



Municipal Budget Circular for the 2014/15 MTREF

This circular provides further guidance to municipalities and municipal entities for the preparation of their 2014/15 Budgets and Medium Term Revenue and Expenditure Framework (MTREF). It must be read together with all previous MFMA Budget Circulars, and specifically MFMA Circular No. 70 – Municipal Budget Circular for the 2014/15 MTREF.

CONTENTS

1	KEY FOCUS AREAS FOR THE 2014/15 BUDGET PROCESS	3
2	DIVISION OF REVENUE BILL 2014	4
2.1	ADDITIONAL ALLOCATIONS TO LOCAL GOVERNMENT 2014	4
2.2	CHANGES TO THE 2014 DIVISION OF REVENUE BILL (DORB)	4
3	HEADLINE INFLATION FORECASTS	6
4	REVISING RATES, TARIFFS AND OTHER CHARGES	7
4.1	OPERATING REVENUE	7
4.2	NERSA'S PROCESS TO APPROVE ELECTRICITY TARIFFS	7
4.3	ESKOM BULK TARIFF INCREASES	8
5	FUNDING CHOICES AND MANAGEMENT ISSUES	8
5.1	REMUNERATION OF COUNCILLORS	8
5.2	EMPLOYEE RELATED COSTS	8
5.3	COST CONTAINMENT MEASURES	8
5.4	ACHIEVING VALUE FOR MONEY AND IMPROVED OUTCOMES	9
5.5	2014 NATIONAL ELECTIONS	9
5.6	TABLING A SURPLUS BUDGET	10
5.7	CAPITAL EXPENDITURE – INTERNALLY GENERATED FUNDS: CAPITAL REPLACEMENT RESERVE	10
5.8	SERVICE STANDARDS	10
5.9	WATER SECURITY VERSUS THE DEVELOPMENTAL OBJECTIVE OF LOCAL GOVERNMENT	11
5.10	INTERGOVERNMENTAL RELATIONSHIP BETWEEN DISTRICT AND LOCAL MUNICIPALITIES	11
5.11	THE MUNICIPAL REGULATION ON A STANDARD CHART OF ACCOUNTS (SCOA)	12
5.12	BUDGETING FOR THE PENDING DEMARCATION OF VARIOUS MUNICIPAL BOUNDARIES	12
6	CONDITIONAL TRANSFERS TO MUNICIPALITIES	13
6.1	TIMING OF MUNICIPAL CONDITIONAL GRANT TRANSFERS	14
6.2	PAYMENT SCHEDULE FOR TRANSFERS	14
6.3	PROVINCIAL PAYMENT SCHEDULES	14
6.4	RESPONSIBILITIES OF TRANSFERRING AND RECEIVING AUTHORITIES	15
6.5	UNSPENT CONDITIONAL GRANT FUNDS FOR 2013/14	15
6.6	CRITERIA FOR THE ROLLOVER OF CONDITIONAL GRANT FUNDS	16
6.7	APPROPRIATION STATEMENT (RECONCILIATION: BUDGET AND IN-YEAR PERFORMANCE)	17
6.8	REPORTING AND ACCOUNTING FOR MUNICIPAL APPROVED CONDITIONAL GRANT ROLL-OVERS	17
7	THE MUNICIPAL BUDGET AND REPORTING REGULATIONS	17
7.1	BUDGET COMPLIANCE AND BENCHMARKING PROCESSES	19
7.2	CERTIFICATION THAT BUDGET IS CORRECTLY CAPTURED	20
8	BUDGET PROCESS AND SUBMISSIONS FOR THE 2014/15 MTREF	21
8.1	SUBMITTING BUDGET DOCUMENTATION AND SCHEDULES FOR 2014/15	21
8.2	BUDGET REFORM RETURNS TO THE LOCAL GOVERNMENT DATABASE FOR PUBLICATION	22
8.3	PUBLICATION OF BUDGETS ON MUNICIPAL WEBSITES	22
8.4	PUBLICATION OF MUNICIPAL BUDGETS ON THE NATIONAL TREASURY WEBSITE	22

9	GENERAL	23
9.1	SECTION 71- CONSUMER COLLECTION RATES VERSUS ACTUAL CASH FLOW	23
9.2	OFFER OF GRANT FUNDING TO MUNICIPALITIES: METRO GRANT HOLDING	24
9.3	ANNEXURES TO MFMA CIRCULAR NO. 72	24
	ANNEXURE A	25
	CERTIFICATION OF AUDITED ANNUAL FINANCIAL STATEMENTS BY THE AUDITOR GENERAL	25
	ANNEXURE B	26
	ACCOUNTING TREATMENT FOR AGENCY SERVICES - HOUSING	26
	LEVELS OF ACCREDITATION AND THE IMPLICATIONS ON THE ACCOUNTING TREATMENT	27
	ANNEXURE C	29
	OBSERVATIONS FROM THE MID-YEAR PERFORMANCE ENGAGEMENTS: INFORMAL SETTLEMENTS	29

1 Key focus areas for the 2014/15 budget process

The 2014 Budget Review notes that while twenty years of democracy have brought enduring achievements for South Africa, there is no room for complacency. To overcome apartheid's spatial legacy, the provision of housing and social infrastructure needs to be improved, and planning frameworks across government strengthened. The budget policy framework for the next three years is designed to manage risk in a constrained fiscal environment, while building a foundation for economic growth which is supported by the implementation of the National Development Plan (NDP). Although South Africa's economy has expanded over the past years, the rate of growth has steadily declined, from 2.5 per cent of GDP in 2012 to 1.8 per cent in 2013; it is however projected to increase to 2.7 per cent in 2014, and gradually increase to 3.5 per cent by 2016. This trend reflects a confluence of unfavourable global and domestic circumstances which impact on all spheres of government. Aware of these risks, government is maintaining its expenditure ceiling and no additional funds have been added to the total expenditure announced in last year's Budget. Inflation and a nominal spending ceiling will put real budgets under pressure over the medium term, requiring all spheres of government to work more efficiently.

Measures to support faster growth include accelerated public infrastructure development, new spatial plans for cities, improved public transport, upgrading of informal settlements, the implementation of steps to professionalise the public service, overhaul procurement and supply chain management, and broadening and strengthening of industrial development. The medium-term budget framework shows how government has adapted its plans in a challenging economic and fiscal environment. Importantly, government continues to fund core economic and social priorities.

The NDP has been implemented to create a framework to accelerate economic growth, eliminate poverty and reduce inequality. The budget policy framework for the next three years reflects greater alignment with the plan, as spending programmes begin to address economic constraints and the need for greater state efficiency. The NDP identifies a number of microeconomic reforms needed to boost economic growth. These include reducing the cost of living for poor households and the costs of doing business, support for small, medium and micro enterprises (SMMEs), entrepreneurs and business start-ups, a greener and more sustainable economy, support for local production and employment through government procurement and broadening and strengthening industrial development.

Municipalities will have to revise their spending plans and reprioritise funds to ensure key objectives are achieved and well-performing programmes are supported. Expenditure plans need to reflect both the medium-term investment plans and long-term goals identified in the NDP. Over the next three years, government as a whole will have to learn to do more with less. The efficiencies that are achieved will protect public finances and enable the country to accelerate development when economic conditions improve. Local government must ensure that efficiency gains, eradication of non-priority spending (cost containment measures) and the reprioritisation of expenditure relating to core infrastructure continue to inform the planning framework of all municipalities. Consequently, municipal revenues and cash flows are expected to remain under pressure in 2014/15 and ***municipalities must adopt a conservative approach when projecting their expected revenues and cash receipts.***

In addition, municipalities should carefully consider affordability of tariff increases, especially as it relates to domestic consumers while considering the level of services versus the associated cost. Municipalities should also pay particular attention to managing revenue effectively and carefully evaluate all spending decisions.

2 Division of Revenue Bill 2014

2.1 Additional allocations to local government 2014

The 2014 Budget Review and the 2014 Division of Revenue Bill indicate that over the 2014 MTEF, R296 billion will be transferred directly to local government and a further R27.4 billion has been allocated to indirect grants over the next three years. Direct transfers to local government in 2014/15 account for 8.9 per cent of national government's non-interest allocations and when indirect transfers are included this amount rises to 9.6 per cent. An amount of R4.7 billion is added to the local government equitable share to meet the rising costs of providing municipal services and to help rural municipalities, and R1.9 billion is added to direct conditional grants, which include the municipal infrastructure, public transport network operations and integrated city development grants. A further R2 billion is added to indirect transfers, through whom national departments and public entities provide infrastructure and services on behalf of municipalities.

