

ANALYSING THE FINANCIAL PERFORMANCE AT THE MUNICIPALITY OF KARIBIB

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ABSTRACT

This paper analyzed the financial performance at the municipality of Karibib. The study adopted a quantitative approach. In this regard, this study made use of secondary data. Annual data was collected for the period 2004 – 2008. Secondary data was collected from the annual financial statements of the Municipality of Karibib. The financial performance was analyzed by employing ratio analysis namely, profitability ratios, liquidity ratios and activity ratios. The results show that the municipality of Karibib has been performing poorly in terms of financial management.

Keywords: Financial performance, human resource, institutional development, organizational development.

INTRODUCTION

The Municipality of Karibib is situated in Erongo Region of Namibia, situated 183 km from Windhoek the capital city, almost mid-way on the 353 km main road from Windhoek to Swakopmund. In 1855, rich copper deposits were discovered in the Khomas highlands, particularly around the Karibib area (Barnett, 1997). In 1900, the town's population was 10 people. However, the statistics available that were collected in 2006 indicate that the population of Karibib was estimated in late 2006 at 6,898.

Once one of Namibia's rich municipalities due to its gold resources, the Municipality of Karibib continues to struggle financially in spite of the many interventions that have been put in place both at the national level and at the municipality level. In particular, the report on the accounts of the Municipality of Karibib for the Financial Year ended 30 June 2004 showed that the ever increasing balance of consumer debtors remained a cause of concern. Reconciliation of the municipality of Karibib's financial records was not done or was not up to date. According to the report, the overall control and quality of accounting records had deteriorated badly. The report went on to state that the municipality had a net accumulated shortfall of N\$ 5 401 292 in 2004 and N\$ 4 376 167 in 2003 which strongly indicated that the municipality was not able to continue as a going concern under these conditions. Furthermore, audit report on the accounts of Municipality of Karibib for the financial year ended 30 June 2004 indicated that temporary advances of N\$ 2 059 454 in 2004 and N\$ 1 643 230 in 2003 were made from the Fund accounts to the Revenue Account to finance running expenses. This situation underlined the cash flow problem, in particular, and financial performance problem, in general, of the Municipality of Karibib (The Namibian, 2004 10/07/2007).

The fact that the Municipality of Karibib should be enjoying a lot of revenue generated by the business activities in its vicinity such as gold mining besides tourism, the municipality has had financial difficulties. This creates a gap in understanding reasons as to why the

municipality is struggling financially (Economic News, 2004-10-19). The background information presented thus far raises questions about the potential difficulties and challenges of financial performance in the Municipality of Karibib. Therefore, this warrant for an investigation into the financial performance at the municipality of Karibib, thus the study draws its primary interest from this. The objective of the paper is to analyze the financial performance at the Municipality of Karibib.

The paper is organized as follows: the next section presents a literature review. Section 3 discusses the methodology. The empirical analysis and results are presented in section 4. Section 5 concludes the study.

LITERATURE REVIEW

In evaluating the performance of an organization there are various approaches used. There is a need to understand the various aspects of financial performance as outlined below.

Financial Statements as Sources of Performance Information

According to Haller (1985), the collecting, verifying and presenting of financial information about the many transactions that compose the business functions in the conversion cycle are the main subjects of accounting. Regardless of the size of an organization, the keeping of elementary financial records, commonly referred to as the books, is necessary in order to account for the effects of business decisions that were made in the past. Their formats are aimed at measuring the costs and revenues associated with past decisions, changes in the composition and amounts of resources, and changes in the financing approach. Business decision making involves the utilization of available skills and resources, or the acquisition thereof, for continued economic activity. The financial information helps to guide future decisions about the use and availability of resources and the financing strategy. Gitman (1991) indicates that every organization has many and varied uses for the standardized records and reports of its financial activities. Periodically, reports should be prepared for regulators, creditors, owners and management. Regulators, such as government and securities commissions, enforce the proper and accurate disclosure of corporate financial information. Creditors use financial data to evaluate the organization's ability to meet scheduled debt payments. Owners use the information to assess the organization's financial position and in deciding whether to buy, sell or hold shares. Management is concerned with regulatory compliance, satisfying creditors and owners, and monitoring the firm's performance.

Accountants summarize the financial information in reports known as financial statements. The income statement, balance sheet, cash flow statement and equity statement are the four primary financial statements. These statements summarize the business transactions for a specific period and show the financial position at a specific date at the end of that period (Gitman, 1991). The guidelines used to prepare and maintain financial records and reports are known as generally accepted accounting principles (Haller 1985). These accounting practices and procedures are authorized by the accounting profession's rule-setting body, the Financial Accounting Standards Board. These principles provide not only a unifying standard for the profession, but also allow users to assume conformity to certain accounting standards.

(i) The Income Statement

According to Marx et al (1999), the income statement provides a financial summary of the firm's operating results over a period of time by comparing revenue with expenses. If

revenue exceeds expenses, the firm is operating at a profit and therefore ensures its survival. Most commonly, an income statement covers a one-year period ending at a specified date; however, monthly or quarterly income statements are also prepared by most organizations. This is essential for management to know on a monthly basis whether income is increasing or decreasing, whether expenses and losses are being held at the anticipated level. It also assesses how net income compares with that of the preceding month and the corresponding month of the preceding year.

