

MFMA, Act 56 of 2003

Chapter 10

Municipal Entities Report

2022

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1. INTRODUCTION

The Constitution of South Africa requires that municipalities provide services as provided for in legislation. The Municipal Systems Act (MSA) enables municipalities to provide services through an internal mechanism or external mechanisms. These include mechanisms such as municipal departments, municipal entities or through a service delivery agreement with a third party. A municipal entity is therefore, an operational arm through which a municipality provides function or services to its community.

Each municipal entity is an "organ of state" and must adhere to the legislative framework of Chapter 10 in the Municipal Finance Management Act (MFMA), that ensures accountability and transparency in all aspects of financial management

Municipal entities are accountable to the municipality or municipalities that established the entity and are required to adhere to a service delivery agreement consistent with the municipality's strategic plans and performance objectives.

Municipal entities have a Board of Directors and an Accounting Officer (the Chief Executive Officer), who exercises oversight and is responsible for the operations of the entity. The separation of these roles is also legislated in the MFMA and MSA.

2. LEGISLATIVE FRAMEWORK

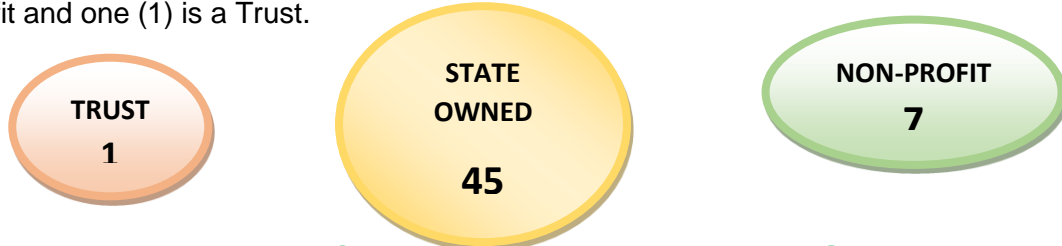
Municipal entities are established and function in terms of the MSA and the MFMA. The provisions of the MSA, including Chapter 8A, came into effect on 1 August 2004. The provisions of the MFMA took effect on 1 July 2004.

In terms of the MSA, there are three types of entities that may be established by a parent municipality, namely, a private company, a service utility or a multi-jurisdictional service utility. Prior to the MSA and MFMA requirements taking effect, municipalities entered into arrangement with trusts, section 21 companies and private companies. The changes to the legal framework required that municipalities review and ensure municipal entities are consistent with the new framework.

The establishment of a municipal entity follows a due process by the municipality that encompasses a robust consideration of the objectives of the entity, the purpose for its establishment, the efficiency and effectiveness that should be achieved through its establishment; that it will provide value for money; be driven sustainable budgets and viable funding, be self-sustainable and that the governance structures will provide effective municipal oversight, accountability, transparency and reporting.

3. TYPES OF MUNICIPAL ENTITIES

Of the fifty-three (53) municipal entities in 2022, forty-five (45) are State Owned, seven (7) are Non-Profit and one (1) is a Trust.

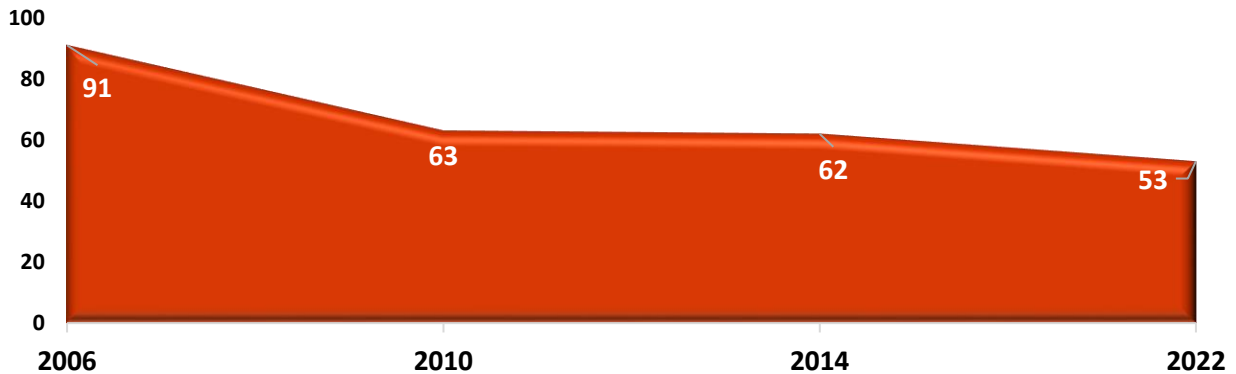


4. CHANGE IN MUNICIPAL ENTITY NUMBERS

Since the establishment of Ekurhuleni Water Care Company (NPC) and Durban ICC (SOC) Ltd in 1992, the number of new municipal entities were established, while others were disestablished. However, there has been an overall trend of a reduction in the number of municipal entities over the years.

