

The effect of good working capital policy on exploiting the
fiscal capacity of municipalities in KZN

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By
J R Maharaj
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Supervisor- Dr. H. de Villiers

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(for her guidance in all matters academic and esoteric).

Executive Summary

With the advent of the Municipal Management Finance Management Act, (Act 56 of 2003), working capital issues have been legislatively forced onto managers' daily agenda. Municipal finance officials have been given a clear mandate to focus greater attention on issues such as debt and cash management and stricter policies relating to short term credit financing. The MFMA allows for the unlocking of the fiscal powers of a municipality to generate its own income.

Research objectives This research is intended as a pilot study that argues greater focus on and improvement of, working capital procedures would assist a municipality to exploit this fiscal capacity.

Other objectives include:

- Generate greater interest in this topic amongst researchers.
- Identify factors that limit the implementing good working capital policy.
- Identify factors that affect the income earning ability of municipalities.
- Identify possible best practices benchmarking.

Research methodology Evidence will be gathered according to prescribed, recommended and appropriate methods. Only municipalities in the Kwa-Zulu Natal Province will be invited to participate. A combination of questionnaires and interviews will yield the information to form an opinion.

The published works of scholars on the issues of working capital will form the starting point of information gathering so as to inform the researcher of current knowledge and trends in this field of study.

Gathering of information will be done on a voluntary basis and any participant choosing not to supply data will be excused without prejudice. Informative will be interpreted by analyzing the responses against the backdrop of legislature and available literature.

Outcomes Results and the research statement will be related and the research statement restated in line with the findings. Arguments will be built that will either prove or refute the research statement.

Recommendations will be made regarding the issues surrounding the hypothesis in relation to the weaknesses and limitations evidenced by the findings of this research.

1. Chapter one – Problem in context

1.1. Introduction

Polity, (Polity, 2011): Terrence Nombembe speaks of areas requiring attention in Kwa-Zulu Natal, (KZN), municipalities and refers to matters relating to finance, compliance and performance. These issues are matters of concern for most municipalities in South Africa as evidenced by further Polity reports on Nombembe's comments on the remaining eight provinces. The primary focus of municipal regulatory authorities and research based on municipal finances has been on matters of compliance and performance. Municipalities also have the legislated function of generating their own revenues and can therefore, earn their own income. What is interesting is that compliance, performance and financial indicators do not consider the exploitation of fiscal capacity when being assessed; compliance to legislature is the focal point of discussion. Should Municipalities exploit this fiscal capacity, the burden placed on National Treasury to increase funding via grants would be lessened.

Working capital, when managed properly, has the benefit of improving cash flows by decreasing outstanding debtors, reducing excessive stock holdings, and, utilizing credit terms from creditors, (Pauw, et al., 2009: 208).

Working capital, (also referred to as, "liquidity", [Vigario, 2008:381]), "involves the simultaneous decisions about current assets and current liabilities". "Fiscal capacity" refers to a municipality's ability to generate its own income. Municipalities, for the most part acquire financing through grants and subsidies from National Treasury and this places a greater burden on taxpayers. Given that municipalities possess the ability to generate their own income, what factors could enhance their ability to exploit this capacity. The Municipal Fiscal Powers and Functions Act, (Act 12 of 2007), and the Municipal Property Rates Act, 2004 (Act 6 of 2004), both give municipalities the power to raise and collect own income. This report will investigate whether good working capital policies assist municipalities in exploiting their fiscal powers so as to maximize their own income.

1.2. Problem in context

The recent events in the local governance of the Limpopo province, (January, 2012), has created greater awareness in both local and provincial financial management. Issues that have been highlighted, in particular, are cash management and staffing. Misappropriation of cash, irregular and unauthorized expenditure due to fraud and negligence or incompetence at local government level, has created many challenges for National Government. These challenges have included investigations, punitive measures and remedial action, all at the expense of the tax payer. When municipalities and districts fail to maximize their own revenue generating activities, these entities place greater reliance on external sources of funding, (Allen and Heese, 2011), turning to National Treasury and foreign assistance. Failure to collect one's own revenue, (rates, taxes, services, etc...), leaves local government unable to meet the day-to-day activities of the entity, makes the municipal budgetary process difficult and leads to increasing compliance risk.

"Prior to the introduction of the Public Finance Management Act, (Act no. 1 of 1999), working capital had hardly been a management issue for the numerous government bodies ..." (Pauw, et al., 2009: 207) Section 38(1)(c)(iii) provides that the "accounting officer must take appropriate steps to manage available working capital efficiently and economically".

Vigario, (Vigario, 2008: 381), refers to working capital as being synonymous with liquidity. Howard, (Howard, 2006: 343-4), states, "A government that cannot meet its obligations on time is technically insolvent. The risk of becoming technically insolvent is measured by one of two things: current ratio or the amount of net working capital." Both Vigario and Howard look to working capital as the indicator of solvency/liquidity and working capital to measure the going concern principle. The Limpopo province, having experienced liquidity issues, is a case in point that has given credence to the words of Howard, in particular.

Working capital has been described by Pauw et al., (Pauw et al., 2009: 206), as, "mostly realisable cash, in the case of government departments - which is available for supporting the day-to-day operations of an organisation." The aim of good working capital policy is to balance the needs of having sufficient cash on hand to manage the day-to-day expenditure of an entity and investing surplus cash wisely so as to maximise returns. Monies are made available to local government from National Treasury in terms of the approved budget to assist municipalities in meeting their objectives. A municipalities' budget also indicates funds

generated by rates, taxes and services, (own revenue). When own revenue is not collected greater reliance is placed on grants and funding from Government. “Indeed, grants as a proportion of revenue in municipalities, has doubled over the past seven years as municipalities have begun to rely more and more on grants and less on their own revenue.” (Allen and Heese, 2011)

Morning news presenter on Radio Five News, (10 June, 2009) stated that Trevor Manuel, (Head of Planning Commission) said that donor funding of many African countries have not been honoured by their donor countries. This means that municipalities that have included donor funding from affected countries in their budgets are likely to fall short in the cash inflows, hence placing further importance on municipalities to collect a larger portion of their own revenue through rates, services and fines than presently collected.

Municipalities relying more heavily on grants and less on their own revenue generating abilities, is in not in keeping with the Municipal Finance Management Act, (Act 56 of 2003) section 54(1)(a), which states that the accounting must ensure , “that the municipality has effective revenue collection systems ...”

This inability to maximize their fiscal capacity in not in keeping with either the Property rates Act, or the Municipal Fiscal Powers and Functions Act. Municipalities, unlike provincial departments, have the ability to raise their own revenue. Factors which will exploit this earning potential require investigation.

1.3. The problem review

The process of induction requires that we, (Cooper and Emory, 1995: 28), “observe a fact”: There are some municipalities that experience difficulty collecting their own revenue which translates to cash flow problems and rising debtors, (Peel, 2004: Lubbe and Rossouw, 2005: Serfontein, 2009). Reverting to the problem in context, it is evident that there are many municipalities that, for differing reasons, are unable to manage their working capital effectively. This has translated into situations where large amounts of own revenue have remained uncollected, placing greater burden on external sources of finance.

To go through a full list and investigate every possible reason why this situation exists would be to breach the boundaries of this intended research. What has been proposed is that good working capital policies

could improve local government's ability of collecting a greater portion of its revenue.

A solution or solutions to assist municipalities to better perform in terms of their revenue earning abilities would alleviate the burden placed on National Treasury. In spite of the PFMA, MFMA, Preferential Procurement Policy Framework Act, (act No. 5 of 200), Treasury Regulations, the Municipal Systems Act, (No. 32 of 2000), etc... there are municipalities that are failing to manage working capital to best advantage.

This research attempts to investigate the impact that good working capital policies have on a municipalities' ability to collect their own revenue. Identifying working capital as the primary construct and its components as secondary/sub constructs, an attempt will be made to prove the hypothesis that good working capital policy can assist in increasing revenue balances in local government.

1.4. Problem Statement/Research Statement

"... no new knowledge can be arrived at if there is no problem to be investigated." (Karl Popper quoted in Hofstee, 2009: 85) This report investigates whether good working capital policy can positively influence the amount of own income a municipality earns.

The evidence points to municipalities, in general relying more heavily on grants, (Allan and Heese, 2011). This indicates that there is a problem that municipalities are experiencing in collecting all of their own revenue. Lubbe and Rossouw, (Lubbe and Rossouw, 2005), have provided, 'non-payment and other reasons', for increasing the outstanding debtors of municipalities. Schoeman, (Schoeman, 2006), writes, "Overall an alarming trend was discovered, namely the debt management and the services expected of municipalities." Serfontein, (Serfontein, 2009), "Chief Financial Officerscomplaints ... difficulties they face to collect their hard earned cash."

