

# **Establishment of the Tshwane Development Agency**

## **An Internal Assessment of Current Development Functions**

**PREPARED BY  
PAN-AFRICAN INVESTMENT & RESEARCH SERVICES**

**8 December 2005**

## **INTERNAL ASSESSMENT**

The internal assessment for the establishment of the TDA is based upon severely constrained information. This assessment is based on information made available by the City of Tshwane to Pan-African Investment & Research Services (PAIRS). Given the available information PAIRS has compiled this report to the best of its ability. However, PAIRS is also of the opinion that any assessment of the internal mechanism that currently exist in the City of Tshwane is hampered by:

- Inadequate financial records by Section 21 companies
- Inadequate operational reporting by the Section 21 companies
- Inadequate information on development activities of the City of Tshwane

The assessment is based on the following information sources:

- Financial statements and audit reports on three Section 21 companies
- Interviews and discussions with staff
- Resolutions adopted by the City Council
- Strategy Documents
- Information available to the public via the internet

The lack of controls and transparency in the current structure both impedes and strengthens the case for the TDA. The financial statements that have served as the source documents for the internal assessment have, for the most part, been approved by the auditor with substantial qualification regarding revenues, expenses and fixed assets. This fact in and of itself makes a compelling argument for a structure with better information systems and internal controls. The TDA envisaged as the answer to many of the problems highlighted in this document does not contain any of the personal accused of mismanagement or irregularities within the current structure. The financial ramifications of converting some of the Section 21 Companies, particularly Trade Point, into a municipal entity remains uncertain. In general, there is an uncertain contingent liability to outside investors upon the winding up of the Section 21 Companies.

Based on the available information it is concluded that an internal mechanism is not a preferred option for the City of Tshwane.

## INTERNAL ASSESSMENT

### 1. Introduction

The internal assessment is guided by and performed in compliance with the Municipal Systems Act 32 2000 [section 78 (1) (a)].

The scope of the assessment was guided by the function of the proposed alternative service delivery mechanism, the Tshwane Development Agency (TDA).

The function of the TDA is defined as:

*Facilitate and promote local economic development in the municipal area of the City of Tshwane Metropolitan Municipality through initiating, facilitating and implementing projects to further the economic development objectives of the municipality. The TDA will assume the operational responsibility for*

- *Business support*
- *Marketing of projects, the City and the TDA*
- *Project research and development.*

*And implement special projects designed to meet the City of Tshwane's strategic economic and social objectives.*

Currently there is not any pure internal mechanism that deals exclusively with these issues. In cases where municipal staff is involved with the issues they it is part of a wider focus with the result that the specific focus areas of the proposed TDA gets little attention.

However, there are three existing Section 21 companies which deals directly with most (but not all) of the functions of the TDA. These companies are supposed to provide the current development function of the City. They are:

- Enterprise South Africa Tshwane (ESA-T)
  - Trade Point Pretoria Tshwane (TPPT)
  - Centre for Business Information and Support (Cenbus)
- (i) The direct and indirect costs and benefits associated with the project if the service is provided by the municipality through an internal mechanism, including the expected effect on the environment and human well being and safety.

(a) Direct Costs and Benefits

It cannot be expected from the majority of development functions to be profitable. Therefore, in profit terms benefits associated with development functions will rarely outstrip the costs associated with delivering the service. However, it is important that the total benefit to society be greater than the total costs put towards providing the service.

In the case of Tshwane, calculating an exact amount of costs to deliver the service is extremely difficult due to either lack of financial information or because there exist no service being delivered. Even more difficult than reporting costs is determining the benefits to society due to a lack of:

- Performance management within the current mechanism
- Continuity within the current system
- Accountability in the current system

Based on the information available to PAIRS no evidence could be found to determine the direct monetary benefits of the current internal mechanism to the City and its residents. However, from the audited reports and supporting documents reasons for lack of benefits to society could be found. From this analyses it is clear that direct costs of the current system outstrips the benefits to the greater society.

In Table 1 below an income statement for the three Section 21 companies was constructed to analyse the costs.