The trend is illustrated in the graph below:

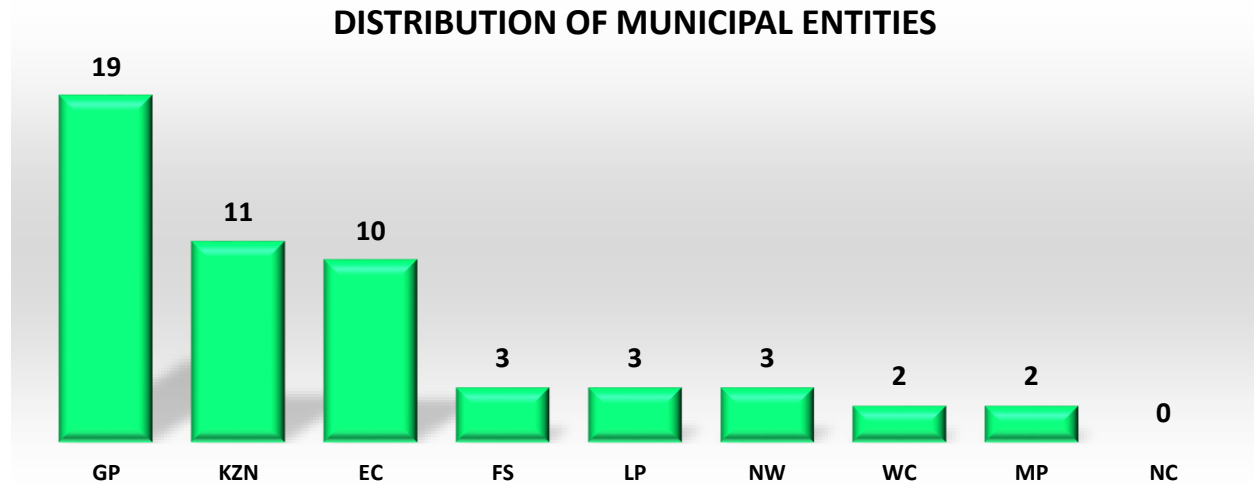
CHANGE IN MUNICIPAL ENTITY NUMBERS: 2006 - 2022



The initial list of municipal entities which was published in 2006, presented ninety-one (91) municipal entities. By 2010 the number of municipal entities had reduced by 31% to sixty-three (63) with a further reduction to sixty-two (62) municipal entities in 2014. In the last eight (8) years there has been a further reduction to fifty-three (53) municipal entities as at the date of this report.

5. DISTRIBUTION OF MUNICIPAL ENTITIES PER PROVINCE


The graph below shows the provincial distribution of the fifty-three (53) municipal entities that are currently either active or dormant.