The problem that is indicated by these authors is cash and debtor management. Poor cash and debtor management leads to shortfalls in collected revenues, possible late payment of creditors and ultimately, to a liquidity crisis; "... overarching working capital issue of liquidity ... poor management in this area has frequently forced otherwise viable businesses to discontinue their operations", (Paul et al., 2009): the principle of sustainability is then at risk.

The sub constructs of working capital are cash, debtors, creditors and inventory. The literature suggests that the primary concern is a rise in debtors due to poor revenue/cash collection. Previous authors have written of a culture of non-payment for rates and services whilst others have indicated socio-economic factors as a reason, (Kanyane, 2011).

The aim of this report is to place emphasis on the importance of sound working capital policies and the influence that this has on the ability of municipalities to raise, collect and exploit their own income earning powers. The literature review has indicated that there is insufficient evidence regarding this issue. This research will look at compliance in terms of debtors, cash and creditors in terms of the MFMA and the efforts made by individual municipalities to exploit their income earning potential.

1.5. Research questions

Hofstee, (Hofstee, 2009: 85), "Research questions are sometimes used when not enough is known about the problem to allow a thesis to be formulated or convincingly argued." The literature review has shown that very little has been written about working capital issues and fiscal capacity.

The questions that arise from this research report involve day-to-day operations of municipalities;

- Are municipalities using good working capital policies?
- Are municipalities following legislated policy, (MFMA), regarding issues of working capital?
- Are municipalities aware of the benefits of sound working capital policy?
- Are municipalities using good working capital policies to improve their own income earning capacity?
- Are there factors that undermine the benefits of good working capital policy in exploiting fiscal capacity?

1.6. Research objectives

Primary objective: To identify if a relationship exists between good working capital policies and a municipalities' ability to generate and collect its own income. The report thereon is intended as a pilot to further studies in this area of municipal finance. Literature is available on single components of working capital, individually dealt with, and findings discussed. This issue

has been given importance in both the PFMA and the MFMA with mention in the National Treasury's compliance check list.

Ancillary objectives:

- To identify other factors that affect a municipality exploiting its fiscal capacity?
There exists the possibility that sound working capital policy may not improve cash and debt collection, or the objectives of the MFMA. Extraneous factors could marginalize the policies put in place to raise revenue accurately, collect cash from debtors, pay creditors timeously and have excess cash to invest to earn interest.
- Identifying best practices for possible benchmarking for lesser performing municipalities.
The research methodology will provide information on municipalities that perform better than others. The data collected would give an indication as to why performance differs and if there is a possibility of under-performing municipalities adopting the policies that provide better results.

The **purpose of this study** is to highlight the importance of working capital management within the municipal sector and, how it relates to fiscal capacity of these entities. This report is a pilot study and is intended to pave the way for further studies in this area by the researcher or other scholars either across provincial boundaries, or, at national level. The research has both socio-economic and financial relevance as many municipalities are relying more heavily on grants than generating their own income, (Allan and Heese, 2011). This places added burden on National Treasury due to an increase in subsidized funding and decreases the burden on municipal officials to fully utilize their fiscal powers.

The objectives are achievable as the research methodology supports the finding of the required information. The determinant factor in the quantity and quality of data collected and the number of participating municipalities would be the municipal officials in the Kwa-Zulu Natal region.

1.7. Delineation of the study

The components of working capital that could generate income and/or cash savings are regarded as follows:

- Cash, (current asset), as this can earn interest,
- Debtors, (current asset), (any debt of the municipality that is payable to the municipality within a period of less than a year), primarily focusing on outstanding monies for rates and services as this, in essence, forms the bulk of a municipality's fiscal capacity, and,
- Creditors, (current liabilities), and the possibility of savings through early settlement discounts and avoidance of interest penalties through late payment.
- Working capital = current assets - current liabilities.

Stock or inventories has been purposefully excluded from this study as stock is not intended to be resold; it possess' more of a consumable nature at municipal level and is therefore not intended to generate a profit. The procurement process of stock within municipalities can be effective cost saving exercise, (Pauw al., 2009: 225), in terms of ordering systems and safeguarding of stock. However, the researcher has decided that the procurement process, being so exposed to fraud and corruption, (as evidenced in The Mercury headline, "Suttcliffe to face police probe", (Mercury, May 2012: 1), should best be dealt with in a separate paper.

Delimitations of the report:

- Time constraints– this research has strict time frames and has affected the level of detail in the investigation.
- Scope – has been limited to Local Municipalities in KwaZulu Natal. This is also related to time constraints; District Municipalities have been excluded.
- Number of interviewees – due to this being a "busy" time for the management of municipalities, permission for interviews and meetings has been limited in terms of the amount of time allowed and the number of interviews granted by municipal officials.
- All local municipalities within the province of Kwa-Zulu Natal will be requested to participate. The number of respondents will determine the scope limitation in terms of municipalities that are included in the research findings.

- The recent publicised events regarding local governance has led a few interviewees be wary of this research topic.
- Operation Clean Audit 2014, could have altered municipalities willingness to participate in any research activities at present.

Limitations:

- All municipalities in KZN will be sent the questionnaire. It is unsure of the number that will respond favourably.
- Of the sample that does respond, the sample may not be reflective of the entire population chosen.
- Of the sample that does respond, all questions may not have been addressed in the questionnaire.
- Better performing municipalities might be more willing to participate than their counterparts.
- Although every municipality is legally required to place their annual financial statements on their webpage, some have not complied with this requirement.
- Some of the financial information used will not have been audited or given an unqualified opinion by the Auditor General's office.
- The information supplied may be incorrect.

Assumptions that this study makes

- The willingness of all municipalities to participate in this study, (in the geographical area of KZN), has been assumed. The financial data for all municipalities is freely available on the National Treasury website, yet, qualitative information makes participation essential.
- The assumption has also been made that surveys will be returned timeously and that interviews will be granted on mutually agreed dates.
- Finance staff has an understanding of the history of the municipality so as to highlight any peculiarities that would challenge normal day-to-day operations and data analysis and indicate any trends that affect the municipality.

- Property valuers and independent municipal consultants are willing to share their knowledge and experience relating to municipalities valuations and finances.
- All financial data supplied by the municipalities' accounting divisions is accurate and can be relied upon.

1.8. Importance of the study

It is hoped that this study will begin a more earnest and constructive debate, (intended as a pilot study), in the public sector arena regarding the relationship between working capital policy and fiscal capacity on the local sphere of government. Working capital issues in the private sector are well tended as profit margins dictate the survival of these private entities. Due to the infrastructure that the local government sector provides, government bail-outs through increased unbudgeted funding is an option: this marginalizes the process of earning and collecting own revenue and removes accountability from municipal officials to utilise legislated fiscal capacity.

Fiscal capacity is an area which requires greater attention within the public sector to relieve financial burden on National Treasury, the South African Revenue Services and ultimately, the South African taxpayer.

Non-collection of monies for rates and services perpetuates a culture of non-payment, makes revenue driven budgets less relevant and reliable and begs the question as to whether the municipal budget is indeed funded, [MFMA requirement, S18(1)(a)].

Should the hypothesis be disproved, the findings would then provide reasons as to why sound working capital policies may not always assist a municipality in exploiting its own revenue generating and collecting abilities.

The research methodology is designed to provide information on whether municipalities in the province of Kwa-Zulu Natal actively seek out opportunities to earn own revenue. This would provide information on efforts to exploit fiscal capacities, and, could be used as a possible best-practices benchmarking for other municipalities.

1.9. Outline of the report – per chapter

Chapter two focuses on the problem analyses and the more theoretical considerations of this report. This chapter unravels the problem in context using emerging themes and tools.

Chapter three gives an overview of what is written about the topic by contemporary authors and where this research will complement such existing studies and philosophy.

Chapter four looks at the research method that will be employed to gather data and how the data will be manipulated to provide information on the research topic.

Chapter five details the data that the research methodology has provided.

Chapter six looks at the conclusions that are supported by the research evidence and any recommendations that could be offered to improve functionality and effectiveness with this area of public finance.

1.10. Summary

Municipalities have the fiscal capacity to generate their own income. Collection of rates, fines, service payments, etc. allows for income over and above grants and subsidies. Municipalities have the tools provided by working capital theory to exploit these income earning opportunities. This report investigates the effects of good working capital policy on this fiscal capacity.

2. Chapter two – Problem analysis/theoretical considerations

2.1. Introduction

Working capital theory has been used effectively by many companies to manage debtors, cash, inventories and creditors so as to maximize cash the flow of the enterprise: "Working capital management plays a critical role in a company's quest to maximize its shareholder value." (Strischek, 2003) Municipalities have this tool at their disposal to improve cash flows and improve their revenue generating abilities; the theory and principles of working capital theory relates to all entities.

2.2. Emerging themes

The emerging themes can be described by the words that are repetitive in the preceding discussion; working capital, debtors, cash, creditors, generating own revenue and fiscal capacity.