Local government allocations receive additional funds to address among others:

- Compensate and support municipalities with lower revenue-raising potential such as rural, local and district municipalities;
- Compensate for the rising costs of providing free basic water and electricity to poor households;
- Accelerate provision of access to clean water through bulk and reticulation projects;
- Accelerate provision of access to electricity and improving the sustainability of access through the refurbishment of key infrastructure;
- Expand the collection and use of data on the condition of municipal roads;
- Increasing the number of interns with infrastructure-related skills working in municipalities; and
- Promote more spatially integrated and efficient cities.

This means the baseline allocations to local government for the 2014/15 are R44.5 billion to the local government equitable share and R36.1 billion for conditional grants, capacity building (such as the municipal systems improvement grant and infrastructure skills development grant) and other grants (such as water services operating subsidy and energy efficiency and demand-side management grant). By 2016/17 these allocations are envisaged to have increased to R52.8 billion and R41 billion respectively.

This document is available on National Treasury's website at:

<http://www.treasury.gov.za/documents/national%20budget/2014>

In addition, National Treasury will send out 'allocation letters' informing each municipality of its equitable share, national conditional grants and provincial transfers (as reflected in the relevant provincial budget and gazette).

Municipalities must ensure that their tabled budgets reflect the equitable share and conditional grant allocations set out in the 2014 Division of Revenue Bill.

2.2 Changes to the 2014 Division of Revenue Bill (DoRB)

Providing greater certainty in relation to the Public Transport Infrastructure Grant

Clause 8(34) of the DoRB also requires consultation before funds for Public Transport Infrastructure projects are altered downwards by the National Treasury. This will provide certainty and protect against reductions in future budgets enabling municipalities to secure loan financing and better project management implementation.

Enhancing transparency and accountability in the management of grant funds

Clause 12(3) of the DoRB deals with the responsibilities of receiving officers of conditional grants which includes a requirement that if a grant transfer is withheld or stopped, the province or municipality must provide reasons why a grant transfer was stopped or withheld in its monthly and quarterly expenditure reporting.

Promoting more integrated cities

South African cities have grown tremendously since the end of apartheid and are considered engines of economic growth. However, in many ways their spatial development patterns continue to perpetuate the inequalities of apartheid; poor households are located on the peripheries of our cities and businesses are far from the people who work there. The City Support Programme (CSP) is working with metropolitan municipalities to ensure that their long-term development patterns and spatial form becomes both more equitable and more efficient; over time this strategy should support faster economic growth and a reduction in inequality. In support of these objectives, several new provisions have been introduced in the 2014 Division of Revenue Bill such as the introduction of clause 14 which requires **metropolitan municipalities to draw-up and submit a Built Environment Performance Plan (BEPP)**. The BEPP is a strategic summary of the city's infrastructure programme (including grant and own revenue funded infrastructure) that must demonstrate how the city will use its infrastructure investments to change the way the city develops. Institutionalisation of the BEPP will require metropolitan municipalities to:

- Submit a Council approved BEPP that provides a strategic summary of how the infrastructure programme will be used to develop a more integrated and efficient city in terms of the spatial targeting approach of the Urban Network Strategy and associated development indicators;
- BEPPs must include projects partially or fully funded by all infrastructure grants metros receive (Urban Settlements Development Grant, Integrated National Electrification Programme Grant, Public Transport Infrastructure Grant, Neighbourhood Development Partnership Grant); and
- Transferring national officers are required to consider a city's BEPP when monitoring allocations to metros and determining future allocations. They also cannot make transfers if a BEPP is not submitted (Clause 10(9) of the DoRB).

The BEPP is intended to bridge the gap between the Integrated Development Plan and the Budget of a municipality, giving effect to Spatial Development Frameworks; a critical instrument for investment prioritisation and focus on spatial targeting and integration.

Requiring greater consultation with national transferring officers

Clause 21 explicitly requires consultation with the respective department managing a grant before National Treasury will consider approving the conversion from one type of grant to another in-year (for example converting a direct grant to an indirect grant).

Allowing funds to shift between Public Transport Grants

Clause 21(1)(b) of the DoRB provides for the shifting between capital and operating grants that fund municipal public transport systems in cities through a gazetting process. This provides greater certainty to cities in that in-year shortfalls on one aspect of the grant framework for public transport can be offset by shifting funds from another grant.

Municipal Water Infrastructure Grant

Based on the experience with the first year of the grant, approximately half of the grant totalling R3.3 billion will be a direct grant to municipalities while the remaining half will be changed to an indirect grant through which the Department of Water Affairs will implement projects in municipalities with a poor track-record on implementing projects.

Conversion of allocations

Clause 21 of the DoRB further provides for the conversion of the Municipal Infrastructure Grant (MIG) and the Urban Settlements Development Grant (USDG) from a direct grant to an indirect grant if the conversion will improve service delivery. Municipalities are therefore reminded to prioritise the eradication of the bucket system; failure to adhere to this requirement will result in the National Treasury invoking the relevant clauses of the Division of Revenue Act against Schedule 6 Grants.

Technical amendments

In addition to the various changes to the 2014 Division of Revenue Bill, there have also been technical amendments as follows:

- The objects of the Bill have been redrafted to reflect the language of section 214(1) of the Constitution, which, read with the Intergovernmental Fiscal Relations Act, 1997, requires the introduction of a Division of Revenue Bill annually;
- Changes have been made to the way financial years are referred to so as to minimise any confusion and to clarify when the national/provincial financial year is applicable and when the municipal financial year applies;
- Clauses that facilitate the stopping and reallocation of funds to a different sphere in the case that a function is assigned during the financial year have been redrafted to clarify that the normal rules and procedures for a conditional grant will apply to the transfers to the newly assigned sphere. Municipalities that are assigned the housing function must also confirm or amend the expenditure plans previously submitted by a province to the national transferring officer;
- Clarification has been included that National Treasury must set the date for any conditional grant funds that remain unspent at the end of the financial year to be returned to the National Revenue Fund; this forms part of the annual process in considering roll-overs;
- Clarification has been added that the recovery of any fruitless and wasteful expenditure in terms of the Division of Revenue Act should be done using the procedures in the Public Finance Management Act, 1999, and Municipal Finance Management Act, 2003;
- Clarification has been added that the national transferring officer (accounting officer of a national department) must sign-off the grant allocations and frameworks submitted to National Treasury for the 2015 Division of Revenue Bill and that the accounting officer may delegate the authority to sign-off these allocations; and
- Clarification has been included in clause 29 that if the documents required by that section have already been submitted in terms of the timeframes set out in the Municipal Finance Management Act, the documents do not have to be resubmitted.

3 **Headline Inflation Forecasts**

Municipalities must take the following macro-economic forecasts into consideration when preparing their 2014/15 budgets and MTREF –

Fiscal year	2012 Actual	2013 Estimate	2014	2015 Forecast	2016
Real GDP growth	2.5	1.8	2.7	3.2	3.5
CPI inflation	5.6	5.7	6.2	5.9	5.5

Source: Budget Review 2014

Note that the fiscal year referred to is the national fiscal year (April to March) which is more closely aligned to the municipal fiscal year (July to June) than the calendar year inflation.

4 Revising rates, tariffs and other charges

4.1 Operating Revenue

Municipalities are reminded to refer to MFMA Circular No. 70 to ensure they abide to legislative prescriptions as contained in the MFMA and guidance in setting revenue projections. Furthermore, considering the overall economic pressures as explained in the start to this Circular, municipalities need to demonstrate how they have minimised increases in rates, tariffs and other charges through the identification of inefficiencies and the application of cost containment measures while ensuring an appropriate balance between the interests of poor households, other customers and ensuring the financial sustainability of the municipality.

National Treasury has observed that municipalities unjustifiably approve property rate and service charge tariff increases far above the 6.0 per cent upper boundary of the inflation target; in some instances municipalities have increased annual tariffs in excess of 100 per cent in a single financial year. For this reason **municipalities must justify and substantiate in their budget documentation (budget narrative) all increases in excess of the 6.0 per cent** upper boundary of the South African Reserve Bank's inflation target. If municipalities continue to act in this manner the National Treasury will have no other option but to set upper limits of tariff increases for property rates and service charges to which municipalities will have to conform.