Campsey and Brigham (1985) specify that net sales, from which various costs are subtracted to obtain gross profit, are reported at the top of the income statement. Gross profits are then reduced by all operating expenses to obtain operating profits. Operating profits are further reduced by interest payments on debt, which should be paid whether the company is profitable or not. Taxes further reduce this amount. Financial managers often refer to net income as the bottom line, denoting that, of all the items on the income statement, net income draws the greatest attention. The net income is either paid to the shareholders in the form of dividends or retained by the organization to support its growth. Haller (1985) emphasizes the fact that cost determinations in the income statement are based on an accrual basis. This means that they are abstracted from when they are incurred or obligated, rather than when they are paid, and are therefore not always an accurate reflection of cash flows.

(ii) The Balance Sheet

According to Campsey (2007) the balance sheet may be thought of as a snapshot of the firm's financial position at any point in time. The left-hand side of the balance sheet shows the organisation's assets and the right-hand side shows the claims against those assets. These claims are divided between funds supplied by the owners, namely owner's equity, and the money the company owes to non-owners (liabilities). According to Marx et al (1999), when examining a balance sheet, the amounts listed indicate neither the prices at which the assets could be sold, nor the cost at which they could be replaced. Thus, one useful generalization that can be made from this is that a balance sheet does not show the real value of the business at all times

Haller (1985) highlights that the word balance comes from the fact that resource or asset values on the financial statement always equal the amount of financing for them. The value of resources is entered into the books at the cost of acquisition. The balance sheet is always based on the relationship that asset value equals the cost provided by financial sources, namely the owner's equity and liabilities.

Under the balance sheet there is a cash flow statement. According to Marx et al (1999), the cash flow statement deals with cash receipts and payments between two consecutive balance sheets. The objectives of the cash flow statement are to provide information regarding cash utilized or generated by operating, investing and financing activities. Examples of cash inflows from investment activities include cash received from the sale of properties and cash outflows include cash paid to purchase property. Financing activities generally include the cash effects of transactions and other events involving long-term creditors and owners, that is, those activities resulting in changes in the size and composition of the debt and capital of the reporting entity. Drawing up a cash flow statement requires information from the consecutive balance sheets, income statements for the financial year, details of fixed assets and information on the gross movement of cash that may not be reflected on other financial statements.

There is also equity statement. According to Grobbelaar, Van Schalkwyk, Stegmann and Wesson (1999), the equity statement deals with the residual value of assets over liabilities. The classification and application of the different subdivisions of equity are to a great extent governed either by law, or by the memorandum and articles of association of a company. The objective of the equity statement is to show changes in the shareholders' equity by highlighting income received (including capital injections by minorities) and expenses incurred (including payments to shareholders). This is done by reflecting the share capital of ordinary and preference shares, the share premium, and the distributable and non-distributable reserves.

Larson (1990) indicates that the income statement reports the revenues and expenses of the organization and that the resulting net income is reported in the equity statement. The resulting shareholders' equity from the equity statement, carried over and reported in the balance sheet, effectively represents the owners' claims on the organisation. The literature reviewed on financial statements indicates that these statements display the results of the organisation and are thus indicative of key financial management decisions regarding financing, investment, liquidity and risk. It is through the results displayed in these statements that the organisation is able to assess whether it has been successful in pursuing its financial management strategy.

The financial statements described above provide a wealth of data that is available for further interpretation. In order to make the financial results meaningful and easily understandable at a glance, several techniques can be employed. This is what is referred to as measuring financial performance by means of the financial statements.

A business system continuously generates data. Although some data can be directly used as information, in most cases further processing is required to bring out the information content of the data (Bhattacharya, 1995). Various methods are available for the processing of information, but data processing by the ratio method has the ability to bring out the maximum information content if the variables that produce ratios are correctly chosen with regard to the purpose at hand. Ratios enjoy remarkable simplicity and the information revealed by them is so direct to a particular decision-control situation that movement of a ratio or set of ratios gives an indication of the movement of an actual business process. Marx et al (1999) indicate that the basic inputs in ratio analysis are the organization's income statement, balance sheet and equity statement for the periods under scrutiny. The data provided by these statements can be used to calculate various ratios that permit the evaluation of certain aspects of financial performance and condition. Collier et al (1989) highlights that any figure from the accounts taken in isolation is not particularly meaningful. A profit figure, for example, does not indicate how well the organization has performed unless it is related to another variable such as assets. By comparing one item in the accounts with another, a relationship is established in the form of a ratio. However, a ratio in isolation is of limited value unless we have something to compare it against. One method of comparison is past performance, or time-series analysis, which is applied when a financial analyst evaluates performance over time. A comparison between current and past performance, using ratio analysis, allows the firm to determine whether it is progressing as planned. Cross-sectional analysis is another method whereby the organization's performance is compared relative to other organizations in the same industry.

