury’s norm for the cost of borrowing repayments obligations as a percentage of its total operating expenditure is a norm between 6% to 8%. Because the municipality is operating at more than 50% below the norm, the municipality has the capacity to take on additional financing from borrowing.

**Audit Committee Inputs**

Issues raised by the Audit Committees in its “Report of the Knysna Audit Committee on A) The Committee’s response to matters raised in The Auditor-General’s Audit Report for 2018-2019 and B) The financial position of the Municipality as at 30 June 2019” regarding the municipal cash flow.

“OVERALL ASSESSMENT OF THE FINANCIAL POSITION

In his Management Report the Auditor General rated the overall financial viability of the Municipality as “Good”. When viewed from a purely financial point of view, we understand why the AG believes that the Municipality is in a healthy financial position. However, when viewed amongst other factors against the backdrop of the tremendous infrastructure backlogs that have been built up over many years, the problems in
collecting revenues, the looming cash flow situation and the service delivery needs of the burgeoning population with limited means, the outlook is less rosy."

“The AG, in his Management Report, highlights three main concerns, which we also have, regarding the financial position of the Municipality. These are:

• Expenditure Management;
• Revenue Management; and
• Cash Management.

Cash flow from operations still appears to be a serious challenge that we regard with great concern. Ineffective billing and cash-collection processes have hampered progress on meeting service delivery needs. The debt collection rate is still unacceptable and there are still signs of possible cash flow difficulties even though there has been an initiative to improve revenue collection. In addition, there were problems in expenditure management relating to creditor payments. The cash to cost ratio has deteriorated since 2018, as is borne out by the Liquidity Management ratios set out below. While the combined total of capital expenditure plus expenditure on repairs and maintenance rose markedly by 12%, R&M remained at 5% of expenditure on property, plant and equipment and still fell far short of the norm of 8%. There is capacity for additional borrowing, which should be balanced by cash flow needs. There is a need to determine with more certainty the probability of outcomes relating to contingent liabilities, which amounted to R53.4 million, and other, as yet unquantifiable, items.

LIQUIDITY MANAGEMENT

Cash to Cost-coverage Ratio, which measures the Municipality’s ability to meet at least its monthly fixed operating commitments from cash and short-term investment without collecting any additional revenue, indicates 1 month compared to 1 month in 2018 and is in the low end of the norm of 1 to 3 months.

The Quick Ratio: which measures the ratio of current assets excluding receivables and inventory against current liabilities, has decreased slightly from 0.58 in 2018 to 0.56 in 2019. As the norm in this case is 1.00, this indicator also suggests the possibility of a potential liquidity problem.

The Current Ratio: which measures current assets against current liabilities, decreased this year from 1.53 in 2018 to 1.25 in 2019, which is well below the norm of 1.50 to 2.10 and well below the levels in the preceding three years. This ratio indicates the Municipality’s ability to utilize its near-cash assets to pay its short term liabilities as they become due.

The fact that these ratios are below the norm and trending downwards indicates a deterioration in cash management and hence the flashing of very strong warning lights.

DEBTORS MANAGEMENT

Debtors Collection Rate: This ratio shows the level of payments in relation to billings at financial year end and, as in 2018, was 91.0%, which is below the target recommended by National Treasury of 95% (which target was achieved or exceeded in 2017 and 2016). In particular, this highlights the opportunity cost of not assiduously pursuing more effective means of collecting fines.

Net Debtors Days: Shows the average number of days required for the Municipality to receive payment for bills for services is 78 days, Including fines, and 72 days, excluding fines. Both these figures far exceed the norm of 30 days and indicate that the Municipality
continues to be exposed to significant cash flow risk and is facing challenges in the collection of outstanding amounts.

**Bad Debts:** The amount of consumer Bad Debts written off during the year was R18.2 million (13% of the provision). A further R80.7 million was written off non-exchange transactions (rates and fines) in the financial statements (on page 46, note 6) as “amounts written off as uncollectable” and disclosed (on page 6) as “debt impairment” instead of what we believe is the correct description, namely “bad debts”. This disclosure treatment is confusing, and could mislead.