4.2 NERSA's process to approve electricity tariffs

Municipalities should have submitted tariff increase applications from November 2013 aligned to the requirements of section 43 of the MFMA and subsequently NERSA will endeavour to finalise and complete all municipal tariff applications by 15 March 2014. In this regard, municipalities were consistently reminded to submit all outstanding D-forms to NERSA as a matter of urgency as the deadline for submission was 30 October 2013. NERSA will not be in a position to evaluate municipal tariff applications in the absence of complete D-forms. It is important that municipalities and NERSA work together to ensure that the process of approving electricity tariffs does not disrupt the process of compiling municipal budgets or compromise community consultations on the budget.

Considering the above legislative requirements, NERSA approved and communicated the municipal electricity tariff guideline increase on 20 November 2013. NERSA also held numerous provincial workshops and individual engagements with municipalities in assisting with the completion of the Distribution forms (D-forms), which is a crucial part of a tariff review document.

In spite of all the efforts taken by NERSA, there have only been a total of 34 applications received as at 13 February 2014 from municipalities which constitutes only 18 per cent of the licensees. The lack of collaboration from municipalities will therefore inhibit NERSA from achieving the 15 March deadline. In this regard, **municipalities must urgently submit their tariff application together with the accurately and comprehensively completed D-forms to NERSA.**

NERSA has confirmed that they will assess and approve the submitted tariff applications as promptly as possible. However, the lack of cooperation on the part of municipalities has created a bottleneck in the system and will inevitably result in delays. Municipalities are reminded that the tariff application processes as established and institutionalised by NERSA is not voluntary and municipalities must ensure compliance.

4.3 Eskom bulk tariff increases

Municipalities are advised to structure their 2014/15 electricity tariffs based on the approved **7.39 per cent** NERSA guideline tariff increase and provide for an **8.06 per cent** increase in the cost of bulk purchases for the tabled 2014/15 budgets and MTREF. In this regard municipalities are once again urged to examine the cost structure of their electricity undertakings and apply to NERSA for electricity tariff increases that are cost reflective and ensure continued financial sustainability.

5 Funding choices and management issues

5.1 Remuneration of councillors

Municipalities are advised to budget for the actual costs approved in line with the latest Public Officer Bearers Act issued in December 2013 inclusive with the provision of an increase equal to the estimated CPI inflation over the MTEF.

5.2 Employee related costs

Municipalities must take into account the multi-year Salary and Wage Collective Agreement for the period 1 July 2012 to 30 June 2015. The agreement provides for a wage increase based on the average CPI for the period 1 February 2013 until 31 January 2014, plus 1 per cent for 2014/15 financial year (with effect of 1 July 2014).

The average CPI for the period February 2013 to 31 January 2014 is 5.79 per cent which compares well to the estimate of 5.9 per cent for 2013 as provided for in the 2013 Medium Term Budget Policy Statement. Municipalities are therefore advised to provide for increases related to salaries and wages as follows:

2014/15 Financial Year – 6.79 per cent (5.79 per cent plus 1 per cent)
2015/16 Financial Year – 6.40 per cent (5.40 per cent plus 1 per cent)
2016/17 Financial Year – 6.40 per cent (5.40 per cent plus 1 per cent)

It is recommended that the projected inflation forecast plus one per cent be applied to the 2015/16 and 2016/2017 financial years in the absence of a collective Salary and Wage agreement.

5.3 Cost containment measures

In MFMA Circular No. 70 municipalities were strongly advised to take note of the Cabinet resolution of 23 October 2013 by which all national and provincial departments, constitutional institutions and all public entities are required to implement cost containment measures with effect of January 2014. The cost containment measures must be implemented to eliminate waste, reprioritise spending and ensure savings on six focus areas namely, consultancy fees, no credit cards, travel and related costs, advertising, catering and event costs as well as costs for accommodation. Municipalities were subsequently strongly urged to take note of the cost containment measures as approved by Cabinet and align their budgeting policies to these guidelines to the maximum extent possible.

Although it's acknowledged that local government is autonomous in its strategy formulation (IDP) and setting of budget appropriations, local government remains a sphere of government and must therefore align itself to the maximum extent possible to that of national and provincial government. In this regard in terms of section 62(1) of the MFMA the accounting officer of the municipality is responsible for managing the financial administration of the municipality, and must for this purpose take all reasonable steps to ensure:

- That the resources of the municipality are used effectively, efficiently and economically;
- That full and proper records of the financial affairs of the municipality are kept in accordance with any prescribed norms and standards;
- That the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control; and of internal audit operating in accordance with any prescribed norms and standards; and
- That unauthorised, irregular or fruitless and wasteful expenditure and other losses are prevented.

It's within the spirit of cooperative governance and intergovernmental relations that all accounting officers take note of the cost containment measures and adopt similar measures as part of their municipal budgeting processes. In this regard, previous MFMA Circulars provide guidance as to what is considered as non-priority spending. As part of the annual 2013/14 and 2014/15 audit process the Auditor General will be required to verify if municipalities have adhered to the Cabinet Decision with regard to this matter.

5.4 Achieving value for money and improved outcomes

The 2014 Budget aims to improve the quality of public services by achieving better outcomes within the current fiscal envelope. If resources are wasted or diverted, the potential outcomes are diminished and so is the case for increased resource allocation. In ensuring value for money through improved outcomes there are various initiatives underway, including:

- Several spending reviews are under way, conducted jointly by the National Treasury and the Department of Performance Monitoring and Evaluation. The reviews aim to provide greater understanding of performance and value for money in areas such as housing, education and industrial policy;
- Similar spending reviews have been conducted in provincial government, and suggest a range of efficiency improvements that can enhance value for money; and
- As part of efforts to combat waste, government issued the cost containment instructions in January 2014.

5.5 2014 National Elections

In terms of Government Notice R.145 of 2014, Government Gazette No 37387, the date of the election of the National Assembly and the election of Provincial Legislatures will be held on 7 May 2014.

Municipalities are reminded that the pending elections are for the sole purpose of electing the National Assembly and Provincial Legislatures; subsequently there is no impact on municipalities and hence all municipalities must refrain from making any contribution, be that monetary or in kind to any political party.

In terms of Section 236 of the Constitution funding is provided to political parties participating in national and provincial legislatures on an equitable and proportional basis; this Fund is controlled and managed by the Independent Electoral Commission. Any municipality that is found to have contributed to the national and provincial election process, be that directly or in kind, will be in direct contravention of legislation and subsequently the associated expenditure will have to be dealt with as unauthorised and irregular.

In addition, it has come to the attention of National Treasury that prior to a national, provincial or local government election some municipalities cease debt collection and credit control measures; this done to win public support prior to the election. Not only is this practice completely irresponsible, it also jeopardises the financial sustainability of the municipality, and is outside the policy framework governing the municipality. A debt collection and credit control policy is a resolution of the municipal council and only through that resolution being rescinded by the municipal council can the debt collection and credit control measures be suspended. **Hence, no municipality is allowed to suspend debt collection and credit control measures prior to the National Elections.** Accounting officers need to take note that if a municipality is found to have suspended their debt collection and credit control measures, this action will be considered a serious violation of the MFMA in that it constitutes an act of financial misconduct and the necessary action will be taken by National Treasury. With municipal elections national and provincial government respect the autonomy of the process and demonstrate a level of consideration; the same is expected from municipalities during the National Elections.

5.6 Tabling a surplus budget

National Treasury has consistently urged municipalities to table and adopt a surplus operating statement of financial performance. Through the in-year reporting framework it has been observed that a direct correlation exists between municipalities that adopt a deficit position on the statement of financial performance and that of cash and liquidity challenges. In addition, many municipalities are increasingly becoming dependent on grants to fund their budgets as no operating surpluses are generated to supplement the capital programme. Consequently **all municipalities are required to adopt a surplus position on the statement of financial performance with the 2014/15 MTREF budget.**

5.7 Capital expenditure – Internally generated funds: Capital Replacement Reserve

Municipalities are required to supplement their capital expenditures from own funds through the application of the Capital Replacement Reserve (CRR) and current year surpluses; this is considered a prudent and supported principle in supplementing the overall capital programme in funding new infrastructure and renewing aging assets. Notwithstanding the importance of supplementing the capital programme from own funding, many municipalities provide funding appropriations from own internally generated funds without the necessary cash backing. This directly implies that the capital programme is unfunded and will inevitably result in cash and liquidity challenges for the municipality. Municipalities must ensure internally generated funds appropriated to the capital programme is adequately cash backed if the funding source is the CRR or that the current year surpluses will realistically realise.