This enables an organization to compare its financial performance against its key competitors or against an industry average. Bhattacharya (1995) highlights a third method of comparison

which is the comparison of performance against predetermined budgetary standards derived from the business plan of the organization. Gitman (1991) highlights that ratio analysis is of interest to both current and prospective shareholders who are interested in the organization's actual and future levels of risk and return. The organization's creditors are interested in its short-term liquidity and its ability to make interest and other principal payments. They are, however, also interested in the profitability of the organization and its continued success.

Marx et al (1999) indicate that financial ratios can be divided into numerous basic groups, namely, profitability ratios, liquidity ratios, current ratios, activity ratios and debt/solvency ratios. Each of these is discussed below.

(a) Profitability Ratios

According to Morley (1984), every business in the private sector must be profitable if it is to survive in the long run. Investors and lenders are only likely to provide continued support to a profitable business. However, profitability cannot be assessed by simply considering the annual profit figure, as these figures reveal little about whether the company is well run, whether it is worth investing in or whether it is likely to continue trading in the foreseeable future. To make informed decisions about these matters, it is necessary to relate the profits to other accounting figures. These ratios are described below.

(i) Gross Profit Margin

The gross profit margin indicates the percentage of each sales rand remaining after the firm has paid for its goods. It is calculated by dividing gross profits (profits less expenses) by sales and the higher the profit margin, the better. The gross profit should be sufficient to enable the firm to pay its operating expenses and to earn a profit (Marx et al, 1999). This figure is always expressed as a percentage, and highlights the difference between the cost of producing or purchasing goods and the price at which they are sold (Steyn, Warren and Jonker, 1998). This percentage usually remains fairly constant as businesses tend to have fixed guidelines regarding the mark-up of their goods in order to cover selling and administrative costs, whilst ensuring sufficient return on investment in the undertaking. Any changes in the gross profit percentage can generally be traced back to the mark-up, the sales mix, stock levels, theft and trade discounts.

(ii) Net Profit Margin

The net profit margin measures the percentage of each sales rand remaining after all expenses, including taxes, have been deducted. It is calculated by dividing the net profit after tax by sales and the higher the net profit margin, the better. The net profit margin is a commonly cited measure of a firm's success with respect to earnings on sales. There is no single quantum amount that can be used as an indicator of a successful company, as the definitions of a good net profit margin will differ considerably across industries (Marx et al, 1999).

(iii) Return on Equity

According to Steyn et al (1998), the object of any business activity is the production of a profit commensurate with the amount of investment by the entrepreneur and the risks involved. Morley (1984) indicates that the return on equity measures the return earned on the owner's investment. It is calculated by dividing the net profit after tax by the shareholders' equity. Generally, the owners are better off the higher the return on equity.

(iv) Operating Expenses/Operating Income

Operating expenses refer to the sum of all expenses incurred from operations. Operating income encompasses all revenue derived from operations, including interest and noninterest revenue. This ratio is calculated by dividing operating expenses by operating income and seeks to measure how well an organization can cover its costs with operating revenue (Consultative Group to Assist the Poorest, Inter-American Development Bank and U.S. Agency for International Development, 2002). This has been used in the banking industry as a key measure to determine how well a particular organization can control its costs and thus operate in a cost-efficient manner.

(v) Net Interest Income/Operating Income

This ratio is calculated by dividing net interest income (NII) by operating income. Net interest income is income derived from interest earned less any interest related expenses. The purpose of this ratio is to determine the percentage of operating income that can be attributed to interest earnings and is thus widely used in the banking sector (University of Pennsylvania, 2001).

(b) Liquidity Ratios

According to Steyn et al (1998), the liquidity of an enterprise revolves around its ability to meet its short-term liabilities out of short-term assets and cash flows. Essentially, liquidity is the solvency of the organization. The liquidity ratios are not only of concern to the short-term creditors but also to the long-term creditors, as the ability to remain liquid will directly affect the ability of the organization to repay long-term funds. Key liquidity ratios are explained below.

(i) Current Ratio

According to Steyn et al (1998), this ratio indicates the organization's ability to pay its current liabilities out of current assets, and is of interest to short-term creditors and bank managers. A standard for this ratio which has been successfully used for many years is 2:1, meaning that there are two rands worth of current assets for each rand of current liabilities. This standard may, however, vary across industries. The current ratio is always expressed as a ratio and never as a percentage. Campsey and Brigham (1985) indicate that it is computed by dividing current assets by current liabilities. Current assets usually include cash, marketable securities, accounts receivable and inventories. Current liabilities consist of accounts payable, short-term notes payable, current maturities of long-term debt, accrued income taxes and other accrued expenses. If an organization is getting into financial difficulty, it begins paying its accounts payable slowly, often with the assistance of bank loans. If these current liabilities are rising faster than current assets, the current ratio will fall and this could be an indicator that the organisation may be heading for trouble. Accordingly, the current ratio is the most commonly used measure of short-term solvency.