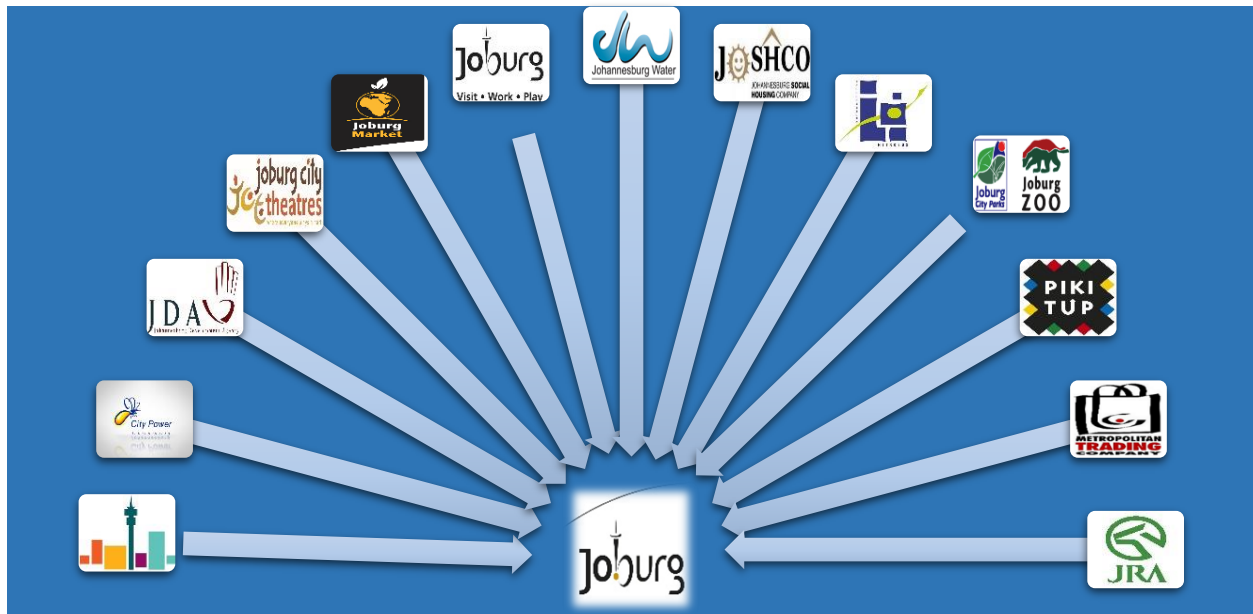
Initially municipalities opted to embrace the municipal entity model as a means to provide service delivery to citizens, with the emphasis on development agencies, responsible for stimulating economic development in the regions and fostering local business, often through the promotion of the area as a tourist destination.

Gauteng Province currently has the highest concentration of municipal entities (19 municipal entities) with thirteen (13) controlled by the City of Johannesburg.

The City of Johannesburg, through a restructuring process, lead the way in establishing eleven new municipal entities, effectively delegating some of its core municipal functions while maintaining 100% shareholding and control:

-  2000: City of Joburg Property Company (a property management company tasked with the maintenance of council owned properties);
-  2000: City Power (an electricity distributor);
-  2000: Johannesburg City Parks and Zoo (developing, maintaining and conserving public open spaces, cemeteries and the zoo for future generations);
-  2000: Johannesburg Water (supplying water services);
-  2000: Metrobus (offering public transport);
-  2000: Pikitup Johannesburg (waste management);
-  2000: Johannesburg Fresh Produce market (providing infrastructure for the distribution of fresh produce);
-  2001: Joburg City Theatre (providing entertainment and facilities);
-  2002: The Johannesburg Development Agency;

- ✚ 2003: Johannesburg Social Housing Company (providing affordable rental housing to the lower income bracket);
- ✚ 2003: Johannesburg Tourism company. This entity has not traded to date, however, there is currently a move towards providing communication and tourism functions.



City of Johannesburg has since added the Metropolitan Trading Company (in 2015), to house and manage the Broadband Network for the municipality and Johannesburg Roads Agency (in 2020), responsible for construction and maintenance of roads, traffic signals and storm water infrastructure.

Collectively these 13 municipal entities are responsible for a significant portion of the municipal expenditure and service delivery programmes with a combined budget of R42,8 billion. (AGSA MFMA 2019/2020 report)

The remainder of the municipal entities are split between West Rand District municipality which has a development agency, Tshwane Metropolitan municipality, also with a development agency as well as a housing agency and Ekurhuleni Metropolitan Municipality, which originally had three municipal entities providing bulk sanitation services, property development and management and public transport respectively. It has since been resolved to incorporate the latter, namely Brakpan Bus Company into the municipal bus services, creating a single bus service within the City of Ekurhuleni.

The province with the second largest number of municipal entities is **KwaZulu Natal**, which features eleven (11) municipal entities. The municipal entities are spread throughout the province and provide a less diverse spread of municipal functions than that of Gauteng.



Of the eleven municipalities, seven (7) municipal entities have been established to promote economic development, with an additional three specifically focused on attracting business and tourism. The others are located in the eThekweni Metropolitan Municipalities operating the Durban International Convention Centre, which provides conferencing facilities, the Durban Marine Theme Park, and also the Ugu District, Ugu South Coast Tourism. In Msunduzi, Safe City Msunduzi was established in 2003 to provide street and strategic surveillance for the capital city of the province and three municipalities, namely uMzinyathi District Municipality, Amajuba District Municipality and Newcastle Local Municipality have equal shares in uThukela Water, a water services municipal entity.