However, it is the total level of the impairment provision of R275.8 million for doubtful debts compared to the monies owed to the municipality amounting to R417.3 million that gives cause for concern, which amounts to 66.1%. Again, this points to the inefficiency of debt collection processes. To put this further into context, this total impairment provision was 30.0% of the Municipality’s total revenues for the year of R934.9 million.”

“**LIABILITY MANAGEMENT**

Capital Cost to Total Operating Expenditure: remained at 5% in 2019, against a norm of 6.0 to 8.0%. This shows the cost (interest payments plus redemption payments against operating expenditure) of borrowing and remains below the norm and does indicate opportunities for higher borrowing to fund capital expenditure for service delivery.

Debt (Total Borrowings) to Revenue: The ratio of total borrowings (debt) to total operating revenue (excluding conditional operating grants) is 25% in 2019 compared to 21% in 2018 and the norm of 45%. This also indicates significant space for more borrowing. However, the need for more borrowing will have to be weighed carefully against the cash flow needs of the Municipality.”

**DISCUSSION**

At this time, due to time constraints, an in-depth analysis of the circumstances that led to the cash flow crisis is not possible. However, the following should be considered, and how by addressing them Council could mitigating the cash crisis until a full analysis/investigation can be undertaken.

- Unsustainable budgeting, ineffective management, weak or no controls and limited or no detection and monitoring processes and systems.
- The table below reflects the increase in capital expenditure for the period 2015/2016 to 2019/2020, R 48 million [2015/2016], R 190 million [2019/2020] and increase of R 141 million, 293% over a four year period excluding grant funding and donations.
• The Cash (Internally generated funds) in the graph above indicates that there has been an excessive reliance on cash funded capital as illustrated in the table below.

<table>
<thead>
<tr>
<th>Adjusted budgets</th>
<th>Borrowing</th>
<th>Cash (Internally generated funds)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015/2016</td>
<td>17,458,000</td>
<td>30,785,000</td>
<td>48,243,000</td>
</tr>
<tr>
<td>2016/2017</td>
<td>9,552,000</td>
<td>34,610,000</td>
<td>44,162,000</td>
</tr>
<tr>
<td>2017/2018</td>
<td>23,463,000</td>
<td>45,946,000</td>
<td>69,409,000</td>
</tr>
<tr>
<td>2018/2019</td>
<td>73,308,000</td>
<td>65,542,000</td>
<td>138,850,000</td>
</tr>
<tr>
<td>2019/2020</td>
<td>87,188,000</td>
<td>102,462,000</td>
<td>189,650,000</td>
</tr>
<tr>
<td>Total</td>
<td>210,969,000</td>
<td>279,345,000</td>
<td>490,314,000</td>
</tr>
<tr>
<td>Increase 15/16 vs 19/20</td>
<td>69,730,000</td>
<td>71,677,000</td>
<td>141,407,000</td>
</tr>
<tr>
<td></td>
<td>399%</td>
<td>233%</td>
<td>293%</td>
</tr>
</tbody>
</table>

This relates to taxation in advance of need, the principle that current ratepayers and consumers should not pay for benefits that future ratepayers and consumers would enjoy. For example, a vehicle with an expected five-year lifespan should be matched and funded by a five-year loan and not be purchased with operational funds.

• The municipality is spending cash reserves on capital projects to the extent that cash reserves are exhausted instead of borrowing money although the municipality only has utilized 50% of its capacity to borrow money. The Current Capital Cost and Debt ratios for 2018/2019 indicate that there is some room for switching from cash to loans, however not enough to cover the whole R 102 million a quick desk to calculation below.
  o 2018/2019 Current Capital Cost ratio (interest paid and redemption) as a % of total operating expenditure = 5% NT norm 6-8%
    ▪ Based on the 2018/2019 figures and utilising 8% to determine an estimated maximum for interest and redemption payments could be increased by R 25 million.
  o 2018/2019 Debt ratio (Total Borrowings ÷ Revenue) = 25% NT norm 45%
    ▪ Based on the 2018/2019 figures and utilising 45% to determine an estimated maximum for debt could be increased by R 150 million.
R 150 million less R 87 million current loan funding equates to an estimated availability of R 63 million based on 2018/2019 and current figures. However, it should be kept in mind that this would have an impact on future year funding of budgets.