(ii) Acid-test Ratio

The acid-test ratio is similar to the current ratio except that it excludes inventory, which is generally the least liquid current asset. This ratio indicates the ability of the enterprise to pay all its current liabilities out of quick assets, that is, assets which are either cash or quickly convertible into cash. This ratio is calculated by subtracting inventory from current assets and then dividing the amount by current liabilities. The usually acceptable norm for this ratio is 1:1, meaning that each rand of current liabilities is covered by a rand of quick assets (Steyn et al, 1998).

(c) Activity Ratios

Activity ratios are used to measure the speed with which various accounts are converted into sales or cash. Measures of overall liquidity are generally inadequate because differences in the composition of a firm's current assets and liabilities may significantly affect the firm's true liquidity. It is therefore important to look beyond measures of overall liquidity to assess the activity of the most important current accounts, which include inventory, accounts receivable and accounts payable (Gitman, 1991).

(i) Average Collection Period

The average age of accounts receivable, also known as the average collection period, measures the average length of time a business waits to receive a cash payment for credit sales, and thereby measures the internal credit and collection effectiveness of the credit department (Bradshaw and Brooks, 1996). The average collection period is meaningful only in relation to the organisation's credit terms. It is important to bear in mind that, due to the time-value-of-money and the opportunity cost concept, the organisation is losing interest if the cash is tied up in accounts receivable. This interest could have been earned if the money was invested elsewhere or, alternatively, the organisation could be paying interest on an overdraft to finance the accounts receivable. The average collection period is calculated by dividing the average daily credit sales by the accounts receivable balance.

(d) Debt or Solvency Ratios

Debt management ratios are measures that show how the use of debt affects the organisation's ability to repay its obligations in the long term. Financial leverage is a term used to describe the magnification of risk and return introduced through the use of fixed cost financing such as debt and preference shares (Marx et al, 1999).

Correia et al (2000) indicate that debt management plays an important role in financial management and that the extent of financial leverage of the organization has a number of implications. Firstly, the more financial leverage the organization has, the higher its financial risk. As debt finance incurs interest, which is a fixed cost to the organization every month, earnings become more volatile with debt finance. However, additional risk yields additional return and if the firm earns more on the borrowed funds than it pays in interest, the return on owner's equity is magnified. Finally, by raising funds through debt, the shareholders can obtain finance without losing control of the organization. There are thus basically two aspects to financial leverage: firstly, a change in financial risk and, secondly, some implications for the returns attributable to shareholders. The debt management ratios try to assess the impact of financial leverage on risk and attempt to determine if the firm has overextended itself through the use of financial leverage, while the profitability ratios will indicate the impact of financial leverage on shareholders' returns.

(i) Debt Ratio

The debt ratio is the ratio of total debt to total assets and measures the percentage of total funds provided by creditors. Total debt includes current liabilities and, in most instances, preference shares. The higher the debt ratio, the higher the financial risk. Creditors thus prefer low debt ratios since the lower the ratio, the greater the security against creditors' losses in the event of liquidation. The owners, on the other hand, may seek high leverage, either to magnify earnings or because selling new shares means giving up some degree of control (Correia et al, 2000).

(ii) Times Interest Earned

According to Finkler (1992), the times interest earned ratio is also known as the interest coverage ratio. It compares the funds available to pay interest to the total amount of interest that has to be paid. The funds available for interest are the organisation's profits before interest and taxes. As long as profit before interest and taxes is greater than the amount of interest, the organisation will have enough money to pay the interest owed.

Correia et al (2000) highlight that this ratio measures the extent to which earnings can decline without causing financial losses to the organisation, and an inability to meet the interest cost. Failure to meet this obligation could result in legal action and ultimately insolvency. According to Finkler (1992), this ratio is determined by dividing earnings before interest and taxes by the interest charges. The higher this ratio, the more comfortable creditors will feel. This is the type of ratio that should be maintained at a certain level, dependent on the organisation's strategic objectives and the industry's norms.

In applying ratio analysis there are important factors that should be taken into account. Morley (1984) provides some caution relating to the use of financial ratios. He indicates that ratio analysis is a useful tool for those who base decisions on financial accounts; however, the tool can sometimes be dangerous as it can mislead decision makers and result in bad decisions. Firstly, such danger can occur when the ratio user ignores a company's accounting policies. Ratio users should always bear in mind that the reliability of a ratio is no better than that of the accounting figures comprising its numerator and denominator. The figures may be misleading if changes to a company's accounting policies are not taken into account.