**Table 1: Income statement for the financial year ended June 2005**

	Trade Point		ESAT		Cenbis	
	Rand ('000)	% of total	Rand ('000)	% of total	Rand ('000)	% of total
<b>INCOME</b>	<b>717</b>	<b>100</b>	<b>1142</b>	<b>100</b>	<b>1497</b>	<b>100</b>
Grants	687	96	1121	98		
Other	30	4	21	2		
<b>EXPENDITURE</b>	<b>793</b>	<b>100</b>	<b>1211</b>	<b>100</b>	<b>1508</b>	<b>100</b>
Audit Fees	11	1	43	4	25	2
Bank Charges	1	0			10	1
Computer Expenses	11	1			11	1
Marketing	6	1			104	7
Office Rentals			0		3	0
Operational Expenses	500	63	780	64	216	14
Research	105	13				
Administration	51	6			160	11
Salaries and Wages	175	22	474	39	834	55
Staff Recruitment and Training	34	4			50	3
Specialist Services					5	0
Depreciation	59	7	0		90	6
<b>SURPLUS/(DEFICIT) BEFORE TAX</b>	<b>-76</b>		<b>-70</b>		<b>-11</b>	

The quality of the financial data and its availability is extremely poor. This is evident in the fact that the auditors did not want to express their opinion on the state of ESAT for the financial year ended June 2005. Nether the less, from Table 1, it is evident that a large portion of the income goes to salaries and wages, leaving very little for operations. This of course leads to cash flow problems and inadequate resources to implement development projects.

From the little information available it appears that there might be some double costing because the entities are run as separate organisations. This is especially true in bank charges, audit fees, marketing, and administration. However, the exact extent of double costing is not available.

Another direct cost that the current mechanism has incurred is large amounts of debt. This includes private debtors as well as tax liabilities to SARS.

One benefit that should appear from having separate entities managing the functions of development is a specific focus with great flexibility. However, it appears that this benefit was not utilised as the operational activities became bogged down by administration and a top heavy structure.

#### (b) Indirect Costs and Benefits

##### Cost: Lack of transparency and accountability

The lack of adequate financial data weakens the case of an internal mechanism. Past financial performance and financial reports underlines the lack of accountability and control prevalent in the existing system of decentralisation. Our underlying, and very reasonable, assumption is that agencies will engage in cost rationing behaviour to the extent that they are held accountable for it. Accountability is underpinned by the ability to adequately measure costs and performance against predetermined levels. When financial statements were available, in some cases it was the opinion of the auditor that the Section 21 Company not continues as a going concern. In another instance the auditors did not want to express an opinion due to a lack of basic financial information available.

Many of these organisations have assessed losses and loans on the balance sheet that will have to be covered by the municipality. Some of the organizations were in the process of winding up at the time of their last financial statements and in that regard had implemented cost cutting procedures which did not reflect operational expenses during the normal course of business. In some cases, the Section 21 Companies have been operating under the assumption that they are not municipal entities. In these cases, as in all other cases, activities will be brought into alignment with the Act or abandoned. Activities of the Section 21 Companies have, in some cases, been partially subsidised by other government agencies. The continued willingness of the government agencies to continue the support, once the activities have been taken over by the municipality in the form of the TDA, remains uncertain and there is a possibility that the municipality will have to increase its grants if these government agencies are unwilling.

#### Costs: Inadequate leadership and management in current system

A September 2005 document gives important strategic input on behalf of CenBis and ESAT with regard to the formation of the TDA. The document gives the performance evaluation the following considerations:

- Inadequate and insecure funding
- Duplication of facilities and resources
- Perceived duplication of services
- Competition for funding

In order to avoid repeating the mistakes of the past, attention must be drawn to many of the problems encountered by the Section 21 Companies.

- The Trade Point staff and the organization as a whole needs to be more proactive in its activities by getting into the field and making daily contact with companies. There is a need for better allocation of resources and improved management. Information systems are needed to enable measurement of field work and accountability to ensure performance.

- The Trade Point needs to take stock of its operational functioning to improve its efficiency and to better allocate tasks and responsibilities in order to achieve its objectives and ensure that it remains on track in its trade promotion efforts. The TDA is designed with the intention of creating efficient financial and operational management systems.
- Failure to register for VAT in some cases lead to large contingent liabilities on the balance sheet which posed a serious threat to operational liquidity.
- In many cases, the unwillingness of Auditors to express an opinion on the accuracy of financial statements or the expression of such opinions with many qualifications impedes the ability of the agency to raise money in a cost effective manner.
- Poor fixed asset register management could mean the loss of substantial resources for the organization. In many instances it appears as if the fixed asset registers did not comply with Section 284 of the Companies Act.
- Stable corporate governance, multiple directors within a single financial year creates uncertainty and interrupts operations. In some cases, outgoing directors had to be paid amounts equal to the remuneration they would have received if they had completed their contracts. Through thorough recruiting procedures, efficient remuneration packages which pay after and not before fulfillment of performance criteria and controls to implement accountability, the TDA will improve corporate governance.
- Poor internal controls lead to late detection of irregularities within some of the Section 21 Companies. Conflicts of interest and the use of assets for personal gain were not detected in time to prevent gross irregularities.
- Failure to compile concise job descriptions lead to redundancy and duplication of efforts.