Recently, four municipal entities have been disestablished, three in the King Cetshwayo District Municipality, namely the uThungulu Financing Partnership (in 2018), the uThungulu Housing Development Trust (in 2020) and uThungulu Fresh Produce (in 2020). The Hibiscus Coast Development Agency, a section 21 company in the Ray Nkonyeni Local Municipality, was disestablished in 2016. (These entities have not been counted in the twelve entities indicated above).

The **Eastern Cape** follows closely after KwaZulu Natal in the number of active municipal entities, with ten (10) municipal entities, all development agencies, seeking to implement catalytic and strategic economic growth and development for their relevant regions to bring about socio-economic transformation and sustained job creation. Emphasis is placed on promoting the region as a tourist destination, while at the same time promoting small businesses, agriculture and agro-processing, as well as urban renewal. All are state owned companies, with the exception of Mandela Bay Development Agency, which is a non-profit company.



In the **Free State**, the three (3) municipal entities fulfill the following functions, namely that of water services, electricity services and local economic development. It is only the latter, namely Lejwe Le Putswa Development Agency, that is funded by grants provided by the parent municipal, whilst the other two entities providing water and electricity, mainly generate their own income. All three are state owned.

In **Limpopo** there are currently two municipal entities that are providing local economic development and one entity, namely Thabatshweu Housing Association (Pty) Ltd trading as Polokwane Housing Association, which provides low cost rental housing. All three are supported by government grants, except for Polokwane Housing Association where the revenue is supplemented by rental income.

Two of the three municipal entities in the **North West Province** are economic development agencies, and the third, namely Rustenburg Water Services Trust, provides sewer treatment and rectification, and water to two large mines and Rustenburg Local Municipality.

Both municipal entities in the **Western Cape** manage revenue generating facilities, namely the Cape Town Convention Centre, which offers conferencing facilities and the Cape Town Stadium. 5.4% of the shares in the Cape Town Convention Centre are owned by SunWest International (Pty) Limited. The stadium is partially grant funded.

In **Mpumalanga**, two (2) municipal entities were established to promote economic development in their respective regions, namely City of Mbombela Development Agency (CoMDA) and Thaba Chweu Local Economic Development Agency (THALEDA).

There are no municipal entities reported for municipalities in the **Northern Cape**.

6. OWNERSHIP OF MUNICIPAL ENTITIES

The Municipal Systems Act of 2000, provides for a municipality to engage a third party by way of a service level agreement, to provide municipal services on its behalf. A municipal entity is therefore a separate juristic person and is established after due process is followed by means of a municipal by-law, which regulates the functioning and control of the entity through the by-law and by virtue of its controlling shareholding.

All except four (4) active municipal entities, are wholly owned (100%) municipal entities controlled by the relevant parent municipality. The split shareholding of three of the entities is detailed in the table below:

MUNICIPAL ENTITY	PURPOSE	OWNERSHIP
uThukela Water	Provision of water services	1. uMzinyathi District Municipality (33%) 2. Amajuba District Municipality (33%) 3. Newcastle Local Municipality (34%)
Ekurhuleni Water Care Company (ERWAT)	Provision of bulk sanitation services	1. City of Johannesburg Municipality (1.5%) 2. Lesedi Local Municipality (1.5%) 3. Ekurhuleni Metropolitan Municipality (97%)
Cape Town International Convention Centre Company	Operates an International Convention Centre	1. Provincial Government of the Western Cape (23.2%) 2. SunWest International (Pty) Limited (5.4%) 3. City of Cape Town Metropolitan Municipality (71.4%)