5.8 Service standards

The setting of service standards is an integral part of the service delivery value chain. It provides transparency in understanding performance indicators and hence strengthens the entire performance management system. In addition it ensures accountability on the part of the officials responsible for providing the service.

Local government is mostly classified in the service delivery and governance category and as such needs to be clear on what the public at large can expect as a service delivery standard. Rate payers must be placed in a position by which they are able to measure the service outputs against the predetermined service standards. This also serves as a performance rating instrument at an organisational and individual level. It is for this reason that a municipality must adopt services standards as part of their strategic objectives and report on the achievements. All municipalities are required to formulate service standards by the end of January 2015 which must form part of the 2015/16 draft MTREF budget documentation. In addition, the service standards need to be tabled before the municipal council for formal

adoption. The service standards must at a minimum incorporate the administrative, technical, and economic development categories of the municipality. The following can be used as a guide in the development of these service standards:

- Administrative service standards
 - Turnaround time in dealing with correspondence (electronically or other) received.
 - Turnaround time in opening a consumer account.
- Technical service standards
 - Turnaround time in dealing with reported incidents (water leakage, pothole, etc.).
 - Turnaround time in restoring water and electricity connectivity.
- Economic development service standards
 - Turnaround time in processing rezoning applications.
 - Turnaround time in processing building plans.
 - Turnaround time in processing special business applications.

While its acknowledge that 'a one size fits all approach' is not feasible and that service standards will differ between municipalities. Notwithstanding, all municipalities need to proceed with the process of developing service standards to be approved by the municipal council.

5.9 Water security versus the developmental objective of local government

Water is a scarce resource and proactive measures need to be implemented by all municipalities in ensuring the management of this resource. This should however not impede municipalities in pursuing a developmental agenda aimed at stimulating local economic growth. In mitigating against this imminent risk, the Department of Water Affairs developed strategies and issued reduction targets in water consumption patterns of municipalities; the target date for achieving these predetermined reductions is 2014. Although some progress has been made by certain metropolitan municipalities in reducing consumption levels, the overall target has not been achieved. Municipalities need to ensure that strategies are in place to reduce overall water consumption including proactively managing non-revenue water. The Department of Water Affairs has finalised a report in this regard and the Minister will release the findings in due course.

5.10 Intergovernmental relationship between district and local municipalities

The role, purpose and mandate (power and functions) of district municipalities in relation to local municipalities are clearly defined in the Constitution. The current perception is that district municipalities don't serve any purpose and don't add value to broader service delivery outcomes in that they are a duplication of the functions undertaken by local government. This perception has been created by a blurring of the roles and responsibilities by these municipalities.

District municipalities are reminded that the grant framework and sharing of nationally raised revenue is based and informed by the actual allocation of functions such as the water function. If a district municipality has devolved the water function to the local municipalities within its area of jurisdiction it needs to ensure it provides for the transfer of a portion of the equitable share to the local municipalities actually performing the function through the district's budget process. The equitable share is gazetted as a transfer to the district and does not take into consideration internal arrangements and agreements between district and local municipalities.

Being highly grant dependent to fund operations district municipalities have started implying that the fiscal framework (grant framework) does not adequately fund their operations and directly contributes to imputed service delivery performance. It needs to be noted that National Treasury has in the past observed district municipalities spending excessively on new administrative buildings and luxurious office furnishings. In addition, excessive spending on vehicles, travelling and subsistence and over bloated remuneration structures has also been observed. District municipalities are reminded that they need to perform a support function to local municipalities and in doing so prioritise their budget appropriations accordingly and align to the national and provincial objectives in executing their mandate.

District municipalities are once again requested to ensure that they utilise grant funding in accordance with the national objectives and to ensure that grant funding reaches targeted focus areas.

National Treasury in consultation with the Department of Cooperative Governance will be reviewing the powers and functions of district municipalities in relation to the powers and functions of local municipalities; this will include a review of the intergovernmental fiscal framework.

5.11 The Municipal Regulation on a Standard Chart of Accounts (SCOA)

The publication of the draft Municipal Regulation on a Standard Chart of Accounts in September 2013 informed the formal consultation sessions held with representatives from municipalities and invitees from various stakeholders. Comments were invited, summarised in a register, discussed in detail by a workgroup consisting of senior officials from the National Treasury and appropriate comments and actions formulated. These inputs, among others, will inform SCOA Version 5 that will be made available with the final SCOA Regulation.

National Treasury would like to urge the management of municipalities to prioritise the preparation for implementation as a focus area for this budget planning period and the periods to follow to ensure that sufficient resources are available for this critical project. Implementation of a project of this nature, scope and resource allocation needs to become a strategic objective of the municipal council to ensure successful implementation.

The principles of SCOA are enshrined in Version 4 (available on the National Treasury website) of the classification framework and endeavours by the municipality to prepare for implementation should not be limited by the pending finalisation of SCOA. Immediate attention is required to bring the municipality on track for SCOA implementation and subsequent reporting in terms of this classification framework.

The Municipal Regulation on a Standard Chart of Accounts is in its final stages and will be gazetted by the Minister of Finance in due course. A follow-up MFMA Circular will be issued in guiding municipalities, with among others, the change management process and implementation phase of the SCOA.

5.12 Budgeting for the pending demarcation of various municipal boundaries

The Demarcation Board recently published proposed changes to municipal boundaries including the merging of various municipalities. Although it's acknowledged that any municipal boundary changes and incorporation of municipalities will have an impact on the municipal planning and budgeting processes, municipalities must maintain the status quo and budget as if it's business as usual; this includes providing for revenue appropriations as per the gazetted DoRA. Further guidance will be provided to affected municipalities as the process unfolds.

6 Conditional transfers to municipalities

Section 214 of the Constitution provides for national government to transfer resources to municipalities in terms of the annual Division of Revenue Act (DoRA) to assist them in exercising their powers and performing their functions. These allocations are announced annually in the national budget. Transfers to municipalities from national government are supplemented with transfers from provincial government. Further, transfers are also made between district municipalities and local municipalities.

The DoRA provides for funds to be allocated in different 'schedules'. Each of the schedules provide for grants of a particular type as follows:

Schedule 1		Equitable division of revenue raised nationally among the three spheres of government
Schedule 2		Determination of each province's equitable share of the provincial sphere's share of revenue raised nationally (as a direct charge against the National Revenue Fund)
Schedule 3		Determination of each municipality's equitable share of the local government sphere's share of revenue raised nationally
Schedule 4	Part A	Allocations to provinces to supplement the funding of programmes or functions funded from provincial budgets
	Part B	Allocations to municipalities to supplement the funding of programmes or functions funded from municipal budgets
Schedule 5	Part A	Specific purpose allocations to provinces
	Part B	Specific purpose allocations to municipalities
Schedule 6	Part A	Allocations-in-kind to provinces for designated special programmes
	Part B	Allocations-in-kind to municipalities for designated special programmes
Schedule 7	Part A	Allocations to provinces for immediate disaster response
	Part B	Allocations to municipalities for immediate disaster response

It is important that the transfers applicable to municipalities are made transparently, and properly captured in municipalities' budgets. In this regard, regulation 10 of the *Municipal Budget and Reporting Regulations* provides guidance on when municipalities should reflect a transfer or donation in their budgets. Note that promises of funds that do not meet the requirements set out in regulation 10 must not be included in the municipality's budget.

Municipalities are advised not to provide for transfers from national or provincial departments that are not gazetted in terms of the 2014 Division of Revenue Act (once enacted) or the relevant provincial budget, or that are not related to a properly approved agency agreement. Such ad hoc transfers are very often unauthorised expenditure at the national and provincial level, and are invariably related to fiscal dumping.

Also note that grants-in-kind (e.g. capital assets transferred by a district to a local municipality) need to be budgeted for as a 'transfer or grant' on Table A4 by the district municipality (and not on their Table A5 Capital Budget – since the expenditure does not get capitalised), and as a 'contributed asset' on Table A4 by the local municipality, and from there directly on Table A6 Budget Financial Position.