- The net effect of Grants for the months of November and December 2019

<table>
<thead>
<tr>
<th></th>
<th>November</th>
<th>December</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unpaid Conditional Grants</td>
<td>(31,267,114.70)</td>
<td>(40,874,198.77)</td>
</tr>
<tr>
<td>Unspent Conditional Grants</td>
<td>39,103,063.26</td>
<td>37,064,846.85</td>
</tr>
<tr>
<td>Subsidised to/(by) municipality</td>
<td>7,835,948.56</td>
<td>(3,809,351.92)</td>
</tr>
</tbody>
</table>

- Historically unreliable budgeted monthly cash flows.

- The impact of debt collection versus affordability of tariffs and charges. Consideration should be given to cost-reflective service tariffs and moving away from annual percentage increases on tariffs. Councils approach on pro-poor versus prosperous rates and service charges should also be contained in the IDP and MTREF. Councils approach on pro-poor versus prosperous rates and service charges should also be contained in the IDP and MTREF. A quick analysis of the 2019/2020 increase indicates that the current approach is in favour of the prosperous.

- In an effort to determine a more accurate payment ratio, the actual payments for receivables for 2018/19 were calculated because it is known and audited which would result in a more reliable basis for calculating anticipated payments.
Table 7: Payments calculation (Opening Balance + Levy’s - Written Off - Closing Balance) = Payments

<table>
<thead>
<tr>
<th>2018/19 R(million)</th>
<th>Opening Balance</th>
<th>Levy’s Written off</th>
<th>Closing Balance</th>
<th>Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electricity</td>
<td>36.224</td>
<td>246.03</td>
<td>-</td>
<td>41.38</td>
</tr>
<tr>
<td>Water</td>
<td>72.068</td>
<td>68.83</td>
<td>18.238</td>
<td>69.86</td>
</tr>
<tr>
<td>Sewerage</td>
<td>24.816</td>
<td>29.98</td>
<td>-</td>
<td>36.80</td>
</tr>
<tr>
<td>Refuse</td>
<td>26.300</td>
<td>22.10</td>
<td>-</td>
<td>33.62</td>
</tr>
<tr>
<td>Rates</td>
<td>64.305</td>
<td>215.55</td>
<td>-</td>
<td>75.32</td>
</tr>
</tbody>
</table>

From the above information, reliable payment ratios are as follows:
- Electricity 98%
- Water 77%
- Sewerage 60%
- Refuse 67%
- Rates 95%

The adjusted forecast for revenue for services and rates as reflected in the mid-year budget assessment is as follows:

<table>
<thead>
<tr>
<th>R (million)</th>
<th>Payment ratio</th>
<th>Payments Received Forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electricity</td>
<td>R 270.91</td>
<td>98%</td>
</tr>
<tr>
<td>Water</td>
<td>R 73.928</td>
<td>77%</td>
</tr>
<tr>
<td>Sewerage</td>
<td>R 31.866</td>
<td>60%</td>
</tr>
<tr>
<td>Refuse</td>
<td>R 23.08</td>
<td>67%</td>
</tr>
<tr>
<td>Rates</td>
<td>R 229.18</td>
<td>95%</td>
</tr>
</tbody>
</table>

When the above realistic figures are compared with the midyear cash flow projection in table C7, the following differences are noted:

<table>
<thead>
<tr>
<th>2019/20 full year Forecast- Table C7</th>
<th>Prediction as calculated above</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rates</td>
<td>R 224.25</td>
<td>R 217.72</td>
</tr>
<tr>
<td>Services</td>
<td>R 431.13</td>
<td>R 357.07</td>
</tr>
</tbody>
</table>

From the above, it is clear that the anticipated forecast for services is far too optimistic. The fact that the adjustment budget only reflects total revenue for services for an amount of R399.784 million, a payment ratio of 108% must be achieved which clearly indicates that the forecast in the midyear assessment is incorrect. On the other hand, when the actual payments received, as also reflected in table C7, amounted to R177.918 is projected, an amount of R355.836 would realize. This amount correlates close to the historical payment ratios of R357.07 as set out above.