- Competition amongst agencies for funding instead of automatic grants has proved effective.
- Financial mismanagement has lead to agencies taking out loans to the extent that future liquidity and operational efficiency have been jeopardized.

#### Cost: Staff turnover and lack of skills

The lack of incentive schemes and management expertise increased the costs of operations in delivering the development services.

The instability of a decentralized delivery system increased the operational costs that stem from uncertainty. The existing agencies have experienced staff losses due to irregular salary payments, making it impossible to be attractive on the job market. By enhancing the cash generating activities of the existing agencies, partly due to inadequate performance related salaries, the current system had little self-sufficiency and the autonomy with respect to financial management.

It must be added in defence that it is unlikely that all development functions can be self-sustaining. However, through inefficient incentives and business support the indirect costs to the City might be great. These indirect benefits are difficult to measure.

#### Cost: Coordination problems

The current decentralised development function might not enable the municipality to take advantage of instances where alignment of its strategic objectives and those of SEDA and GEP is possible. This is due to the operational budget constraints that the current system experiences, small size of the relevant operations and lack of credibility as far as delivery is concerned.

#### (Possible) Benefit: Control

The benefit of the current system is that falls directly under the control of the municipality. This allows for possible tight control. However, history has shown that often little control is taken over the expenditures of the development functions. In cases where control did take place, the Section 21 Company ran into serious cash flow problems due to improper budgeting.

- (ii) The Municipality's capacity and potential future capacity to furnish the skills, expertise and resources necessary for the provision of the services necessary.

Without a detailed list of the personal working for the existing section 21 companies, it is difficult to gauge the ability of the existing staff to meet the human resource requirements for an internal mechanism to be successful. In general, it is likely that a decentralised operations functions shared by all agencies such as accounting or IT is duplicated.

It appears from the financial statements as well as Council reports that there is a lack of leadership in the companies. Without adequate leadership it will be difficult to build capacity internally. Given that many of the personnel have resigned, and that current performance appears to be inadequate, it might be necessary to start from top to bottom with capacity building. With the poor financial history of the current companies it will be extremely difficult to attract people with the right skill and competence.

The current lack of incentive based salaries and rigorous measurement and accounting systems further hampers capacity building. Contractual incentive schemes, penalties for non-performance and the means to measure performance are the means by which accountability is achieved. The municipality currently does not have the capacity to introduce this kind of system; however the benefits of more effective service delivery will outweigh the costs of obtaining such a system.

- (iii) The extent to which reorganisation of its administration and the development of human resource capacity within that administration could be utilised to provide a service through an internal mechanism

The establishment of accountability mechanisms implies a self contained entity. Different entities with different methods of performance measurement contained within a single institution compromises both entities. However, given that it is possible to create a single development structure as an internal mechanism, it is likely that this structure will be incapable to function efficiently.

Firstly, there are many processes to follow in a large structure like the City Municipality, which might be unnecessary for development purposes. This might derail projects and its implementation.

Secondly, it is likely that when the development function is situated within the Municipality there is a real probability that employees might get entangled in administration duties instead of implementation duties.

Lastly, as mentioned before, managing performance through an internal mechanism is more difficult than an external mechanism. The internal mechanism leaves little room for rewarding innovation and initiatives and therefore is not suited towards facilitating these development functions.

- (iv) The likely impact on development, job creation and employment patterns in the municipality

The section 21 companies that will form the TDA are not strictly part of the municipality; therefore any rationalisation within the organisations that will form the TDA will not affect the municipality. The TDA is being created with the intention that its functions do not overlap with any of the functions provided by the municipality, therefore there will be no redundancy or need to rationalize employment within the municipality. If indeed cases arise where personal within the municipality have functions that are closely related to some of the functions performed by the TDA, then clear and separate mandates must be defined for both parties. Section 21 companies have struggled to recruit skilled personal in the past due to financial constraints; better financial management will improve recruitment processes and enhance service delivery for the municipality. In general, the net benefits of the TDA will differ from the aggregate of the smaller agencies due to the more efficient use and conservation of resources, in short there will be greater service delivery for the same amount of expense in the new TDA.

**-End-**