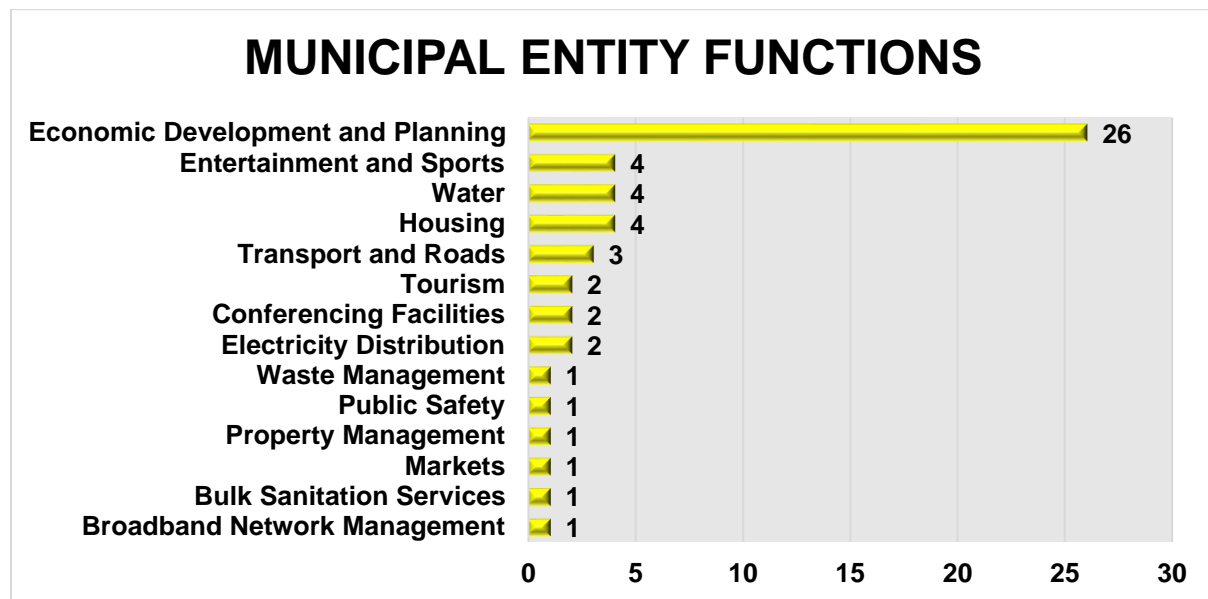
One municipal **Special Purpose Vehicle** exists, namely **Rustenburg Water Services Trust**, which is effectively controlled by Rustenburg Local Municipality. It is not a separate legal entity. The Trust is governed by a board of trustees to which the municipality has a right to appoint 4 out of the 7 representatives. The sole beneficiary of the Trust is the Rustenburg Local Municipality. Currently the term of office of the trustees has expired and the Trust is advertising for a new board.



Fifty percent (50%) of the revenues of the Trust is provided by two major platinum mines (Anglo Plat and Impala Plat), who have entered into an agreement when the Trust was established, to purchase non-potable treated wastewater from the Trust for 25 years. The arrangement was signed in 2003. The other 50% off its revenue comes from the sale of bulk water and the provision of sewerage services to the municipality for household purposes. Trust funds are ring-fenced and a commercial loan was obtained at formation from ABSA bank to finance the water and wastewater infrastructure upgrades and expansion.

7. NATIONAL DISTRIBUTION OF FUNCTIONS PERFORMED BY MUNICIPAL ENTITIES

Most municipal entities are established to assist municipalities in meeting their service delivery objectives. Functions performed by municipal entities range from promoting economic growth, to provide marketing, rural development, waste management, water and sanitation, electricity distribution, conference facilities, housing development, road maintenance, and public transportation services. The national distribution by function provided by municipal entities, is illustrated



Included in the above graph are two municipal entities that are currently dormant, namely Zululand Economic Development Agency of Zululand District Municipality in Kwa-Zulu Natal and Johannesburg Tourism Company of the City of Johannesburg in Gauteng.

The above graph does not, however, include the 4 municipal entities that have recently been disestablished but includes the Brakpan Bus Company that is still in the process of being incorporated into Ekurhuleni Metropolitan Municipality.

8. MUNICIPAL ENTITY PERFORMANCE AND AUDIT OUTCOMES

The financial year of a municipal entity is required to be the same as that of the parent municipality and the entity is audited separately from the parent, although the financial statements are consolidated and reported in the annual report of the parent municipality.

In addition, the municipality reports to the parent municipality in terms of its budgets, finances and performance. The parent municipality also determines the upper limits of the salary, allowances and other benefits of the CEO and senior management of the entity and monitors employment expenditure and staff remuneration matters.