This, unfortunately, would result in a cash deficit of an amount close to R67 million and not a cash surplus of R13 million as indicated in table C7.

The municipal budget for the 2019/2020 financial year is therefore fundamentally flawed in respect of the principles applied in the compilation thereof to the extent that the municipality currently finds itself with a budget which is not cash funded, neither...
credible nor did it support the principles of financial sustainability and viability. It was
evident that certain revenue streams were unlikely to realize and a correction needed
to be done.

PROPOSED REMEDIAL ACTIONS

Actions which would have an immediate effect

The municipality has to immediately arrange an overdraft facility with the bank. This is
necessary for only short-term bridging finance, and may not exceed the capital projects
earmarked to be financed from borrowing.

The capital projects earmarked to be financed from loans must all be reconsidered and only
those projects which are absolutely essential must continue. The other projects should be
delayed, or cancelled.

The projects which would continue with, must then also be financed from loans.

The calculated capital needed for the projects must be immediately borrowed, and not
waiting until the projects are completed

All future capital projects to be financed from loans, until the municipality has recovered from
the cash flow deficit and has rebuilt a healthy Capital Replacement Reserve.

A moratorium should be placed on the filling of all budgeted vacancies, except where it is
again absolutely critical for essential service delivery. This must prevail until a proper work
study is conducted, in order to ensure that the organogram is aligned to the Integrated
Development Plan (IDP) which is efficient, affordable and sustainable.

| If the recommendations were applied, the projected cash deficit of R 64 million would be replaced with a projected cash surplus of R 40 million. |

RISKS ASSOCIATED WITH THE IMPLEMENTATION

The successful implementation of the Draft Cash Management Plan has certain risks
associated with the outcome, these need to be identified and mitigating measures
be assigned to each project and be monitored. Some of the risks that have been
identified are:
- Oversight and leadership instability
- Insufficient controls and reporting/dashboards
- Funding limitations
- Bloated organizational structure
- Lack of credible financial data in order to complete credible budgets
- Lack of long term plan supported by a long term financial plan

RELEVANT LEGISLATION

Municipal Finance Management Act 56 of 2003 (MFMA).
RECOMMENDATION OF THE MUNICIPAL MANAGER

[a] That a Committee, to review and monitor the cash flow, amend budgets and financial plans to ensure continued financial viability and sustainability, be established as follows:

________________________ (Chairperson)
________________________
________________________
________________________

[b] That all current municipal financial policies, strategies and operational plans as required to address the successful implementation of the plan, be drafted and updated;

[c] That, with immediate effect, all operational and capital tenders not yet awarded and not funded by grants, be placed on hold, subject to [d] below;

[d] That exceptions regarding Capital Projects be considered based on impact and expected financial returns with an emphasis on short term returns, subject to [g] below;

[e] That Capital and Operational programs and projects funded by loans and own funding, be reprioritized;

[f] That drawdown loan funding on an ongoing basis match expenditure bases;

[g] That no Capital Projects be funded by own funding (cash) until such time and only when such funds are cash-backed;

[h] That the possibility of procuring additional loan funding, be investigated;

[i] That the use of consultants be limited to professional services directly related to service delivery and not to those functional areas included in employee job descriptions;

[j] That all virements be placed on hold until appropriate controls have been established;

[k] That a moratorium on filling of all vacant posts, without exception, be placed until clarity has been obtained on the cash flow, subject to [l] below;

[l] That a work study, in order to ensure that the organogram is aligned to the Integrated Development Plan (IDP) which is efficient, affordable and sustainable, be conducted;

[m] That controls and dashboards to monitor cash flows, be developed and implemented;

[n] That Activity-Based Costing, in order to determine inter-departmental costs associated with Trading Services, be implemented;

[o] That a Long Term Financial Plan (10 - 15 years), aligned to the Vision and Mission of the Municipality, be developed;
[p] That an overdraft facility, with immediate effect, be arranged with our Banker; and

[q] That quarterly progress reports on the implementation of the plan, be submitted to the Municipal Council.

File Number : 9/1/2/14
Execution : Municipal Manager

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