Similarly, the ratio user can also be misled if they compare the ratios of two companies which use dissimilar accounting policies. This danger is especially great if two companies are incorporated in different countries, since then it is highly likely that different accounting policies will exist. The way to avoid these dangers is to read through the notes of the accounts and to make comparisons only between ratios constructed from figures which are based on similar accounting policies. Secondly, the ratio user should consider why the organization concerned has chosen the date used for the accounting year-end, and whether trade is seasonal or steady throughout the year. In trades with seasonal fluctuations the yearend figures for stocks, debtors and creditors may give a false impression of their average values over the year. It follows that ratios based on these untypical figures will be misleading. Thirdly, the purpose of calculating a ratio is often to compare it with the same ratio for other organizations. Caution should be exercised in selecting comparable organizations and, as the crude industrial classification is not always sufficient, it is often necessary to determine the core focus of the institutions by reading through the statement of principal activities in the financial report. Fourthly, the ratio user should consider whether any technical errors have been made in the calculation of the ratios. The definitions of the numerator and denominator should be compatible in that their coverage should be the same. Fifthly, whilst ratio analysis offers help and guidance, it is not a magic panacea and organizational decisions should never be solely based on ratios. Additional analysis can be employed as discussed below.

Comparative Financial Statements and Trend Analysis

Financial statements are compared by setting up balance sheets, income statements, equity statements or cash flow statements side-by-side and reviewing the changes that have occurred from year to year. The most important factor that is revealed from a comparative analysis is the trend because it will indicate the direction, rate and amount of change that has occurred.

A meaningful trend can only be established if financial information is available for five to 10 years. This information is very important to analysts as it helps them to project future results (Correia et al, 2000).

Common-size Statement Analysis

According to Gallinger and Poe (1995), common-size statement analysis is a technique that enables the make-up and patterns of a organization's balance sheet, income statement and equity statement to be determined. The analysis can either be horizontal across years or vertical within a year. Common size analysis reduces absolute numbers to percentages of components at one point in time or to percentages of change in components over time, thereby revealing possible trends. Correia et al (2000) highlight that, in a common-size balance sheet, the capital employed is expressed as 100 percent and each item is expressed as a percentage of the total. In the common-size income statement, the turnover is expressed as 100 percent and every other item is expressed as a percentage of the turnover. Gallinger and Poe (1995) point out that with horizontal analysis, several balance sheets, income statements and equity statements are arranged in vertical columns so that the annual changes in related items can be compared from year to year.

This comparison of the accounts generally reveals a pattern that may suggest management's underlying philosophies, policies and motivations. The annual financial statements are no longer simple snapshots but, instead, become important messages of management decisions and actions. Vertical analysis is the process of finding the proportion that an item, such as inventory, represents of a total group, such as assets. This method is used when the financial results of one year are analysed.

Funds Flow Analysis

According to Gallinger and Poe (1995), accrual accounting concepts recognize that it is the economic substance of a transaction that determines the timing of accounting recognition rather than the activity of receipt or payment of cash. However, investors use cash flows to value the firm as they wish to assess the actual cash inflows and outflows of the business. Many organizations report positive net income amounts, yet have negative cash income. Funds flow analysis is thus important for understanding the true cash flows of the business. It restates the organization's flow of funds from an accrual accounting basis to a cash accounting basis, and thus excludes all non-cash reserves and expenses recorded by accrual accounting. Generally, the funds flow analysis is split to indicate the net cash flow from operations or productive activities, the net cash flow from investments, and the net cash flow from financing the business. Financial performance can thus be analyzed through ratio analysis, comparative financial statements and trend analysis, common-size statement analysis and funds flow analysis.

Determinants of Financial Performance

Ejikeme Nonso (2012), argues that Finance is a necessity for the existence of any organization or institution, no doubt. Local governments are autonomous units within a state with certain statutory rights and responsibilities, an agent of decentralization and democratic stability; therefore, the place of finance in local government administration is really crucial.

Rainey and Steinbauer (1999) proposed a framework that contains a set of factors likely to explain the effectiveness of public agencies. These factors are support and control from external stakeholders, resource availability, organizational culture, leadership, mission valence, and task design. In the same line of thinking, Boyne (2003) proposed that public services performance is likely to be explained by the amount of resources, regulation, differences in market competition, organizational factors, and management. The question that still remains is whether we need to deal with these predictor factors together, or is it possible to identify the individual contribution of each factor to performance?

In terms of managing performance, finance is a resource and, therefore, also very likely to be an end in the performance management framework. As a main assumption of this investigation, we contended that by wisely managing financial resources, managers are more likely to improve the quality of services provided to the public. Some studies associate high quality financial management with several dimensions of performance (Ogden & Watson, 1999; Stanwick & Stanwick, 1998; Waddock & Smith, 2000). This makes it reasonable to assume that good financial management is a determinant factor of superior organizational performance.

According to Zafra-Gómez, López-Hernández and Hernández-Bastida (2009), there are several ways for assessing local government financial conditions, but assets and liabilities are to be taken into account in order to assess sustainability, flexibility and vulnerability. The authors particularly stress the importance of vulnerability as “an organization’s level of dependence on external funding received via transfers and grants” (Bohte, 2001). The greater the dependence on external funds, the higher the level of dependence and the lower the level of discretion (Pfeffer & Salancik, 2003) for making decisions and for devising policies. In the same line of thinking, (Kloot, 1999,) recommended “debt reduction strategies to demonstrate responsible financial management: ‘never to be in the red’; infrastructure and asset management; and long-term economic and social sustainability” as managerial drivers for local governments. Corroborating the idea that sustainability is associated with performance, Mogues and Benin (2012) found out that external grants discourage local government efforts to raise revenue locally. Another way of assessing government financial performance relates to the fiscal health of the city in terms of the risk of bankruptcy, which according to Whitney (2013,.) is the result of “budgetary mismanagement coupled with rising pension and debt costs”. In the United States there are several cases of cities that have declared bankruptcy in order to have “the time and fiscal breathing room required to develop and negotiate plans for reorganizing debt while protecting government from its creditors” (Whitney, 2013, p. 186).