In support of regulation 10 of the *Municipal Budget and Reporting Regulations*, the 2014 Division of Revenue Bill provides that –

1. In terms of section 16, National Treasury is required to publish in the *Government Gazette* the allocations and indicative allocations for all national grants to municipalities;
2. In terms of section 30, each provincial treasury is required to publish in the *Government Gazette* the allocations and indicative allocations per municipality for every allocation to be made by the province to municipalities from the province's own funds; and
3. In terms of section 29, each category C municipality must indicate in its budget all allocations from its equitable share and conditional allocations to be transferred to each category B municipality within the category C municipality's area of jurisdiction.

The Government Gazette reflecting the allocations and indicative allocations for all national grants to municipalities will be available within 14 days of the 2014 Division of Revenue Act being signed into law at the following address:

<http://www.treasury.gov.za/legislation/bills/2014/Default.aspx>

In addition, National Treasury publishes a payment schedule that sets out exactly when the equitable share and national conditional grant funds are to be transferred to municipalities. This will be available at:

http://mfma.treasury.gov.za/Media_Releases/Municipal%20Payment%20Schedule/Pages/default.aspx

6.1 Timing of municipal conditional grant transfers

In order to facilitate synchronisation of the national / provincial financial year (1 April to 31 March) with the municipal financial year (1 July to 30 June), the 2014 Division of Revenue Bill requires that all equitable share and Schedule 4 and 5 conditional allocations to municipalities must be transferred to municipalities within the period 1 July 2014 to 31 March 2015. Municipalities must not accept any equitable share, Schedule 4 and Schedule 5 transfers from national or provincial departments outside of these timeframes.

National and provincial departments are also advised to only transfer grant funds and to only make agency payments to municipalities within the period 1 July 2014 to 31 March 2015. This is to ensure the municipality is able to include such funds on its budget for 2014/15 and to ensure that reporting on the use of the funds is properly aligned across the national, provincial and municipal financial years.

6.2 Payment schedule for transfers

National Treasury has instituted an automated payment system for transfers to municipalities in order to ensure appropriate safety checks are put in place.

Section 23 of the 2014 Division of Revenue Bill requires transfers to municipalities to be made as per the approved payment schedule published by National Treasury. Through this system, any transfers not in line with the payment schedule will be rejected. In addition, *if the payment details of the municipality are not up-to-date the transfers will also be rejected.*

6.3 Provincial payment schedules

The payment schedules that provincial treasuries are required to submit to National Treasury in terms of section 30(5) of the 2014 Division of Revenue Bill will be published on National Treasury's website, along with the national payment schedule.

6.4 Responsibilities of transferring and receiving authorities

The legal obligations placed on transferring and receiving officers in terms of the 2014 Division of Revenue Bill are very similar to previous requirements. National Treasury intends ensuring strict compliance in order to improve spending levels, and the quality of information relating to the management of conditional grants.

Municipalities are again reminded that compliance with the annual Division of Revenue Act is the responsibility of the municipal manager as the “receiving officer”. The municipal manager is responsible for, among other things, the tabling of monthly reports in council on whether or not the municipality is complying with the Division of Revenue Act. He/she is also responsible for reporting on any delays in the transfer or the withholding of funds. Failure on the part of a municipal manager to comply with the Act will have financial implications for the municipality as it will lead to the municipality losing revenue when funds are stopped and/or reallocated.

Where the municipality is unable to comply, or requires an extension, the municipal manager must apply to the National Treasury and provide comprehensive motivation for the non-compliance.

6.5 Unspent conditional grant funds for 2013/14

To bring legal certainty to the process of managing unspent conditional grant funds, section 21 of the 2013 Division of Revenue Act contains all provisions relating to the treatment of unspent conditional grant funding.

The process to ensure the return of unspent conditional grants for the 2013/14 financial year will be managed in accordance with section 21 of the Division of Revenue Act. In addition to the previous MFMA circulars, the following practical arrangements will apply –

- Step 1: Municipalities must submit their June 2014 conditional grant expenditure reports according to section 71 of MFMA reflecting all accrued expenditure on conditional grants.
- Step 2: When preparing their annual financial statements a municipality must determine what portion of each national conditional allocation it received remained unspent as at 30 June 2014. These amounts **MUST** exclude all interest earned on conditional grants and all VAT related to conditional grant spending that has been *reclaimed from SARS*, which must be disclosed separately.
- Step 3: If the receiving officer wants to motivate in terms of section 21(2) of the Division of Revenue Act 2013 that the funds are committed to identifiable projects or wants to propose an alternative payment method or schedule, the required information must be submitted to National Treasury by 29 August 2014. **National Treasury will not consider any rollover requests that are incomplete (see item 7.6 below) or that are received after this deadline.**
- Step 4: National Treasury will confirm in writing whether or not the municipality may retain as a rollover any of the unspent funds because they are committed to identifiable projects or whether it has agreed to any alternative payment methods or schedules by 1 October 2014.
- Step 5: A municipality must return the remaining unspent conditional grant funds that are not subject of a specific repayment agreement with National Treasury to the National Revenue Fund by **21 October 2014**. Failure to return these unspent funds by this date will constitute financial misconduct in terms of section 34 of the Division of Revenue Act.
- Step 6: Any unspent conditional grant funds that should have, but hasn't been repaid to the National Revenue Fund by 21 October 2014 will be offset against the municipality's November 2014 equitable share allocation.

All the calculations of the amounts to be surrendered to the National Revenue Fund will be audited by the Auditor-General.

6.6 Criteria for the rollover of conditional grant funds

Municipalities may not rollover unspent conditional grant spending in terms of section 28(2)(e) of the MFMA (read together with regulation 23(5) of the Municipal Budget and Reporting Regulations) because they are national/provincial funds. The applicable rollover process is then given effect through the municipal adjustments budget in January/February each year for all the cash/transfers that had already been transferred to the bank accounts of municipalities prior to the end of the financial year. In this regard refer to MFMA Budget Circular No. 51 for more information.

Section 21 of the 2013 Division of Revenue Act requires that any conditional grants which are not spent at the end of the municipal financial year must revert to the National Revenue Fund, unless the receiving officer proves to the satisfaction of National Treasury that the unspent allocation is committed to identifiable projects, in which case the funds may be rolled over.

When applying to retain unspent conditional allocations committed to identifiable projects or requesting a rollover in terms of section 21(2) of the Division of Revenue Act, municipalities must supply National Treasury with the following information –

1. A formal letter addressed to the National Treasury requesting the rollover of unspent conditional grants in terms of section 22(2) of the 2013 of DoRA;
2. List of all the projects that are linked to the unspent conditional grants;
3. Evidence that work on each of the projects has commenced, namely either of the following:
 - a. Proof that the project tender was published and the period for tender submissions closed before 30 June; or
 - b. Proof that a contract for delivery of the project was signed before 30 June.
4. A progress report on the state of implementation of each of the projects;
5. The amount of funds committed to each project, and the conditional allocation from which the funds come;
6. An indication of the time-period within which the funds are to be spent; and
7. Proof that the Chief Financial Officer is permanently appointed. ***No rollover requests will be considered for municipalities with vacant or acting chief financial officers.***

If any of the above information is not provided or the application is received by National Treasury after 29 August 2014, the application will be declined.

In addition, National Treasury will also take into account the following information when assessing rollover applications, and reserves the right to decline an application if there is non-performance by the municipality in any of these areas:

1. Compliance with the in-year reporting requirements in sections 71 and 72 of the MFMA and section 12 of the 2014 DoRA, including the municipal manager and chief financial officer signing-off on the information sent to National Treasury;
2. Submission of the pre-audit Annual Financial Statements information to National Treasury by 29 August 2014;
3. Accurate disclosure of grant performance in the 2013/14 pre-audit Annual Financial Statements;
4. Cash available in the bank as at 30 June 2014 to finance the roll-over request; and

5. Incorporation of the Appropriation Statement (discussed in point 6.7 below) as part of the pre-audit Annual Financial Statements.

When approving any rollover requests, National Treasury will use the latest conditional grant expenditure information available at the time, which in this instance is likely to be the disclosure of grant performance in the 2013/14 pre-audit Annual Financial Statements which must to be concluded by 31 August 2014.