Wellman et al., (Wellman et al., 2010: 213), suggests that theme identification is closely linked to qualitative data analysis. Much of the research will be qualitative in nature, yet, revolve around the manipulation and discussion of the financial data of the participating municipal entities.

The primary theme is between the implementation of working capital theory to improve a municipality's ability to generate further income in terms of the constraints of the Municipal Finance Management Act and National Treasury Regulations. Public entities are more regulated than private entities. Private business has greater flexibility in terms of autonomous financial governance in terms of how they structure debt, debt payments, collect cash and remedial measures against errant debtors. Municipalities are given thirty days to pay creditors and have indigent debtors that need special consideration. Recent years has seen King III released. King III places emphasis on the sustainability of all entities, public and private. Liquidity translates to sustainability and has good working capital policies as one of the pillars.

2.3. Tools to unravel complexity

The theory of working capital will be investigated, together with the constraints of the MFMA, relevant statute and National Treasury regulations. Data will be collected through interviews, questionnaires, publications and internet sources.

The financial management tools of ratios, comparisons and trend analysis will be employed to assist in unraveling the complexity of the problem. Working capital ratios will be calculated and reasonability tests done on provisions to understand why there are municipalities that fail to earn and/or collect their own revenue. The strategy that is employed by municipalities in terms of working capital is detailed by the MFMA. As such, factors that cause a strategic drift and a move away from legislated practices/goals will be investigated.

2.4. Theoretical considerations

The MFMA is clear on the management of debtors, cash and creditors. It forms the legislative guidelines on public sector working capital. Working capital theory will be looked at in conjunction with the MFMA. Theoretically, the implementation of the MFMA guidelines will improve compliance and exploit fiscal capacity. The MFMA places several issues of compliance on managements' daily agenda:

- Calculate revenue monthly, raise debtors, charge interest on overdue accounts, has a system of internal control for debtors and revenue, weekly revenue reconciliations.
- Invest monies not immediately required,
- Tariff policy, rates policy credit control and debt collection policy and supply chain management policy.
- Pay municipal creditors 30 days on invoice or statement.
- Do variance analysis of projected and actual revenue.
- All revenue due to the municipality is collected.
- municipal officials effectively and economically manage the municipalities available working capital
- that the municipality has and maintains a system of internal control of assets and liabilities.

This can be regarded as a municipal working capital policy with the internal controls achieving legislated and budgeted outcomes.

Vigario, (Vigario, 2008: 387-8), lists the following strategies/working capital policies to reduce the duration of cash cycles and improve liquidity:

- “Delay the accounts payable, but still take advantage of cash discounts.
- Collect accounts receivable as soon as possible.”

Similarities do exist between the private and public sectors regarding working capital policy, yet, the public sector is more regulated and prescriptive.

Work of other scholars on the topic will be considered. This will afford a well-balanced argument based documented research by peers. “... utilise what others have done, and to incorporate their work in yours when it contributes to making your point.” (Hofstee, 2009: 149) Peer review affords the opportunity of gaining a second opinion that helps bring perspective to one’s findings. This would increase the validity of this research report.

Ethical considerations, (Lewis et al., 2003: 129), “... refers to the appropriateness of your behavior in relation to the rights of those who become the subject of your work, or are affected by it.” A Municipality a being a juristic person falls within ambit of, ‘Subject of your work’, and this includes the municipal staff and government oversight agencies such as the Auditor General’s Offices and National Treasury. The questionnaires are done on a voluntary basis and so are interviews. The respondent retains the right to divulge information at all instances. Any other source of information used other than information obtained from interviews and questionnaires will be publicly available information. All information obtained will remain confidential unless otherwise indicated by respondents. Municipalities that choose not to participate will be excused, without prejudice, by the researcher.

2.5. The business case

Municipalities having legislated fiscal capacity, could be likened to a business, yet, not all municipalities are able to exploit their fiscal capacities as is evidenced by large debtors, poor credit management, operating of overdrafts and large debt write-offs; “This municipality, Musunduzi, was placed under judicial management.”(Sahibdeen, 2012). The issue of municipalities and sustainability is of importance as the going concern principle needs to be addressed and satisfied: municipalities provide basic services of water and sanitation to its constituents.

The ongoing provision of basic services is a pre-requisite for both public and private business operations. The operations' of municipality impacts on the economic operations of the businesses within its municipal boundaries. The sustainability of municipalities is therefore of paramount importance to the sustainability of the economic wellbeing of the population within its boundaries.

National Treasury, (National Treasury, 2011: 36), "There is a wide spread perception that municipalities are supposed to be self-sufficient fiscal arrangements set out in Chapter 13 of the Constitution provide that 'local government is entitled to an equitable share of revenue raised nationally and may also receive additional conditional transfers from national and provincial government.'" This statement by National Treasury is not refuted by this research. When revenue budgets are drafted, there are certain implicit assumptions made by the Budget and Treasury Office of the municipality, two of which are that the budgeted revenue amounts are calculated considering all known variables and, that this amount is actually collectible. A realistic, revenue funded budget will be more likely to achieve its objectives and, hence rely less on unbudgeted and unplanned transfers from national and provincial departments.

This research will attempt to look at one variable, (working capital policy), and how its proper implementation or lack of implementation affects the income earning ability of municipalities.

3. Chapter three – Literature review

3.1. Introduction

For research to take place, an understanding of what already exists is essential: It avoids one re-inventing the wheel. Yet, it provides a starting point from which to look at things either in greater depth, or simply, differently.

The texts discussed will provide the models for achieving sound working capital policy and the reason therefore. The articles will provide information regarding the challenges that are faced when implementing the models and when exercising fiscal capacity.

3.2. Discussion of existing literature

Pauw, (Pauw, et al., 2009) has a dedicated chapter on working capital issues at municipal level.

Chapter seven deals with working capital issues detailing procedures and policies, which will lead to effective working capital maintenance. Each secondary construct is dealt with and some financial models provided; (current and quick ratios). Identified in the literature is the risk that poor working capital management could lead to cash restrictions and hinder service delivery. The authors, in principle, agree that sufficient working capital could lead to better cash flows and that “poor management in this area has frequently forced otherwise viable businesses to discontinue their operations.” (Pauw, et al., 2009: 210) The text looks is a theoretical base from which one can gain an understanding of the legislated importance of working capital. The authors overlook the difficulties that municipalities face when registering, billing and collecting debtors. The major revenue generating activity is therefore marginalized and not adequately dealt with, nor, given the fiscal enhancing capacity that it deserves.

Similarly, Visser and Erasmus affords another South African perspective the sub-constructs of working capital and includes related legislature on this issue.

The text deals with cash management in greater detail than any other found literature, within a South African context relating PFMA, MFMA, The Constitution and National Treasury regulations. Business models are detailed to achieve good cash management. This text offers procedural

measures that should be implemented in order to assist with the achievement of the objectives as set out in statute. Similar to the previous text policies are dealt with at National level and does not deal with the local government fiscal capacity in detail. Visser and Erasmus advocates the earning of greater interest on investments, preparation of debtors aging for management follow-up, referral of debts to the attorneys for collection and that late payment of creditors necessarily incurs added financial burden of interest payment. Both texts seek to use compliance in terms of statute, relating to working capital management, to assist with better liquidity and

Following similar ideology is Fourie and Opperman, who provide a dedicated text to the subject of municipal finance and accounting that affords the academic greater insight into this field. The level of detail in chapter three of the text allows for greater focus on local government, yet, is prescriptive in terms of policies and procedures relating to relevant statute, therefore looking primarily at compliance. Creditor repayment procedures, debt collection procedures, requirements for raising rates and cash management procedures are discussed providing a framework for working capital management that is in line with the MFMA. This was the only text book that included a discussion on indigent the importance of correct identification and the related accounting implications. The researcher understands that business in government has the burden of increased regulations, yet appreciates that sound business practice formulated within the private sector should be adopted to improve fiscal capacity.

The three texts discussed offer frameworks for legal compliance relating to the sub constructs of working capital: the authors speak of generating own revenue yet, do not actively promote exploitation of fiscal capacity. Theoretically, sound working capital policies are expected to provide opportunities for fiscal exploitation, yet, this is inferred rather than stated by the preceding texts.

Swaneveld, (Swaneveld, 2005), introduces in his article the new ratios that would assist with interpreting performance of the municipality. The ratios are relevant in that they provide information on trends in expense and comparatives on allocations of rates to general expenses: manipulating income and expenses to generate comparisons. The author does not

include balance sheet items in his analysis of performance and therefore does not emphasise the importance of basic working capital ratios as a performance measure. Liquidity ratios and trend analyses were omitted. Swanepoel has however, brought the importance of structured and tailor-made ratios to the public sector to assist in the interpretation of municipal financial information regarding revenue and expenditure.