METHODOLOGY

The study adopted a quantitative approach. In this regard, this study made use of secondary data. Annual data was collected for the period 2004 – 2008. Secondary data was collected from the annual financial statements of the Municipality of Karibib. An empirical analysis of secondary data was conducted in order to address the objectives of this research. The data was obtained from the office of the Auditor general of Namibia. The data is publically available on the Auditor General website.

To identify the drivers of financial performance and sustainability in municipality of Karibib, the data was estimated by means of econometric regression analysis. The

financial distress/performance status and the audit outcome from the Auditor General of Namibia were the dependent variables, whilst various financial variables used by the national treasury served as the explanatory variables.

According to Malan (personal communication, 31 July 2002) the use of ratios should be consistent with the nature of the organization concerned and the classification of financial performance in the context of the organization. The organization selected for this study was Karibib Municipality and thus ratios used in the manufacturing industry did not apply, as the organization generated a substantial portion of its income through interest as opposed to sales of goods. In addition to this, income and expenses reflected in the income statement were monitored more closely than assets and liabilities reflected in the balance sheet, as the organization concerned did not have to make large investments in capital equipment in order to generate sales. Balance sheet ratios were generally viewed at an organizational level and not at a departmental level as some of the input was based on figures at the organization level. The following ratios were thus selected for this study:

Profitability Ratios

- a) net interest income/operating income
- b) operating expenses/operating income

Liquidity Ratios

- a) Current ratio
- b) Acid test ratio

Activity Ratios

- a) Average collection period
- b) Average payment period

After considering the various aspects of financial performance above, a choice had to be made as to which analysis technique should be used for the purposes of this study. Current measures of financial performance were selected. The method of trend analysis was thus automatically excluded as an option. The cash flow was not considered as a critical measure of performance for the Municipality of Karibib and thus funds flow analysis was rejected as an analysis technique. Furthermore, financial performance should not be viewed within the context of turnover alone and thus the common-size income statement analysis was rejected. For the purposes of this research an objective method is preferred and the information required should be readily available. The data required to calculate ratios is often publicly available in the audited financial reports from the Auditor General's office and would thus not pose a risk to the organization concerned if the ratios were to become publicly available.

Other components of financial performance are not always readily available on the surface and require an in-depth knowledge of the organization's policies and practices in order to analyze them effectively. Audited financial results are generally more reliable, as the financial data being used has been checked for accuracy by an outside auditing firm. It is against this background that ratio analysis was thus selected as the indicator of financial performance due to the fact that ratios are a summary measure of effectiveness and refer to the holistic performance of the organization. In addition to this, they are indicators of the organization's performance that are widely recognized by those who manage and invest in organizations, and are able to provide sufficient information at a glance for investors and the management of an organization to make decisions. The ratios used in this research should be

provided by the Finance Department of the organization concerned and should have been subject to an audit in order to ensure the reliability of the data.

RESULTS AND DISCUSSION

The findings based on secondary data will be discussed in two parts. First, findings based on the audited financial statements of the Municipality of Karibib and Second, Ratio analysis. It is important at this juncture to narrate the findings on the principles and procedures governing the financial statements of the Municipality of Karibib. This is to establish whether it is in conformity with international practice. The accounts of the Municipality of Karibib for the financial years ended 30 June 2004, 2005 and 2006 were reported on in accordance with the provisions set out in the State Finance Act, 1991 (Act 31 of 1991) and the Local Authorities Act, 1992 (Act 23 of 1992). The firm Messrs. KPMG of Walvis Bay was appointed in terms of section 26(2) of the State Finance Act, 1991, to audit the accounts of the Municipality on behalf of the Auditor General and under his supervision. The 2007-2008 financial statements were not yet audited hence could not be used in this report. The figures in this report are rounded off to the nearest Namibian Dollar.

The Municipality's Financial Statements were submitted to the Auditor General by the Accounting Officer in compliance with section (87(1) of the Local Authorities Act, 1992. The audited financial statements are in agreement with general ledger and are filed in the office of the Auditor General. The scope of the audit is designed such that the accounting officer of the Municipality is responsible for the preparation of the financial statements and for ensuring the regularity of the financial transactions. It is the responsibility of the Auditor General to form an independent opinion, based on the audit, on those statements and on the regularity of the financial transactions included in them and to report his opinion to the National Assembly. The audit as carried out by the said firm, included:

- a) Examination on a test basis of the evidence relevant to the amounts, disclosure and regularity of the financial transactions included in the financial statements;
- b) Assessment of the significant estimates and judgments made by the Accounting Officer of the Municipality in the preparation of the financial statements and whether the accounting policies are appropriate to the council's circumstances, consistently applied and adequately disclosed; and
- c) Evaluation of the overall adequacy of the presentation of information in the financial statements:

The audit was planned and performed so as to obtain all the information and explanations considered necessary to provide sufficient evidence to give reasonable assurance that:

- The financial statements are free from material misstatement, whether caused by error, fraud or other irregularities;
- In all material respects, the expenditure and income have been applied to the purposes intended; and
- The financial transaction conforms to the authorities which govern them.