Similarly to the above mentioned rollover process and in accordance with section 22(3)(b) of Division of Revenue Act, Provincial Treasuries are encouraged to institute measures and criteria for the rollover of conditional grant funds that municipalities receive from provincial departments.

6.7 Appropriation statement (Reconciliation: Budget and in-year performance)

In terms of GRAP 24 (Presentation of budget information in AFS) municipalities are required to present their original and adjusted budgets against the actual outcome in the annual financial statements; this is considered an appropriation statement. This statement is subject to auditing and accordingly supporting documentation would be required to substantiate the compilation of this statement. All municipalities were required to compile an appropriation statement with the 2012/13 AFS.

Many municipalities neglected to compile the appropriation as part of their 2012/13 AFS. National Treasury considered this non-compliance in a serious light and going forward the incorporation of an appropriation statement in the AFS will form part of the ***evaluation criteria in considering and approving conditional grant roll overs. In the absence of an appropriation statement National Treasury will not favourable consider conditional grant roll over applications.***

6.8 Reporting and accounting for municipal approved conditional grant roll-overs

A municipality must report separately on the spending of conditional grant funds that are rolled over. National Treasury has provided a separate reporting template to facilitate this. This template must be submitted together with the normal template for reporting conditional grant spending for the current year. The template is customised per municipality and must be requested by e-mail: lqdataqueries@treasury.gov.za.

7 The Municipal Budget and Reporting Regulations

National Treasury has released Version 2.6 of Schedule A1 (the Excel Formats). This version incorporates minor changes as communicated in MFMA Circular No. 70. Therefore ALL municipalities MUST use this version for the preparation of their 2014/15 Budget and MTREF.

Download Version 2.6 of Schedule A1 by clicking [HERE](#)

The Municipal Budget and Reporting Regulations are designed to achieve a range of objectives, including improving the local government sphere's ability to deliver services by facilitating improved financial sustainability and better medium term planning. The regulations, formats and associated guides etc. are available on National Treasury's website at:

<http://mfma.treasury.gov.za/RegulationsandGazettes/Pages/default.aspx>

All municipalities must prepare budgets in accordance with the regulations

Municipalities are reminded that the regulations apply to all municipalities and municipal entities as from 1 July 2009.

All municipalities and municipal entities must prepare annual budgets, adjustments budget and in-year reports for the 2014/15 financial year in accordance with the Municipal Budget and Reporting Regulations. In this regard, municipalities must comply with both:

- The formats set out in the Schedules to the Municipal Budget and Reporting Regulations;
- Ensuring Table A1 to A10 of the Municipal Budget and Reporting Regulations are accurately completed and specifically adopted by the municipal council;
- That supporting tables SA1 to SA37 are comprehensively and accurately completed and tabled before municipal council as part of the budget adoption process; and
- That the budget document (including the above mentioned tables) is supported by clear and concise narratives explaining the budget. It needs to be noted that the budget is an expression of the policy intent (IDP and strategic objectives) of the municipality and needs to be supported by clear narratives explaining the actual objectives over the Medium-term Revenue and Expenditure Framework. In this regard National Treasury issued the 'Dummy Budget Guide' to assist municipalities in compiling their MTREF budgets. Municipalities are urged to refer to the 'Dummy Budget Guide' which can be accessed at:

<http://mfma.treasury.gov.za/Guidelines/Pages/DummyBudgetGuide.aspx>

If a municipality fails to prepare its budget, adjustments budget and in-year reports in accordance with the relevant formats, actions the National Treasury will take include:

- The municipality will be required to **resubmit their MTREF Budget documentation** in the regulated format by a date determined by the National Treasury to the municipal council for adoption;
- The municipality's non-compliance with the required formats will be reported to the Auditor-General; and
- A list of municipalities that fail to comply with the required formats will be tabled in Parliament and the provincial legislatures.

If you require advice with the compilation of your budgets, the budget documents or Schedule A1 please direct your enquiries as follows:

	Responsible NT officials	Tel. No.	Email
Eastern Cape	Templeton Phogole Matjatji Mashoeshoe	012-315 5044 012-315 6567	Templeton.Phogole@treasury.gov.za Matjatji.Mashoeshoe@treasury.gov.za
Free State	Vincent Malepa Kgomotso Baloyi	012-315 5539 012-315 5866	Vincent.Malepa@treasury.gov.za Kgomotso.Baloyi@treasury.gov.za
Gauteng	Nozipho Molikoe Nomxolisi Mawulana	012-395 5662 012-315 5460	Nozipho.Molikoe@treasury.gov.za Nomxolisi.Mawulana@treasury.gov.za
KwaZulu-Natal	Bernard Mokgabodi Johan Botha Walter Munyai	012-315 5936 012-315 5171 012-395 6793	Bernard.Mokgabodi@treasury.gov.za Johan.Botha@treasury.gov.za Walter.Munyai@treasury.gov.za
Limpopo	Una Rautenbach Sifiso Mabaso	012-315 5700 012-315 5952	Una.Rautenbach@treasury.gov.za Sifiso.Mabaso@treasury.gov.za

Mpumalanga	Jordan Maja Anthony Moseki	012-315 5663 012-315 5174	Jordan.Maja@treasury.gov.za Anthony.Moseki@treasury.gov.za
Northern Cape	Willem Voigt Mandla Gilimani	012-315 5830 012-315 5807	Willem.Voigt@treasury.gov.za Mandla.Gilimani@treasury.gov.za
North West	Sadesh Ramjathan Kgothatso Matlala	012-315 5101 012-315 5005	Sadesh.Ramjathan@treasury.gov.za Kgothatso.Matlala@treasury.gov.za
Western Cape	Vuyo Mbunge Kevin Bell	012-315 5661 012-315 5725	Vuyo.Mbunge@treasury.gov.za Kevin.Bell@treasury.gov.za
Technical issues with Excel formats	Elsabe Rossouw	012-315 5534	lgdataqueries@treasury.gov.za

National Treasury, working with the provincial treasuries, will carry out a compliance check and where municipalities have not provided complete information, the budgets will be referred back to the municipalities, and an appropriate letter will be addressed to the Mayor and municipal manager. Municipal managers are reminded that the annual budget must be accompanied by a 'quality certificate' in accordance with the format set out in item 31 of Schedule A in the Municipal Budget and Reporting Regulations. The National Treasury would like to stress that where municipalities have not adhered to the Municipal Budget and Reporting Regulations, **those municipalities will be required to go back the municipal council and table a complete budget document aligned to the requirement of the Municipal Budget and Reporting Regulations.**

Municipalities with municipal entities are once again reminded that they need to produce consolidated budgets and in-year reports for both the parent entity and entity in that they need to produce:

- An annual budget, adjustment budget and monthly financial statements for the parent municipality in the relevant formats; and
- A consolidated annual budget, adjustments budget and monthly financial statements for the parent municipality and all its municipal entities in the relevant formats.

In addition, the A Schedule that the municipality submits to National Treasury must be the consolidated budget for the municipality (plus entities) and not the budget of the parent municipality.

This is to ensure that there is consistency of reporting both across municipalities, but also in respect of the individual municipalities with municipal entities.

7.1 Budget compliance and benchmarking processes

National Treasury and the provincial treasuries will again assess all the municipalities' tabled budgets against the Compliance Checklist. Where there is substantial non-compliance municipalities will be required to re-table their budgets in council as discussed above, otherwise municipalities will be expected to make the necessary improvements prior to tabling the budget for approval by 1 June 2014.

In addition, the National Treasury and provincial treasuries will be conducting benchmark budget hearings on the municipalities' tabled budgets during April and early May 2014 to assess whether the budgets are realistic, sustainable and relevant, and the extent to which they are funded in accordance with the requirements of the MFMA. In this regard, National Treasury will communicate further with the non-delegated municipalities, while the provincial treasuries will communicate with their respective delegated municipalities.

Municipalities are reminded that the Municipal Budget and Reporting Regulations provide not only for the technical framework for municipal budgets but also for minimum requirements in terms of the structure of the budget document, including narratives in support of the budget tables. It has come to the attention of the National Treasury that certain municipalities table their annual budgets (MTREF's) in formats other than that of the prescriptions contained in the MBRR. Tabling and adopting a municipal budget (MTREF) in a format other than that of the MBRR constitutes gross financial negligence on the part of the municipality and is outside the legislative framework.