SALGA, (SALGA, 2010), "All municipalities, including those heavily dependent on grant funding, should exert the maximum effort to collect their own revenues, even though these may be limited. SALGA will continue to strongly encourage its members to do so by improving metering, billing, credit control and other dimensions of revenue management." SALGA argues that the existing fiscal policies should be reviewed and the possibility of implementing a local business tax should be tabled at national level; this would increase the fiscal capacity of municipalities. The researcher agrees that additional taxes and levies payable by residents and local businesses would improve the fiscal earning capacity of municipalities. However, the purpose of this research report is to identify the relationship between **existing** statute/regulations and good business practice on the fiscal capacity of municipalities. SALGA has identified challenges in collecting valid source data to raise revenue in meter readings: meter readings that are excessive will be queried by the ratepayer, whereas, meter readings that are far lower than anticipated will cost the municipality in lost revenue. This forms part of the accounting process that impacts on working capital management in so far as proper policies may be followed with incorrect information. This makes an analysis of whether working capital policy can influence the income earning potential of a municipality difficult.

Schoeman, (Schoeman, 2006) quotes the then Auditor General, "Overall an alarming trend was discovered, namely the debt management and the basis of income generation might not provide sufficient funds for delivering the services expected of municipalities. This means that sustainability of service provision by local government has to be called into question." Schoeman states that, "The process of fiscal decentralisation has not been without problems. In many instances municipalities lack capacity both in terms of skills and finances. National governments have been accused of using the municipalities as a dumping ground for ex-politicians who do not make it in the national or provincial sphere. Corruption and other malpractices seem to bloom – especially in the local government sphere, with a severe lack of electoral accountability." Schoeman argues

that municipalities may not necessarily be better off having their own fiscal capacity due to human resource issues. Schoeman does agree in principle that decentralization has not proved successful in the smaller municipalities. Municipalities lacking accounting skills to adequately understand and implement working capital policy makes gathering of information difficult and could adversely affect this research findings. Schoeman speaks of working capital issues, "... although revenue collected and expenditure is on the increase, the gap is widening, filled by an exponential increase in grants and subsidies from national government. The reason is obvious; the increase in the period within which revenue is collected is on the increase which causes liquidity and cash-flow problems that are not taken into account when funds are spent.", but offers no reason apart from poor management for increase in debt. This report attempts to form a link between sound working capital policies and improving fiscal capacity. The author has provided evidence that under collection of revenue has placed a greater burden on National funds. The researcher will look to evidence gathered to determine if sound working capital policy can remedy this situation.

Muller, (Muller, 2007), states, "The sources of funding for the provision of social and utility services and related infrastructure come from various sources. While it is commonly argued that the social responsibility services should be provided from the rates charged on property, it cannot be denied that the surcharges on fees for services provided by or on behalf of the municipality are also a significant income source of funding in many municipalities. These are also the revenue streams that can be significantly controlled through credit control and debt collection actions." Muller recognizes the power of the legitimate fiscal capacity of municipalities. Muller then acknowledges the limitations of raising new municipal taxes to increase fiscal capacity. The author reverts to sound debt and credit management policies, (part of working capital policy), in order to maximize collecting own revenue.

Kanyane, (Kanyane, 2011), states, "Presumably, without sound financial management systems, municipalities will be forced to discontinue their operations. However, studies in Public Administration confirm that the majority of rural municipalities in South Africa are not self-viable." Kanyane presents a statistical analysis to prove that rural municipalities are experiencing sustainability issues yet his paper does not relate poor cash flows to inappropriate working capital policies directly: The researcher is uncertain if this is inferred by the writer. However, relating

Kanyane's statement to that of Schoeman's, (referring to staff lacking skills), the implementation of sound working capital policies could be adversely affected.

Bubangizi, (Mabungizi, 2008), writes that, "Own resources are drawn from, property rates, electricity charges, refuse removal charges as well as water and sanitation charges. The nature of these levies means that the metropolitan and urban-based municipalities are well placed to draw revenue from these sources as opposed to their rural counterparts. It is in the metros and larger towns that one finds property of high value, high consumption of electricity and other municipal services. This is to say that some urban-based municipalities have a higher tax base and are thus better placed to mobilise funds from their localities; this gives them an unfair advantage over rural municipalities." The argument suggests that exploiting one's fiscal capacity in a municipal entity is determined by the size of the municipality and income of one's constituents, and not directly related to sound financial policies. This research report looks whether working capital policy can be used to exploit this 'tax base', regardless of economic and geographic variables. The discussion of rural municipalities and the challenges they face in exploiting fiscal capacity is of paramount importance to this study as the majority of the participants in this study are rural municipalities. Geographical location, like the writing of Kanyane, (Kanyane, 2011), has been cited as a limiting factor in exploiting fiscal capacity in a municipality.

An article by Kevin Allan and Karen Heese, (Allen and Heese, 2011), on local government revealed that municipalities are not exploiting their fiscal capacities. The article identifies that municipalities are relying more heavily on grants than their own revenue generating ability. They do offer reasons for fiscal capacity being marginalized in certain areas, yet this is not linked to financial models or management styles. What issues have affected the collection of own revenue has not been identified and this requires further investigation so as to formulate remedial and corrective measures to improve the collection of own revenue.

Lubbe and Rossouw, (Lubbe and Rossouw, 2005: 1), on sustainability: "The culture of non-payment, and other reasons, have increased the outstanding debts of municipalities and other public institutions for services rendered by them to disturbing levels. This situation is so serious that one of the most important building blocks of the public sector, namely municipalities, can collapse." Lubbe and Rossouw highlight the

importance the impact of revenue collection and debtor management have on the sustainability of municipalities. The politics and economics associated with non-payment for services is discussed along with the accounting concept of recognition and measurement. The authors also consider the overstatement of debtors as an attempt to window dress the financials. The article implies that sound working capital policy may not always yield increased collection in own revenue.

Serfontein, (Serfontein, 2009), states, "Providing for bad debt and writing off bad debt can become a complicated issue. The complexity of the situation is worsened because of the not-so-straight-forward combination of GRAP/SA GAAP (IFRS) standards that municipalities have to use. In municipalities and many public entities other factors also play a substantial role in determining bad debt write-offs and provisions; for example political considerations and the nature of debtors found in the various sectors." Serfontien identifies challenges in valuing provisions in this instance, a provision based on fiscal capacity and like Kanyane, (Kanyane, 2011), looks at financial systems working effectively, and, like Schoeman, (Schoeman, 2006), looks at the skills of finance staff. It is understood that normal business transactions will entail a degree of non-payment for services or goods: this is an inevitable concomitant of business. However, in municipalities the valuation is subjective. It is based on factors that are unique to each to each municipality and different accountants could value the same municipality's provisions at differing amounts.

Peel, (Peel, 2004), "In a recent report to Parliament, the Auditor-General, Shauket Fakie, questioned the ability of South African municipalities to continue operating as going concerns. He commented that municipalities' mounting level of uncollected debt relative to their income was a cause for concern." Peel reiterates the statements of Lubbe and Rossouw, (Lubbe and Rossouw, 2005), and Schoeman, (Schoeman, 2006), on under-collection of revenue. Raised revenue is evidence of fiscal capacity, yet, by itself, does not guarantee cash inflows: challenges in collecting revenue signals a potential risk to the exploitation of fiscal capacity.

Espach, (Espach, 2009), does not focus, "on those that will not comply with the provisions of section 89 of the MPRA, but the real life challenge to implement the legislation." Espach looks at implementing the Municipal Rates Act and why legislation cannot be always implemented. This has financial and operational risks attached: the value of rates may not be valid and the amount collected insufficient to fulfill the expectations of the

municipal budget. The condition that the municipal budget must be funded is vital to achieving liquidity/working capital and sustainability. This article relates to the Municipal Systems Act (Chapter 9), requires the maintenance of up to date, relevant and reliable data bases on which the amounts to raise and collect revenue will be based.

SALGA, (SALGA, 2012), reported on many issues that required attention at municipal level. Some of these were that “municipalities must exercise their responsibility to close the Fiscal Gap”, “Explore the possibility of developing norms and standards for billing and other systems to enhance the ability of municipalities to collect outstanding revenue”, “Maximise current revenue (e.g. minimise water and electricity distribution losses).”, and, “Efficient Debt Collections (that accommodates the prescriptions of indigent policies)”. These are working capital issues that SALGA indicates requires special attention. These are income generating activities that are related to working capital. SALGA implies that working capital policies would assist in remedying the problems. This research report seeks to either prove or disprove this inference.

3.3. Conclusion

The above review places emphasis on working capital to improve liquidity and sustainability and offers guidance in terms of management models to exploit the potential for improved cash flows. However, there is no literature available that indicates that the application of the MFMA or proper private sector working capital models would, in deed, work within the South African municipal environment. Does the correct implementation of working capital policies positively impact on a municipality's ability to generate its own income, or, are there other factors affecting municipal fiscal capacity?

A gap in the literature exists.