The audit's observations and comments were on two issues. First, long outstanding consumer debtors and bad debts provision. In this regard there is a concern on the ever increasing balance for consumer debtors. Debtors outstanding for longer than 120 days amount to N\$ 1 843 197 and 2005: N\$ 1 751 474 (2004: N\$ 804 602) while the provision for bad debts amounts to N\$ 550 000 and 2005: N\$ 500 000 (2004: N\$ 500 000). The auditors were thus of the opinion that the provision for bad debts by the Municipality is inadequate. Second, the

comments and observations were on accounting records and information. The overall control and quality of accounting records for the years under review were not up to standard. Much reconciliation was not done or up to date and various reports that were requested could not be presented to the auditors. In addition to the audit comments further analysis on financial results were conducted in order to establish the financial position of the municipality.

Table 1 below shows that the municipality had a net accumulated shortfall of N\$ 5 401 292 (2003: N\$4 376 167) which strongly indicates that the Municipality is not able to continue as a going concern under the present situation. The Municipality would have to take drastic actions to become financially viable. It would need to arrange funding, make its operations profitable and to ensure that its debts collection is effective.

Table 1: The results of operations and transactions on the Revenue Account for the year were as follows:

	Revenue	Expenditure	(Deficit)/Surplus	Balance
	N\$	N\$	N\$	N\$
Accumulate loss:01/07/2003				(4 376 167)
General Accounts				
Non- remunerative services	1 037 558	1 462 448	(424 890)	
Self-supporting services	6 88 718	779 728	(91 010)	
Trade Accounts				
Water	1 481 936	1 455 001	26 935	
Electricity	<u>1 797 615</u>	<u>2 190 401</u>	<u>(392 786)</u>	
Subtotal	<u>5 005 827</u>	<u>5 887 578</u>	<u>(881 751)</u>	
Loss for the year				<u>(881 751)</u>
Adjustment and utilizations to the financial statements				<u>(143 374)</u>
Accumulated surplus 30/6/04				<u>(5 401 292)</u>

Source: Author's compilation

Table 2: The results of the operations of, and transactions on the Revenue Account for the year were as follows:

	Revenue	Expenditure	(Deficit)/Surplus	Balance
	N\$	N\$	N\$	N\$
Accumulate loss:01/07/2005				(5 741 511)
General Accounts				
Non- remunerative services	2 148 505	2 403 035	(254 530)	
Self-supporting services	883 569	684 793	(198 776)	
Trade Accounts				
Water	2 924 504	2 968 543	(44 039)	
Electricity	<u>34 607</u>	<u>386 946</u>	<u>(352 339)</u>	
Subtotal	<u>5 991 185</u>	<u>6 443 317</u>	<u>(452 132)</u>	
Loss for the year				<u>(452 132)</u>
Adjustment and utilizations to the financial statements				<u>(114 809)</u>
Accumulated surplus 30/6/06				<u>(6 078 834)</u>

Source: Author's compilation

The municipality had a net accumulated shortfall of N\$ 6 078 834 and 2005: N\$ 5 741 511 (2004: N\$ 5 401 292) see table 1 and 2 above. This strongly indicates that the Municipality is not able to continue as a going concern under the present situation. The Municipality would have to take drastic actions to become financially viable. It would need to arrange funding, make its operations profitable and to ensure that its debts collection is effective.

(a) Profitability Ratios

Using the following financial statement, we are able to compute the following ratios:

Table 3: Income and Expenditure Statement for the Years Ended 30 June

	2006	2005	2004
	N\$	N\$	N\$
Income	4 636 716	6 268 751	5 023 528
Expenditure	<u>5 007 835</u>	<u>5 738 119</u>	<u>5 884 100</u>
Net operating (loss)/income	(371 119)	485 632	(860 572)
Interest earned on fund accounts	<u>39 756</u>	<u>63 767</u>	<u>16 716</u>
Net (loss)/income for the year	(331 363)	549 399	(843 856)
Transfer to/from internal funds	(120 769)	(121 675)	(37 895)
Appropriation account adjustment	<u>114 810</u>	<u>(767 943)</u>	<u>(143 374)</u>
Retained income for the year	(337 322)	(340 219)	(1 025 125)
Accumulated income			
-at beginning of the year	<u>(5 741 511)</u>	<u>(5 401 292)</u>	<u>(4 376 167)</u>
- at the end of the year	<u>(6 078 833)</u>	<u>(5 741 511)</u>	<u>(5 401 292)</u>

$$(i) \text{ Operating expenses/operating income} = \frac{\text{operating expenses}}{\text{Operating income}} \text{ hence}$$

The split is not provided. The expenses given are net i.e. they include an element of income hence giving a false position as far as the formula is concerned. However one can assume that it is immaterial and therefore we cannot determine the operating expense/income.

$$(ii) \text{ Net Interest Income/operating income} = \frac{\text{Interest Income} - \text{interest relate expense}}{\text{Operating income}}$$

2004	2005	2006
<u>16 716</u> (860 572)	<u>63 767</u> 485 632	<u>39 756</u> (371 119)
= -1.94%	13.13%	-10.71%

It is evident that investment has increased from 2004 to 2005 resulting in increase in interest income and high return.