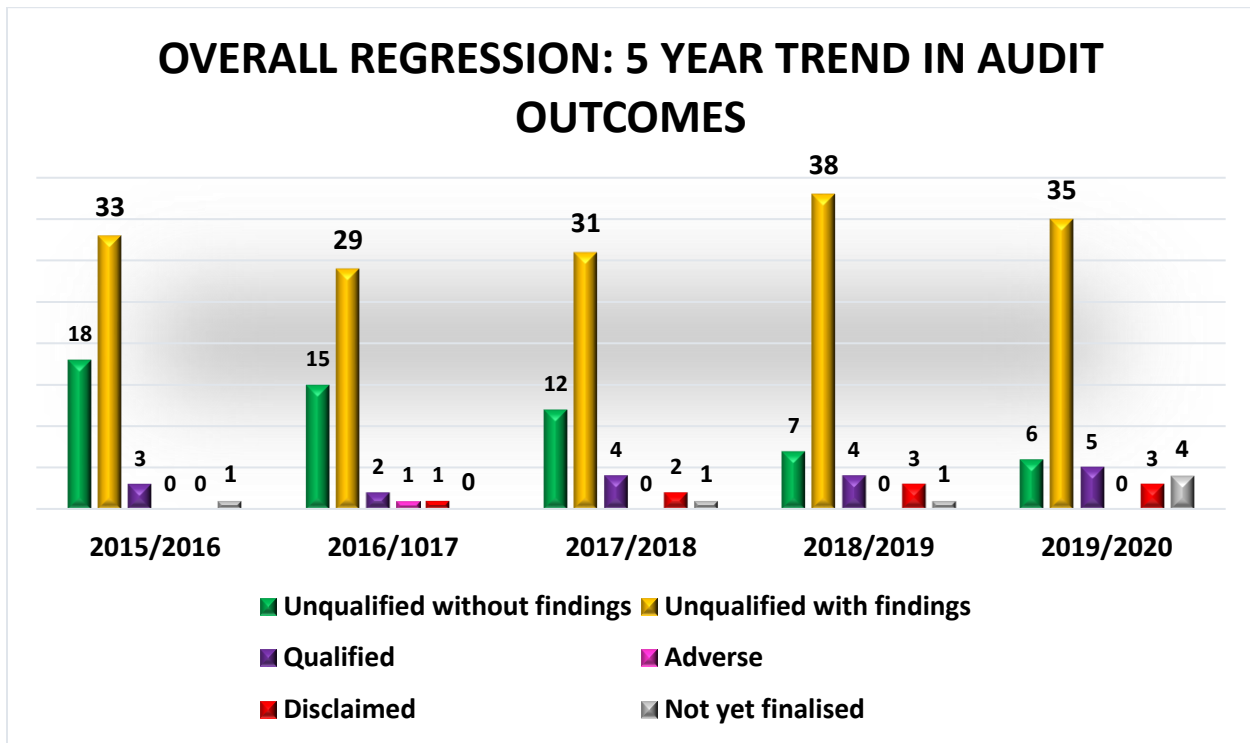
Municipal entities carry a significant portion of municipal budgets and are responsible for important functions that would otherwise have been carried out by the parent municipality. The monitoring by the parent municipality therefore needs to be visible and demonstratively effective not only through their membership on the Boards of Directors.

The statistics below give an indication of the **frequency of parent-entity engagements** (as per the 2021 Reporting Requirement submissions to National Treasury):

- 28 entities indicated that they reported monthly to the parent municipality.
- 11 entities indicated that they report on a quarterly basis to the parent municipality.
- 2 entities indicated that they report on a monthly and a quarterly basis to the parent municipality.
- 7 entities indicated that they report on a monthly, quarterly and annual basis to the parent municipality.

City Power indicated that they report on a daily and a monthly basis to the City of Johannesburg, while Johannesburg Water reported daily, monthly, quarterly and annual interactions with the parent municipality.

Audit results of municipal entities over the past 5 years however, display a regression in the number of unqualified audit outcomes. There has been a decline in number of unqualified without findings audit outcomes, a steady increase in number of unqualified with findings audit outcomes and the emergence of disclaimed audit outcomes which remained for the last 3 years. The number of audits not yet finalized, have increased. This is illustrated in the audit outcomes of municipal entities over a 5-year period as indicated in the graph below:



From the 2019/2020 audit outcomes, the following is noted with regards to the audit outcomes of municipal entities as opposed to the audit outcomes of parent municipalities:



Twelve (12) municipal entities obtained a more favourable audit outcome than the parent with four (4) obtaining an unqualified audit without findings, six (6) obtaining an unqualified audit outcome with findings and two (2) obtaining qualified audit outcomes.



Twenty-five (25) municipal entities obtained the same audit outcome as the parent, and twenty-three (23) of these entities obtained an unqualified with findings audit outcomes, one (1) received a qualified audit outcome and one (1) entity remained on a disclaimed audit outcome.