4. Chapter four – Research methodology

4.1. Introduction

“The main purpose of research methodology is to explain the nature and process of research.” (Wellman et al., 2010: ix) What is the researcher going to do and how will this be done. Accounting figures tell a story on their own, yet without explanation, can often be misleading. Management that put together accounting information can manipulate data and formulate explanations to gain favour for their own agendas. Therefore, the nature of this research requires the researcher to explore many different sources and types of data.

4.2. Data types

The two primary types of data are qualitative and quantitative. Data that cannot be analysed in terms of mathematical techniques is considered qualitative, (Guler, 2004: 13). Quantitative data relates to data that can be expressed in numeric form, (figure), and can be either primary or secondary. Primary data, “comes from original sources and are collected especially to answer our research questions”, while secondary data, “is a source material that has been collected by others for their own purposes” (Emery and Cooper, 1995: 240). Qualitative data will be collected by interviews and questionnaires. The opinions and observations of municipal finance staff and municipal consultants will be collected. Municipal consultants’ observations will be used primarily to either validate or, challenge the findings of the report.

For quantitative data, the researcher will have to rely on two types of data; audited and unaudited. Years 2008 – 2010 will have been audited by the Auditor Generals’ office and can therefore be considered primary data, (external observation and audit of financials). The financials for 2011 have as yet to be audited and this data will be considered secondary.

Qualitative data will all be secondary data as the researcher will collect thoughts, opinions, observations and inferences from both internal sources, (within the municipalities), and external sources, (consultants). Quantitative data will be collected from interviews and the questionnaire, and financial information available on government websites.

4.3. Research design

“A research design provides the glue that holds the research project together. A design is used to structure the research , to show how all the major parts of the research project - the samples or groups, measures, treatments or programmes, and methods – work together to address the central research question(s).” (Laxton, 2004: 35/6). Three questions are critical to the research design: (Questions from Laxton, 2004:36)

- What techniques will be used to gather the data?

Questionnaires for municipalities, interviews with municipal finance staff, interviews with consultants, Government web pages of the different participating municipalities and newspapers and other reputable publications. All participants will be contacted telephonically to ask permission to e-mail, facsimile or post the questionnaire to the municipality and to provide a background to the reason for the research.

- What kind of sampling will be used?

All fifty one municipalities in Kwa-Zulu Natal, (geographical region), will be invited to participate, (district municipalities excluded). (This geographical region will be used to for this pilot study to facilitate refining of the measuring instrument, (Wellman, et al., 2005: 148), namely working capital, as a means of exploiting the fiscal capacity of municipal entities.) The sample used will depend on those municipalities that respond with completed questionnaires.(All returned questionnaire will be included in the sample.)

Two sampling methods will be used: (Lewis et al., 2003: 176-7)

- *Snowballing*

The researcher is to make contact with one or more municipal finance officers and ask for introductions to other finance officers (to set interview dates) from other municipalities, or, ask these officers to hand the questionnaire to their peers in other municipalities. The advantage of this method relevant to this report is that, “... respondents are most likely to identify other potential respondents who are similar to themselves.” (Lewis et al., 2003: 176).

- *Self-selection sampling*

“Self-selection sampling occurs when you allow a case, usually an individual, to identify their desire to take part in the research

.... collect data from those who respond.” (Lewis et al., 2003: 177). There is no legal obligation on part of municipal finance staff to complete questionnaires from external researchers. The researcher can offer no incentive for the filling in of questionnaires except sharing of the results of the research. This makes little choice for the researcher in terms of sampling techniques.

- How will time and cost constraints be dealt with?
Time constraints are set at six weeks after sending out emails with requests for interviews and questionnaires attached. All completed questionnaires returned within this period will form the basis of this research.
Costs will be kept at a minimum by:
 - a) Hand delivering questionnaires to an area from Pietermaritzburg to Hluhluwe only.
 - b) Interviews to be conducted in person only between the above mentioned areas.
 - c) Telephonic and/or electronic interviews for all remaining areas.
 - d) Scanning and emailing of completed questionnaires to the researcher will be requested so as to save time and decrease the risk of lost completed questionnaires.

4.4. Data collection instrument

“A research instrument is pretty much anything that you use to get the data that you are going to analyse. That can range from questionnaire to laboratory equipment to psychological tests or any other tool that provides you with data to analyse.” (Hofstee, 2009: 115/6).

a) *Questionnaires*

“Surveys can be an excellent way of finding out peoples’ opinions, desires and attitudes,” (Hofstee, 2009: 122) This was the primary reason for the questionnaire being used as a research tool: financial data is freely available from the National Treasury website, yet, the underlying explanations and assumptions that these figures were based on lies with the officials of the respective municipalities. Accounting figures without explanations is like looking at an iceberg; the viewer sees only a part of the whole. This also creates a non-threatening environment in which the respondent can address the

questions in the survey. These have been designed in a user-friendly manner with the quantitative data relating to line items in the financials. Qualitative data can be indicated by way of ticks and short explanations.

The purpose is to gain a holistic view of what has transpired in the municipality for the period of the research.

b) Interview questions for finance staff - municipalities

This provides an additional opportunity for officers to provide background information, their opinions and thoughts on working capital issues. Questions are designed to be brief and not to lead the respondent.

The type of interview will be a structured interview, (Lewis, et al., 2003: 246), where respondents will be presented with, "... predetermined, and standardized or identical set of questions." This is to avoid random comments and remarks and to create greater focus on key issues. Standardization affords easier comparison of responses. Respondents will be allowed an informal interview thereafter where any issues that the participant places further emphasis on will be discussed and recorded. Permission for interviews will be obtained from senior municipal staff and senior consultants and times and venues for the interviews will be mutually agreed upon.

c) Interview questions for consultants – public entities

This will provide independent and corroborative evidence to findings. Due to insufficient current literature on this subject, consultants could provide additional evidence through their working at the different municipalities in the geographical area.

d) Internet – world wide web

Peruse municipal and National Treasury websites for financial and non-financial indicators that could increase the quantity of evidence. Management reports will be of particular value when explaining peculiar circumstances that the entities encounter.

e) Newspapers and other publications

Current information from independent sources will add to understanding of the entity itself. Generally, newspapers provide candid views on what has transpired and objectivity is generally maintained through journalistic integrity.

4.5. Conclusion

The research methodology has been tailored to meet the specific needs of this research. Municipal entities are inundated with many different forms to fill in on a monthly basis and a voluntary research questionnaire is not high on the list of priorities of municipal staff and, this is a time of great importance as unaudited municipal financial statements are meant to be released early February, (Mkwanazi, 2012). In addition, most consultants from the Development Bank of Southern Africa are experiencing greater challenges at work and are working under time constraints, (Maharaj, 2012). This has meant a research methodology that is very user friendly and succinct; questions are focused and unambiguous.

Data from internal and external sources will be collected so as not only to improve the quality and reliability of findings, but also to highlight any anomalies that could require further investigation.

5. Chapter Five – Results and Discussion

5.1. Introduction

The province of Kwa-Zulu Natal was chosen as the sample for this study. Questionnaires were sent to all 51 municipalities. Of the 51 municipalities, nine, (9), responded. This led to interviews conducted either telephonically, electronically or in person with representatives from seven of the nine municipalities, (one respondent from the returned questionnaire population declined further participation due to time constraints).

The list of respondents for the questionnaire:

- Ethekeweni Municipality – Durban
- Kwa-Dukuza Municipality – Stanger
- Maphumulo Municipality – Maphumulo
- Mathonjaneni Municipality – Melmoth
- Msunduzi Municipality – Pietermaritzburg
- Ndwedwe Municipality – Verulam
- Big 5 False Bay Municipality – Hluhluwe
- Umhlatuze municipality – Richards Bay/Empangeni
- Umlalazi Municipality - Eshowe

This represents four districts, (Ilembe, Umkanyakude, Uthungula and Umgungundlovu) and one metropolis, (Ethekeweni). Looking at the respondents provincially provides a questionnaire return rate of 17.64% was achieved. However, looking at the response from the district and the number of potential respondents, one finds a questionnaire return rate of 37.5%.

The list of respondents for the interview:

- Kwa-Dukuza Municipality – Stanger
- Maphumulo Municipality – Maphumulo
- Mathonjaneni Municipality – Melmoth
- Msunduzi Municipality – Pietermaritzburg
- Ndwedwe Municipality – Verulam
- Big 5 False Bay Municipality – Hluhluwe
- Umhlatuze municipality – Richards Bay/Empangeni

Four independent consultants to municipalities were interviewed; three municipal finance consultant and one property valuator.