(b) Liquidity Ratios

Using the following balance sheet, we can compute the liquidity ratios as follows:

Table 4: Balance sheet

	2006	2005	2004
	N\$	N\$	N\$
ASSETS			
Noncurrent assets	6 468 724	6 328 967	4 637 440
Property plan and equipment	4 802 708	4 404 677	4 404 677
Investments	388 199	606 688	3 668
Loans(assets)	1 277 817	1 317 602	229 095
Current Assets	3 111 325	2 454 504	1 733 636
Accounts receivable	2 801 015	2 161 748	1 733 324
Cash	310 310	292 756	312
Total Assets	9 580 049	8 783 471	6 371 076
EQUITY AND LIABILITIES			
Funds and reserves	746 284	748 682	(1 107 269)
Noncurrent liabilities	2 223 000	2 324 567	2 420 450
Long term liabilities	6 610 765	5 710 222	5 057 895
Current liabilities	6 578 459	5 631 127	4 751 191
Accounts payable	32 306	79 095	306 704
Bank overdraft			
Total equity and liabilities	<u>9 580 049</u>	<u>8 783 471</u>	6 <u>371 076</u>

(i) Current Ratio =
$$\frac{\text{current assets}}{\text{Current liabilities}}$$

	2004	2005	2006
=	$\frac{1\,733\,636}{5\,057\,895}$	$\frac{2\,454\,504}{5\,710\,222}$	$\frac{3\,111\,325}{6\,610\,765}$
=	0.34	0.43	0.47

This reflects the fact that the Municipality of Karibib has no sufficient liquid assets to meet its immediate liabilities. However the position is improving from year 2004 to 2006.

(ii) Acid Test Ratio

The Municipality of Karibib has no stock at year end hence the acid test ratio will be the same as current ratio.

(c) Activity Ratios

- i. **Average collection period** = $\frac{\text{accounts receivable}}{\text{Annual sales}/365}$

2004	2005	2006
$\frac{1\,733\,324}{(1\,797\,616 + 1\,481\,936)/365}$	$\frac{2\,161\,748}{(2\,730\,527 + 2\,017\,590)/365}$	$\frac{2\,801\,015}{(34\,607 + 2\,924\,504)/365}$
= 192.1 days	166.18 days	345.50 days

This is a vivid indication that the average collection days are too high. In 2006 it took almost a year to collect from their debtors. This is probably the main reason for a negative working capital. As such there is no cash to pay its creditors.

- ii. **Average Payment Period** = $\frac{\text{accounts payable}}{(\text{Average purchases})/365}$

2004	2005	2006
$\frac{4\,751\,191}{(1\,481\,036 + 1\,024\,533)/365}$	$\frac{5\,631\,127}{(1\,749\,402 + 1\,518\,182)/365}$	$\frac{6\,578\,459}{(2\,570\,636)/365}$
= 692.13 days	629.02 days	934.06 days

The high average payment period is not surprising since it takes the Municipality of Karibib close to a year to collect debts from its customers. This is the main reason as to why payment days are too high.

CONCLUSION

This paper analyzed the financial performance at the municipality of Karibib. According to the literature, a proper and efficient decentralized financial function can lead to good financial performance and financial sustainability which in turn lead to service delivery and proper functioning of local government. According to the examined literature, in order to be efficient and to achieve optimal financial performance local government must, amongst others, reduce their dependency on transfers and grants (and increase own revenues), not incur deficits, build human resource capacity and comply and follow regulation. However, local government faces various challenges including of lack of capacity, lack of political will, corruption and other challenges in attaining financial performance and sustainability. Literature also suggests ways to measure financial performance. These financial performance measures appear to be consistent throughout literature and do not only look at financial performance but also sustainability.

The following were the major findings:

- i. There is a significant dependence between governance and compliance and financial performance. Municipalities that comply with legislation and regulation are likely to have good financial performance and sustainability.

- ii. There is a significant dependence between financial performance and the cash coverage position of a municipality. The longer the municipality is able to cover operational expenditure from its cash sources the less financial distress the municipality will experience.
- iii. There is a significant dependence between financial performance and the high reliance on grants and transfers. Municipalities that rely highly on grants and transfers are likely to experience financial distress.
- iv. There is a significant dependence between financial performance and the size of a municipality. The bigger municipalities tend to experience less financial distress than small municipalities.

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