Six (6) municipal entities obtained less favourable audit outcomes than the parent municipality. Of the six, three (3) regressed from unqualified without findings to unqualified with findings, two (2) regressed from unqualified with findings to qualified and one (1) regressed from an unqualified with audit findings to a disclaimed audit outcome, namely, Dr. Kenneth Kaunda Economic Agency.

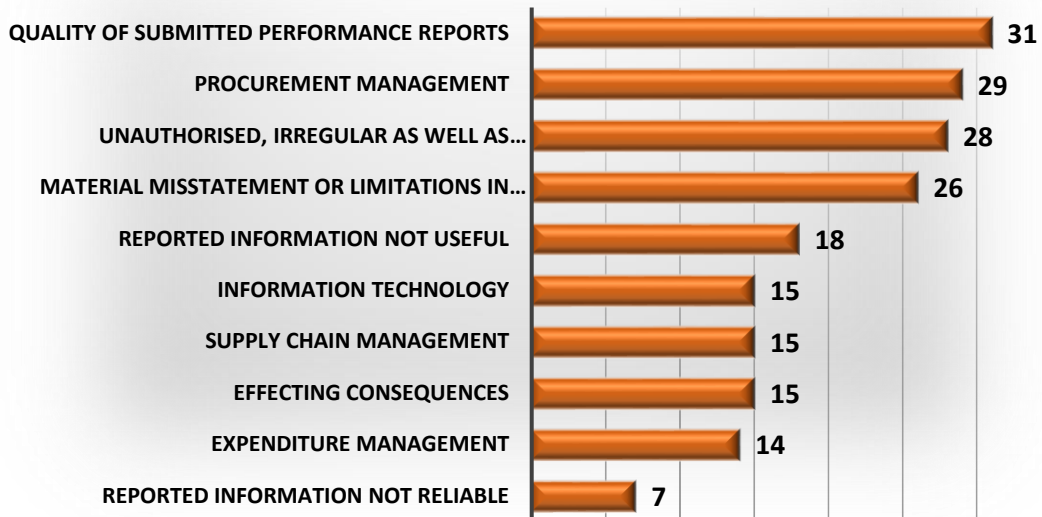
For ten (10) municipal entities or the parent municipalities, the audit for 2019/2020 had not yet been concluded at the time of the Auditor-General of South Africa’s report, hence a comparison could not be performed.

Johannesburg Development Agency regressed from a clean audit outcome, which it had sustained for three years, to an unqualified opinion with findings.





The municipal entities that obtained qualified audit outcomes were Durban Marine Theme Park, Chris Hani Development Agency, Raymond Mhlaba Economic Development Agency, uMgungundlovu Economic Development Agency and Umhlosinga Development Agency.

The AGSA reported that the overall negative trend in municipal entity outcomes could be attributed to non-compliance with legislation. Major root causes for the regression include: uncompetitive/unfair procurement processes, inadequate consequence management and instability of vacancies in key positions or key officials lacking appropriate competencies. This is highlighted in the graph below:

COMMON AREAS OF WEAKNESSES IN MUNICIPAL ENTITIES



The responsibilities of parent municipalities with respect to municipal entities are articulated in the MFMA and Municipal Systems Act. These duties include ensuring:

-  compliance with the MFMA and other applicable legislation by municipal entities;
-  that the entity is managed responsibly and transparently, and meets its statutory contractual obligations;
-  that the Board of Directors and Chief Executive Officers fulfil their responsibilities; and
-  the establishment and maintenance of clear channels of communication between the parent municipality and the municipal entity.

9. CONCLUSION

Sections 74 and 178 of the MFMA, requires that municipalities report to the National Treasury information on all municipal entities, including those structures in existence prior to the MFMA and MSA framework taking effect.

In view of the fact municipal entities perform functions or services on behalf of municipalities, it is imperative that the entities are effectively managed and assessed through the annual performance reviews. It is also important that possible serious financial challenges of entities be averted by periodically assessing the financial viability of municipal entities, particularly considering that the majority of the established entities depend of the parent municipality for resources.

With the future development of the web-enabled FMCMM, audit action plan and monitoring and evaluation calendar, reporting requirements will become easier to manage and communication improved.

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Annexures:

A: Active and dormant municipal entities as at February 2022

B: Disestablished municipal entities as at February 2022