Several challenges arose as in the information collection process:

- Government databases from both MEC's office and COGTA did not have up to date email addresses for financial staff at KZN municipalities. "This is regretted, as it is the info directly supplied by the municipalities. We will investigate. Attached is a list which was updated by this office in August last year. I am submitting it to you in the hope that you will find it useful." (COGTA, 2012) However, the researcher did manage to collect all necessary information regarding contact details of chief financial officers, (CFO), through different methods of enquiry; telephonic, email and speaking to other CFO's.
- The timing of the research coincided with the release of the unaudited financial statements of municipalities for 2012. Many staff members did not have sufficient time to fill in the questionnaire. (The questionnaire is seven pages long.)
- Mandeni Municipality proved unique; the staff member asked to fill in the questionnaire, (by the CFO), remarked that there was no financial compensation to complete this questionnaire: The CFO later replied that they simply did not have the time to complete the information.
- The remaining 41 municipalities did not respond nor provide reasons for not submitting a completed questionnaire.

5.2. Discussion on qualitative issues

Responses from Questionnaires

a) What would you regard as the management style of your entity?

Casual	44%
Democratic	23%
Strict	33%

Given that municipalities are government entities governance is in terms of regulated guidelines in terms of financial and human resources. It is noted that one municipality using the casual style of management has only come out from under judicial management in January 2012. Where strict management styles have been in place, one notices a vast improvement in financial results; case in point –

Kwa-Dukuza Municipality which achieved the highest rating in South Africa this year for their financials. (Weekly Reporter, 2012)

Schoeman, (Schoeman, 2006), has identified lack of skills as impeding the debt collection function. In light of this, a stricter management style with a high degree of supervision should be better suited.

b) Staff turnover in cash, debtors and creditors.

Not significant	22%
Low	67%
High	11%

The majority of municipalities recorded a low staff turnover. One municipality that does have a high staff turnover, responded that they would welcome adequately qualified, pro-bono assistance from external sources to assist as there are definitely problems with continuity and familiarity of important issues, (Mkhwanazi, 2012). All three independent consultants observed that most municipalities have some assistance from various different in This municipality has experienced challenges with timeous preparation of financials, monthly statements and handling long term matters, (indigent register).

c) Does the municipality have a documented working capital policy?

Yes	33%
No	67%
Unsure	-

The MFMA is very clear on issues of working capital:

- S 64 revenue management – calculate revenue monthly, raise debtor, charge interest on overdue accounts, has a system of internal control for debtors and revenue, weekly revenue reconciliations.
- S 13 (b) invest monies not immediately required,
- S 62(1)(f) – tariff policy, rates policy credit control and debt collection policy and supply chain management policy.
- S 65(e) Pay municipal creditors 30 days on invoice or statement.

- S 71 (g) – must do variance analysis of projected and actual revenue.
- S 97 (b) – that all revenue due to the municipality is collected.
- S 65 (g) -municipal officials effectively and economically manage the municipalities available working capital
- S 63 (c) that the municipality has and maintains a system of internal control of assets and liabilities.

These sections detail the manner in which municipal managers should effectively create their own working capital policy within defined parameters. 67% of respondents have not acknowledged the individual working capital components within the MFMA. All three consultants, when asked whether their experience has shown that municipalities are not coping well with working capital issues, replied, “No.” (De Kock, 2012; Brooke-Leggatt, 2012; Dickason, 2012) The evidence gathered supports their observations.

d) Has the municipality had a working capital audit?

Yes	22%
No	78%
Unsure	-

According to the PFMA National Treasury checklist refers to “Does the public entity: ... manage available working capital efficiently and economically?” (National Treasury, 2005) In fact, all municipalities have an annual working capital audit by the Auditor General. 78% of respondents were unaware of this. This would be indicative of the lack of knowledge or misunderstanding that could further complicate financial matters.

e) What is the position regarding indigent ratepayers and the balance sheet?

Treated as foregone revenue	89%
No indigent list	57%

According to interviewed respondents, 57% indicated that the indigent register was not up to date. Two respondents who did indicate that their indigent register was up to date qualified this statement by

adding that all those indigents who have applied for concessions have been added on to the list. Indigent debtors have to be identified or they will clutter the debtors and have interest accrued on their accounts: debtors' balances will be overstated. Van Schalwyk, (Van Schalwyk, 2003:12), "Indigent customers have a right to basic services, even though they may be unable to pay for such services. Any credit control policy is created to collect as much of the arrears in as short a period as possible, and herein lays the dilemma for both the indigent customer and the official. Unless the debt management philosophy and the tariffs for basic municipal services are structured to assist the indigent, those charged with collecting the Council's revenue would remain in this catch twenty-two-situation." The writer succinctly provides the argument why all indigents should be identified.

f) What are the procedures followed when accounts are in arrear?

Most have procedures that are in line with legislature and good business practice. Services are disconnected whereas, in terms of rates, the final step is handing over of the debtor to an attorney. The procedures to be followed are detailed in Pauw, (Pauw, et al., 2010: 219)

- Reminder letter
- Telephone call
- Withholding of further services
- Debt collection agency
- Legal action

However, one respondent indicated that much of this procedure rests with authority being granted from the District Municipality and oftentimes, "a year can go by without response from the District regarding your query." (Mkhwanazi, 2012).

g) Is interest charged on overdue debtors?

In terms of Treasury Regulations 11.5, interest has to be charged on debts outstanding. 89% of respondents said that interest is accrued. Only one respondent replied in the negative, yet, the researcher has reason to believe that this was an error: question 2.9 of the same questionnaire for the same respondent stated that the system accrues for interest automatically for rates only.

h) Percentage interest charged on overdue accounts

Answers ranged from prime + 1, to prime, 7%, 11%, 12%, two municipalities at 18%, one at 15% and one “no response”, (all per annum). The maximum set by government is 18% p.a. Reasons for differences is that some municipalities have found that ratepayers will pay if the interest rate is low, yet, some financial officers claim that interest rates do not play a significant role when collecting outstanding debtors; “Ratepayers who do not pay, will not pay.” (De Kock, 2012, personal interview) However, Dickason argues that, (Dickason, 2012; e-mail), “The 12% agreed upon by council has worked well. A larger percentage of outstanding debts have been collected since the implementation of this percentage. The economic downturn and high unemployment rate has been the primary reason for accepting the 12%.”

Municipalities are choosing interest rates based on individual circumstances. Kwa-Dukuza municipality has recorded success by doing this. However, increased collection has yet to be evidenced in the remaining municipalities.

i) Does the accounting system automatically accrue for the interest?

All but one respondent replied in the positive. The one respondent does not allude to how interest is charged on debtors’ account; simply that the system does not accrue for interest. In terms of internal controls, it is best for the system to automatically accrue as this would prevent loss of income and complaints due to:

- The debtor not being raised
- The interest rate used differing from debtor to debtor
- Method of calculation not consistent, and,
- Incorrect calculations of interest by incompetent staff and or, human error.

j) Are monthly management reports prepared for cash, debtors and creditors?

100% replied, “Yes”. This is in keeping with National Treasury regulations that these reports be issued to Provincial Treasury before the second week of the new month for the preceding month. Therefore, these reports are filled in in the prescribed format on prescribed forms.

k) Are reconciliations between actual and budgeted working capital performed?

In terms of MFMA, monthly reconciliations must be done to determine variances. These variances tell a story of either, what went wrong, or, what went right. Without this type of analysis, it would be difficult to monitor a municipality's performance with regard to achieving working capital objectives. Only 56% of respondents actually do reconciliations and variance analysis. This means that the other 44% are either not monitoring performance, or, are looking to the Auditor General's report to analyse performance. Without variance analysis, the municipality will face challenges in terms of the appropriateness of its budgetary process, the achievement of objectives and monitoring internal controls. Schoeman's, (Schoeman, 2006), statement on the staff lacking skills could well be evidenced by these responses. This is also in keeping with the independent municipal consultants' observations that there are many intervention programmes where consultants are placed in municipalities to address skills shortages. (Brooke-Leggatt, 2012; De Kock, 2012; Dickason, 2012)

l) How often is virement performed?

This question was added to give managers a fast look at the budgetary process and its counterpart, reality. One respondent chose not to answer while 33% said that it was greater than 10 times p.a., 33% - 5 to 10 times p.a., and, 22% said that it occurred less than 1 to 5 times p.a. Virement normally affects expenditure votes creating challenges in that income is calculated and generally under-collected, whereas, expenditure is generally prudently budgeted for. This leads to inequities in the working capital cycle and management through improper assumptions and unrealistic cash flow projections.

m) What are the main concerns surrounding the collection of cash from debtors? (A list of responses from all municipalities.)

- Incorrect addresses of debtors
- Culture of non-payment
- Database not up to date
- Economic downturn
- Affordability
- Unemployment
- Lengthy legal process to collect outstanding monies

- Large section of indigent ratepayers that have not applied for indigent concession.
- Water and electricity meters read incorrectly, not working or averaged.