For all practical purposes, a municipal budget that is tabled and adopted by a municipal council in any other format than the prescriptions of the MBRR does not legally constitute a municipal budget.

As part of the budget compliance and benchmarking processes to be undertaken by both the National Treasury and respective provincial treasuries compliance verification will include:

- Level of compliance to the Municipal Budget and Reporting Regulations;
- Verification of the format in which the 2014/15 MTREF budget was tabled in the municipal council. This will include proof of a council resolution in support of the tabled 2014/15 MTREF budget (Schedule A of the MBRR); and
- Budget document that includes narratives to the prescribed table of content and budget tables covering at least Tables A1 to A10.

With regard to Schedule A of the MBRR, municipalities are strongly advised to specifically pay attention and ensure that the following tables are accurately completed with relevant information as National Treasury and provincial treasuries will be undertaking detailed analysis:

- Table A10 – Consolidated basic service delivery information. Municipalities must ensure that information provided includes, among others:
 - Household service targets for water, sanitation, electricity and refuse;
 - Number of households receiving free basic services it relates to each service;
 - Cost of free basic services provided;
 - Highest level of free basis services provided by the municipality; and
 - Revenue cost of free basic services provided.
- Table SA36 – Consolidated detailed capital budget. Municipalities must ensure that this tables is comprehensively completed, reconciles back to Table A5 (Consolidated capital expenditure) and provides for the GPS coordinates of individual projects.

The above information is critical for, among others, policy formulation at all spheres of government and the information is routinely required by the Presidency (Department of Performance Monitoring and Evaluation).

7.2 Certification that budget is correctly captured

Once the municipal council has adopted the municipal budget in the format of Schedule A the relevant portions of the budgets reflected in Tables A1 to A10 need to be captured on the municipality's financial system so that the municipality can manage its revenue and expenditure against the adopted budget. It has come to National Treasury's attention that many municipalities do not capture their adopted budgets on their financial system, and even those that do, do not 'lock' the adopted budget – meaning that the budget reflected on the system can be changed at any time without following due process.

To eliminate this bad practice, National Treasury hereby requests the accounting officer of each municipality in terms of the section 74 of the MFMA to provide a signed certificate by no later than 15 July 2014 certifying that:

1. The adopted annual budget has been captured on the municipality's financial system, and that there is complete agreement between the budget on the system and the budget adopted by council;
2. That the adopted annual budget on the municipality's financial system is locked; and
3. That the municipality has in place controls to ensure that the budget captured on the financial system can only be changed in accordance with:
 - a. a virement authorised by the municipal manager, or duly delegate official, in terms of a council approved virements policy; and
 - b. an Adjustments Budget approved by council.

A template of the certificate is available on National Treasury' website at:

http://mfma.treasury.gov.za/Return_Forms/Pages/default.aspx

8 Budget process and submissions for the 2014/15 MTREF

Over the past number of years there have been significant improvements in municipal budget processes. Municipalities are encouraged to continue their efforts to improve their budget processes based on all previous guidance provided and the Municipal Budget and Reporting Regulations. Municipalities are reminded that the IDP review process and the budget process should be combined into a single process.

8.1 Submitting budget documentation and schedules for 2014/15

To facilitate oversight of compliance with Municipal Budget and Reporting Regulations, accounting officers are reminded that:

- Section 22(b)(i) of the MFMA requires that **immediately** after an annual budget is tabled in a municipal council it must be submitted to the National Treasury and the relevant provincial treasury in both printed and electronic formats. So if the annual budget is table to council on 31 March 2014, the final date of submission of the electronic budget documents is **Tuesday, 1 April 2014**. Hard copies must be received by no later than **Wednesday, 9 April 2014** including a council resolution in support of the tabled budget; and
- Section 24(3) of the MFMA, read together with regulation 20(1), requires that the approved annual budget must be submitted **within ten working days** after the council has approved the annual budget. So if the council only approves the annual budget on 30 June 2014, the final date for such a submission is **Monday, 14 July 2014**, otherwise an earlier date applies.

The municipal manager must submit:

- the budget documentation as set out in Schedule A of the Municipal Budget and Reporting Regulations, including the main Tables (A1 - A10) and all the supporting tables (SA1 – SA37) and prescribed minimum narrative information in both printed and electronic format;
- the draft service delivery and budget implementation plan in both printed and electronic format; and
- in the case of approved budgets, the council resolution.

As it relates to the hard copies of the budget document to be sent to the national and provincial treasuries, no budget document will be accepted if each page of the budget document (including schedules) are not formally stamped and signed by the secretariat responsible for ensuring accurate records of council decisions.

Municipalities are required to send electronic versions to lgdocuments@treasury.gov.za.

In the event that the file size exceeds 4 MB then please send it to lgbigfiles@gmail.com and notify the Local Government Database team via an e-mail (excluding the attachment) that the budget was submitted to the big files account.

Municipalities are required to send printed submissions of their budget documents and council resolution to:

For couriered documents

Ms Linda Kruger
National Treasury
40 Church Square
Pretoria, 0002

For posted documents

Ms Linda Kruger
National Treasury
Private Bag X115
Pretoria, 0001

After receiving tabled budgets, National Treasury and provincial treasuries will complete a compliance checklist. This checklist will indicate the level of compliance to the Municipal Budget and Reporting Regulations. A copy of the checklist will be sent to the municipality in order to facilitate improvements in the quality of tabled and approved budgets. Please review the municipality's performance last year, and ensure that the gaps are addressed.

8.2 Budget reform returns to the Local Government Database for publication

For publication purposes, municipalities are still required to use the Budget Reform Returns to upload budget and monthly expenditure to the National Treasury Local Government Database. *The old formats **may not** be used to submit 2014/15 budget information.* All municipalities must migrate to using the aligned version of the electronic returns. All returns are to be sent to lgdatabase@treasury.gov.za.

Returns for the 2014/15 budget must be submitted to the Local Government Database by **25 July 2014**.

The electronic returns may be downloaded from National Treasury's website at the following link: http://mfma.treasury.gov.za/Return_Forms/Pages/default.aspx.

8.3 Publication of budgets on municipal websites

In terms of section 75 of the MFMA all municipalities are required to publish their tabled budgets, adopted budgets, annual reports (containing audited annual financial statements) and other relevant information on the municipality's website. This will aid in promoting public accountability and good governance.

8.4 Publication of municipal budgets on the National Treasury website

National Treasury publishes all the approved municipal budgets on its website. However, before publishing National Treasury verifies the correctness of the information submitted by municipalities by comparing the following three sources of information:

1. The Approved Budget, which is the municipality's budget in the format of Schedule A as approved by council (hard copy).
2. Schedule A1, which is the electronic version of the budget Tables A1 to A10, and supporting tables.

3. The Database budgets, which is the municipal budget generated from the information the municipality submits in the Budget Reform Returns.

The information in the Schedule A1 and the Database budget returns **MUST** reconcile with the Approved Budget as this is the budget that council has adopted and is therefore the legal basis for all revenue collection and expenditure activities within the municipality.

While only **149 municipalities** managed to achieve this reconciliation in the 2012/13 financial year, **206 municipal budgets** were aligned in the 2013/14 financial year. Efforts will continue to ensure all municipalities meet requirements and further improve the quality of budget information.

This process of ensuring these three sources of budget information reconcile is referred to as the Budget Verification Process. Municipalities must ensure that all these three sources of information are aligned upon finalising their budgets, and when submitting their budget information to the National Treasury and provincial treasuries. The National Treasury and provincial treasuries will again check for this alignment before publishing the municipal budgets in October 2014.

Municipalities are reminded that the provision of incorrect or misleading information in any document required in terms of the Act constitutes an act of financial misconduct in terms of Section 171(1)(c) of the MFMA. In addition, National Treasury reserves the right to invoke section 38 of the MFMA and withhold a municipality's equitable share if a serious or persistent breach of the measures established in terms of Section 216(1) of the Constitution is committed.

All relevant documents mentioned in this circular are available on the National Treasury website, <http://mfma.treasury.gov.za/Pages/Default.aspx>. Municipalities are encouraged to visit it regularly as documents are regularly added / updated on the website.