5.3. Discussion on quantitative issues

a) Revenue - Rates

There are three distinct components of revenue in a municipality:

- Fixed revenue – rates and services
These are fixed in the sense that we cater for them in the short term and in the absence of many new homes being built, the amount can be predicted and budgeted for with ease. In all municipalities this is determined by the number of ratepayers. Rates should increase by the annual advertised rate and services by the cost of the chosen service provider through proper procurement methods.
- Revenue that the municipality can raise through personal effort
This is the letting of equipment and rental of facilities and interest on investments. If actively pursued, this could be an economically viable activity. Municipalities do not actively pursue these activities and as a result revenue is lost to the public or the not-for-profit sector in terms of hiring. Monies that are not utilized require investing. If these monies are not invested, interest is foregone.
- Revenue that is controlled by the public
This would include fines, licenses and permits and interest earned on debtors. The public determine fines by breaking the law. Licenses and permits are demand driven and interest earned on debtors is reliant on debtors not paying their accounts.

The purpose of working capital management is to bring all of these revenue types under the control of the municipality in order to maximize its revenue earning capabilities.

All municipalities have shown increase in revenue from rates over the periods under review, (2008 – 2011). The legislated function of raising revenue through rates has been adhered to.

Espach, (Espach, 2009), provides a realistic outlook on the MPRA and the challenges faced when implementing this Act. The MPRA provides clear, unambiguous guidelines on the raising of revenue yet its implications may at times be difficult or precarious; Gordon, (Gordon, 2012), speaks from the experience as a valuator, (25 years) and has the following to contribute:

- Property values in the valuation roll, (municipal record of property values), are generally undervalued: Should properties be considered overvalued, the ratepayer makes application for his property to be revalued and hence, his rates are lowered.
- Valuers do not, “push the envelope; they follow the easy line and come under the market value - prudence.” This means rating is based on a lower value.

b) Debtors

The raising of revenue in most cases is a simple task; the information system does this. True exploitation of fiscal capacity comes from the collecting of said revenue.

In terms of debtors to rates and services in year 2011:

- Kwa-Dukuza Municipality – 29%
- Ndwedwe Municipality – 33%
- Maphumulo Municipality – 77%
- Ethekeweni Municipality – 32%
- Big 5 False Bay Municipality – 45%
- Umlalazi Municipality – 28%
- Mathonjaneni Municipality – 20%
- Msunduzi Municipality – 46%
- Umhlathuze – 11%

The analysis shows a decided move towards debtors not being collected timeously. Msunduzi, having just come away from judicial management, together with Maphumulo, indicates collectability issues. Msunduzi have a database issue, (Sahibdeen, 2012), and Maphumulo, a title deed issue, (Manqele, 2012). Umhlathuze performs well on paper

due to the adoption of the presentation of accrued debtors according to the matching principle: 0 – 30 days debtors have two months debtors, (Renald, 2012).

Maphumulo municipality has large outstanding debtors and Manqele, (Manqele, 2012), raises the issue of title deeds not being handed to the Ngoyama Trust; “The people do not have their title deeds so they will not pay rates and our system has to raise these rates for compliance to be met.”

Sahibdeen, (Shaibdeen, 2012), on the Msundizi Municipality, (another municipality with very high debtor balances), raises key issues affecting revenue through rates and services:

- “Debt collection policy requires redressing,
- Database clean-up of addresses as these are incorrect for over 100 million rands worth of debtors,
- Top 100 business’ in the area are not paying and are perpetuating a culture of non-payment,
- The indigent debtor register is not up to date, and,
- The poor economic situation.

This shows a revenue collectability problem, (serious challenge to sustainability and the going concern principle), in the responses and is in keeping with the studies in the literature review; (Schoeman, 2006; Muller, 2007; SALGA, 2010; Lubbe and Rossouw, Peel, 2004 and SALGA, 2012). Working capital relies on cash inflows at regular and predictable intervals to meet planned cash outflows. Contractors are paid for services regardless of whether debtors have paid their accounts, (MFMA 30 day requirement), meaning budgeted income is necessarily timeously matched to budgeted expenses. When income is insufficient to meet expenses, liquidity challenges are faced.

The high incidence of indigent registers being not up to date creates the situation where an unrealistic debt is raised and kept in the records until the ratepayer fills in the necessary forms to apply for exemptions and relief.

c) Creditors

In terms of the MFMA, creditors must be paid within 30 days of statement or invoice.

Municipality	30 days adhered	early settlement discounts
Kwa-Dukuza Municipality	Yes	No
Ndwedwe Municipality	Yes	No
Maphumulo Municipality	Yes	No
Ethekweni Municipality	Yes	Yes
Big 5 False Bay Municipality	Yes	No
Umlalazi Municipality	Yes	No
Umhlatuze municipality	Yes	Yes
Mathonjaneni	Yes	Yes
Msunduzi Municipality	Yes	No

The table indicates that the legislated 30 days is adhered to strictly, yet, only 33% of respondents actively seek to add monetary value to their municipality by seeking early settlement discounts. This is not in keeping with the tenets of sound working capital policy and fiscal capacity can therefore, not be fully exploited.

d) Acid Test Ratio (Current Assets - Inventories: Current liabilities)

This ratio should be either at or above 1:1, meaning that in the very short term, the municipality can pay off creditors with cash and 'near-cash', ('near-cash' = debtors).

Name of Municipality	Quick Ratio - (Current ASSETS - STOCK): Current Liabilities			
	2008	2009	2010	2011
Ethekweni	1.04:1	1.03:1	0.96:1	1.14:1
KwaDukuza	3.83:1	4.47:1	4.77:1	4.56:1
Maphumulo	0.52:1	1.38:1	0.86:1	0.66:1
Mathonjaneni	0.32:1	N/S	N/S	N/S
Msunduzi	2.55:1	2.03:1	2.4:1	3.61:1
Ndwedwe	N/I	N/I	0.55:1	1.44:1
The Big 5 False Bay	N/I	1.88:1	1.02:1	27.36:1
Umhlatuze	1.11:1	1.02:1	0.89:1	0.83:1
Umlalazi	2.15:1	1.47:1	1.65:1	2.10:1

N/I = No information; NS = no information supplied

Evidence from this analysis suggests that Kwa-Dukuza municipality could be used as for possible best-practices benchmarking in that this municipality scores highest on the quick ratio. This is in keeping with the findings of Ratings Afrika Municipal Financial Sustainability Index, (Weekly Reporter, 2012.), which rates this Kwa-Dukuza Municipality as the best performing municipality in South Africa with an index points score of 86.

e) Revenue from rental of facilities and equipment.

Increasing	67%
Decreasing	33%

Renting of equipment and venues is in generally on the increase. In Maphumulo and Ndwedwe, (the two most rural communities in the study), the revenue collected from these two activities has almost doubled. Discussions with municipal staff, (Mkhwanazi, 2012; Khoza, 2012 and Dickason, 2012) have all stated that there is no actively pursued marketing process to improve the income from these rentals. Dickason, (Dickason, 2012), further indicates that in his years of municipal consulting he has not encountered any municipality that actively markets the rental of venues and equipment. SALGA, (SALGA, 2012), urges municipalities to collect more revenue through all available means. This infers a lack of entrepreneurial skills in municipal management.

f) Revenues fines

Increasing	33%
Decreasing	44%
Do not possess this fiscal power	23%

A large percentage of municipalities are not fully exploiting the revenue generating activity of issuing traffic fines. With the new Zero-Tolerance policy by the Traffic Department, one would expect a consistent annual increase in fines collected in the financial statements. SALGA, (SALGA, 2012), urges municipalities to collect more revenue through all available means.

g) Interest earned - external

Yes	67%
No	22%
No information supplied	11%

The MFMA requires additional cash to be reinvested so as to earn interest; S 13(b). The evidence is indicates that six municipalities engage in this practice. The two municipalities that have earned no interest is due to lack of funds to invest, (Mkhwanazi,2012; Manqele, 2012). In terms of National Treasury providing grants in line with the approved budget, there should be unspent monies to reinvest. The

lack of investments and interest income is in line with Schoeman, (Schoeman, 2006), Allan and Heese, (Allan and Heese, 2011) and

5.4. General Conclusion

The respondents' responses have been analysed and interpreted and compared to existing knowledge and practices. Data used was obtained directly from the respondents.

This data reviewed against the backdrop of legislature, the literature review and the research statement has created new knowledge in the area of public finance.

The detailed conclusions and recommendations are detailed in chapter six.

6. Conclusion and Recommendations

6.1. Introduction

The research statement seeks to find evidence that supports the hypothesis that sound working capital policy will enable a municipality to exploit its fiscal capacity, and hence improve its own revenue generating and income collecting abilities thereby placing less reliance on unbudgeted grants and bail-outs by Provincial and National Treasury.

The data gathered from the nine municipalities has been analysed in terms of chapter four research studies of other scholars.

This study is intended as a pilot study, and only one factor was looked at when attempting to determine maximizing fiscal capacity; working capital. However, working capital, at municipal level, involves primarily three sub constructs; cash, debtors and creditors. The study covered all three areas on a relatively small sample and further research is required.

6.2. Conclusions

The analysis of the qualitative and quantitative data gained has provided a basis for academic discussion and conclusions on the research hypothesis. Decentralisation, (Schoeman, 2006), has provided local government with fiscal capacity to generate its own income. The evidence suggests that the scope exists for fiscal capacity to be exploited and, this scope and related monetary amount, rests solely with the financial management teams of municipalities.

The evidence that has been gathered shows an attempt by municipalities to comply either wholly or in part with the provisions of relevant legislature. In keeping with the findings of Bubangizi, (Bubangizi, 2008), it has been noted that rural municipalities face greater challenges with issues of compliance and financial performance.

The research results have indicated many obstacles and challenges to implementing good working capital policy from a high staff turnover and skills shortages to incorrect source data, (billing of potential indigent debtors), and incorrect database details.

For the hypothesis to be tested, it was imperative that sound working capital policies be in place. Evidenced poor working capital management in most municipalities indicates that this hypothesis can neither be proved

nor refuted. The research provided no evidence to suggest or infer any attempt, on the part of municipal staff to exploit the municipalities' earning abilities and potential, or, display municipal staff's entrepreneurial skills apart from legislated activities.

The evidence suggests that the management of municipalities is compliance driven and most municipalities do not achieve a high level of compliance, (Weekly Reporter, 2012). There is no evidence to suggest that exploitation of fiscal capacity is placed in management's daily agenda.

6.3. Recommendations

- Further studies are to be done in this field.
- Programmes are to be implemented to assist municipal managers and chief financial officers with entrepreneurial skills.
- Government needs to take a more realistic view of the fiscal capacity of municipalities in rural areas. Rural communities show a higher incidence of non-payment and indigent ratepayers. Finance officers should be encouraged to be prudent and conservative in their estimate of revenue.
- Municipal boundaries require restructuring in terms of the income generating ability of that area. Boundaries should take cognisance of the fiscal capacity of the demarcated area, and grants and subsidies (equitable share), should be awarded accordingly.
- Greater emphasis needs to be placed on workshops relating to working capital and the positive synergistic effect that well managed components have on cash flow. This should be done in relation to the MFMA regulations dealing with cash, debtors and creditors.
- There should be a provincial drive to assist municipalities update their indigent registers.
- Intervention at provincial level to expedite matters where land owners, occupying their land, are not in the possession of title deeds.
- The national suggested norm, (18% p.a.), for charging interest on outstanding debtors' accounts should be reconsidered as this places a greater financial burden on ratepayers who are unable to pay. Kwa-Dukuza Municipality has decreased interest to 12% p.a. and found that this has assisted in collecting a larger percentage of outstanding debtors.

- The control environment in which management operates should encourage a stricter tone as this management style proves to augur well for better financial management.
- Use of structures in Municipal System's Act, (Act 32 of 2000), S 17. Increased community participation in decision making and community forums to improve understanding the needs and aspirations of the community; the Municipality should serve the needs of the community.
- Benchmarking best practices of Kwa-Dukuza Municipality, (ranked number one in South Africa – 2012) for their financial management.

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Appendices

Appendix A

Questionnaire

Research topic

The effect of good working capital policy on exploiting fiscal capacity in municipalities.

By: J R Maharaj, for the partial fulfillment of the requirements for the Masters Degree in Business Administration, University of South Africa.

Email – aquablaze2@yahoo.com Cell–0837977745 Box 2439, Stanger, 4450

Date: 8 February 2012

Dear Sir/Madam

The research I am conducting relates to working capital management and the impact this has on improving municipalities' revenue generating abilities. My aim is to look at the policies and practices of your entity and relate this to your outcomes to either prove or disprove my hypothesis.

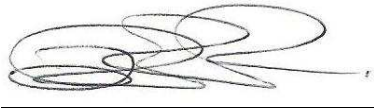
The information required is detailed in the proceeding pages and should not take up more than one, (1), hour of your time. I kindly request the permission to use your municipalities' name in my findings together with the information that is provided in the questionnaire and any interviews.

I will personally pick up the questionnaire when completed, or, it can be posted to me, or, scanned and emailed to me. The completed questionnaire should reach me no later than the 2nd of March, 2012. The information required is mostly factual and no calculations are required on your part; only raw data should be entered.

You may contact me for any information regarding this questionnaire either telephonically or electronically.

I thank you for taking time off your daily tasks to assist me with this research.

Kind regards,



JR MAHARAJ

Name of Municipality _____
Name of person filling in information _____
Title of person filling in information _____

1. **Financial data**- If information is not available, please mark with an X.

The questionnaire is structure in terms of the headings in your financial statements. This is to simplify the filling out of the questionnaire and to limit the amount of time spent by municipal staff on this research project.

1.1. **Revenue**

1.1.1. Rates + penalties imposed and collection charges

2008	2009	2010	2011

1.1.2. Service charges

2008	2009	2010	2011

1.1.3. Rental of facilities and equipment

2008	2009	2010	2011

1.1.4. Fines

2008	2009	2010	2011

1.1.5. Licenses and permits

2008	2009	2010	2011

1.1.6. Interest earned – Debtors

2008	2009	2010	2011

1.1.7. Interest earned – external investments

2008	2009	2010	2011

1.2. Expenses

1.2.1. Bulk purchases

2008	2009	2010	2011

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1.2.2. Contracted services

2008	2009	2010	2011

1.2.3. General expenses

2008	2009	2010	2011

1.3. Accounts Receivable

1.3.1. Debtors' control/ debtors

2008	2009	2010	2011

1.3.2. Debtors' age analyses

2008	2009	2010	2011

1.3.3. Provision for indigent debtors

2008	2009	2010	2011

1.3.4. Provision for bad debts

2008	2009	2010	2011

1.3.5. Reasons for any significant movement in annual figures.

1.4. Creditors

1.4.1. Creditors' control/ creditors

2008	2009	2010	2011

1.4.2. Creditors' age analyses

2008	2009	2010	2011

1.4.3. Is there a policy for making early payments to take advantage of discounts?

1.4.4. Has there been any late payment of creditors for the years under review?

1.5. Cash

1.5.1. Balances

2008	2009	2010	2011

1.5.2. Reasons for significant changes in annual balances, if any.

2. **Qualitative information**– tick the relevant box (✓).

2.1. What would you regard the management style of your entity?

Strict	Democratic	Casual

2.2. Staff turnover in cash, debtors and creditors.

High	Low	Not significant

2.3. Does the municipality have a documented working capital policy?

Yes	No	Unsure

2.4. Has the municipality had a working capital audit?

Yes	No	Unsure

- 2.5. What is your policy regarding the treatment of indigent ratepayers? Are they accounted for in the balance sheet?

- 2.6. What are the procedures that the municipality follows when ratepayers fail to make timeous payment for rates and services?

- 2.7. Is interest charged on overdue accounts?

Yes	No	Unsure

- 2.8. What is the percentage interest charged annually on overdue accounts?

- 2.9. Does the accounting system automatically accrue for the interest?

- 2.10. Are monthly management reports prepared for cash, debtors and creditors?

- 2.11. Are reconciliations between budgeted working capital and actual working capital done?

2.12. How often are funds transferred from one vote to another, (virement)?

1 - 5 times a year	5 – 10 times a year	➤ 10 times a year

2.13. In your opinion, what are the main concerns surrounding the collection of cash from rate payers for rates and/or services.

Thanking you for your participation!

Appendix B

Interview - A few more questions for the municipality

1. Is the amount of debtors > 90 days on the increase?
2. Is your indigent debtors register up to date?
3. What are the major issues/challenges surrounding debt collection in your municipality?
4. Is non-payment for services affecting cash flow?
5. In your opinion what additional structures/mechanisms can be put into place to assist with revenue collection?
6. Do you think that a decrease in tariff increases and interest on overdue accounts would assist in collecting a larger amount of revenue?

Appendix C

Masters Research

Questions for consultants

The effect of good working capital on exploiting fiscal capacity of municipalities in the KZN region

It is my hope that you will kindly assist me by sharing your experience, knowledge, thoughts and observations regarding working capital issues. Answers may be as long or short as you think necessary!

1. In your observations, is there evidence of municipalities investing excess cash to improve future cash flows?
2. Do municipalities actively pursue investment opportunities?
3. Are incidents of municipalities operating bank overdrafts on the increase or decrease?

4. Are there still consultants at local government level assisting in the day-to-day administration of the entity?
5. Have you observed an increased awareness towards working capital issues in municipalities over the last five years?
6. Are municipalities in general, coping with working capital issues?
7. What are your thoughts on municipalities using indirect revenue?
8. Are indigent debtors' registers up to date?
9. Are the provisions for doubtful debts reasonable?
10. Is there trend towards 90 day debtors outstanding increasing?
11. Do municipalities in general, actively pursue early settlement discounts from creditors?
12. Is there need for a separate working capital policy in GRAP?