9 General

9.1 Section 71- Consumer collection rates versus actual cash flow

Various municipalities do not have financial systems in place to report accurately to National Treasury on the breakdown of cash receipts and billings on property rates and individual service charges. It was found that collections are reported in aggregate for property rates and service charges and subsequently equally apportioned to property rates and service charges. In addition, many municipalities consistently report a collection rate in excess of a 100 per cent which is distorted when considering the growth in outstanding debtors. Not only does this deficient management practice detract from evidence based financial management it also distorts the information submitted to National Treasury. This can directly be attributed to weak management practices on the part of the municipality.

This problem is further exacerbated by the inconsistency in the methodologies applied in accounting for outstanding debtors. As a principle, all municipalities **must take note** of the inverse relation between growth in outstanding debtors and the actual collection (payment) rate; if outstanding debtors are increasing then the collection (payment) rate should inversely be decreasing. In addition, from a management perspective municipalities need to distinguish between current (30 day balance) and historic debt collection; debt **must** be classified and accounted for in terms of aging. Institutionalisation of these practices will empower managers to distinguish between the actual current collection rate and annualised collection (including historic debtors). In illustrating, a municipality might have a 100 per cent collection rate but at the same time debtors are increasing by 20 per cent. This scenario directly implies that the

current collection rate is effectively 80 per cent while 20 per cent of collections relate to historic debtors; differentiation in these measures is critical for decision making and performance management.

Municipalities must therefore ensure that the financial systems and subsequent reporting provides a detail breakdown for each service, including property rates which reconciles billings against actual receipts.

9.2 Offer of grant funding to municipalities: Metro Grant Holding

It has come to the attention of the National Treasury that a company by the name of 'Metro Grant Holding' is approaching municipalities with an offer of international donor funding subject to certain conditions. Several documents from the above-mentioned institution were submitted to the Chief Directorate: International Development Cooperation (IDC) regarding the proposed availability of "free funding" for the Republic of South Africa and more specifically municipalities. The National Treasury has concluded that this is in all probability a scam and municipalities must ensure they refrain from any engagements with this institution or any other institution offering donor (free) funding. In the event that municipalities have legitimate proposals of donor/grant funding they need to ensure such proposals are first forwarded to the National Treasury (Chief Directorate: International Development Cooperation) which will undertake the necessary due diligence and verification on the part of the municipality.

9.3 Annexures to MFMA Circular No. 72

Municipalities are once again reminded that through the MFMA Circulars municipalities are continuously advised and guided in respect of various subjects ranging from budgeting and accounting standards to the introduction of leading practices. In this regard municipalities must take note of the following annexures accompanying this Circular:

- Annexure A: Certification of Audited Annual Financial Statements by the Auditor General.
- Annexure B: Accounting treatment for agency services – housing function.
- Annexure C: Observations from the mid-year performance engagements – informal settlements.

Contact



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Post Private Bag X115, Pretoria 0001

Phone 012 315 5009

Fax 012 395 6553

Website <http://www.treasury.gov.za/default.aspx>

JH Hattingh

Chief Director: Local Government Budget Analysis

17 March 2014

Annexure A

Certification of Audited Annual Financial Statements by the Auditor General

It has come to the attention of the National Treasury that municipalities submit annual financial statements to the National and provincial treasuries that do not represent the actual audited annual financial statements of the municipality. Municipalities are not allowed to alter or make any changes to the audited annual financial statements without first obtaining the prior approval of the Auditor General in consultation with the National Treasury. This will ensure that:

- Audited AFS and which are distributed to organs of state and other stakeholders by municipal councils are complete, accurate, correct and certified and signed as final after the audit has been completed, and
- Compliance with Section 127(2) of the MFMA is achieved and presented with accuracy and reliability when the Executive Mayor / Mayor table the annual report to Council.

It is imperative that National Treasury address these inconsistencies by enforcing and eliminating any possibility of the municipality's Audited AFS being exposed to alterations without the knowledge and prior approval of the Auditor General as legislated in terms of Section 126(5) of the MFMA.

For this reason the National Treasury hereby issues the following directives to municipalities and their entities in terms of section 5(2)(f) of the MFMA and has requested the Auditor General to implement the following processes:

- The final adjusted and audited annual financial statements for all municipalities be certified, officially stamped and signed by Auditor General;
- The following statements be certified, stamped and signed by Auditor General:
 - Statement of Financial Position;
 - Statement of Financial Performance;
 - Statement of Changes in Net Assets; and
 - Cash Flow statement.
- The front cover page of the AFS read as follows: "Audited Annual Financial Statements".

The above measures will assist in refining local government processes and improving credibility of reported municipal performance information prior to the presentation to various stake holders and Parliament. Municipalities must therefore ensure the final Audited Annual Financial Statements abide to the abovementioned directives.

Annexure B

Accounting treatment for agency services - housing

Municipalities have requested National Treasury to provide guidelines on the accounting treatment for agency services and more specifically the housing function.

The following scenarios provide further clarification.

Scenario 1 – Construction contract (GRAP 11)

The municipality must account for the revenue and expenses relating to the construction of RDP houses in the statement of financial performance if the municipality is a contractor as defined in GRAP 11 on Construction Contracts.

GRAP 11 determines:

- *A construction contract is a contract, or a similar binding agreement, specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.*
- *A contractor is an entity that enters into a contract to build structures, construct facilities, produce goods or render services to the specifications of another entity, either itself or through the use of sub-contractors.*

In this scenario, the municipality must be appointed as the contractor in the construction of assets i.e. RDP houses.

Scenario 2 – Grant/transfer received from government (GRAP 23)

Depending on the agreement, funds transferred from another sphere of government might constitute a grant/transfer. If this is the case the rules and accounting treatment for grants/transfer should be applied as determined in GRAP 23 and all revenue and expenditure must be accounted for in the budget.

Scenario 3 – Agent vs principal agreements (GRAP 9)

In terms of GRAP 9, an entity is acting as a principal when it is exposed to the significant risks and rewards associated with the sale of goods or the rendering of services. Considerations in determining if an entity is acting as a principal include, but are not limited to:

- GRAP 9, paragraph 13 determines that in an agency relationship, the gross inflows of economic benefits or service potential, including amounts collected on behalf of the principal do not result in an increase in net assets for the entity. The amounts collected on behalf of the principal are not classified as revenue; revenue recognised in the books of the municipality is limited to the commission earned while performing the agency functions. This represents an agency agreement.
- An entity is acting as an agent when it does not have exposure to the significant risks and rewards associated with the sale of goods or the rendering of services. If the parties have entered into an agreement by which the amount the municipality earns is predetermined, being either a fixed fee per transaction or a stated percentage then the probability that the municipality is acting as an agent is high.
- There are instances where the municipality assists the provincial department with the construction of RDP houses within the municipality's jurisdiction; the municipality might also be involved in managing the flow of funds from the department to the contractors.

This represents an agent relationship as it does not provide services directly related to the construction of the RDP houses. Importantly, the receipt of an agency fee is not precondition for the transaction to be classified as an agency service.

If the relationship between the parties is deemed to be an agency agreement, the municipality is not required to reflect funds received from the transferring party as revenue, with the exception of commission. The primary reason being that the revenue is accrued to the contractor and not the municipality; similarly expenditures are accrued to the transferring party and not the municipality.

In dealing with these transactions it's advised that the municipality should account through the use of a creditor's account for all receipts and payments relating to the project; this in turn provides for reconciliation in the statement of financial position at year end. It's also proposed that a separate project account be utilised deal with receipts and payments; this will ensure no revenue and expenditure is reflected on the statement of operating performance.

Levels of accreditation and the implications on the accounting treatment

Level one accreditation – Housing function

Against accreditation level one, municipalities are responsible for beneficiary management, subsidy budget planning and allocation, and priority programme management and administration; municipalities are also responsible for identifying beneficiaries. The respective province is directly responsible for the appointment of contractors and building houses. Level one accreditation therefore constitutes an 'agency' function on part of the municipality as the revenue accrues to the provincial department and all work-in-progress during construction will also be accounted for by the province. In this regard Scenario 3 would apply and the municipality is not required to reflect funds received from the transferring party as revenue, with the exception of commission.

Level two accreditation – Housing function

In addition to the responsibilities associated with level one accreditation, the full programme management and administration of all housing instruments/ programmes are assigned to the municipality. Against level two accreditation, the municipality is responsible for the appointment, payment of contractors and building of houses. The grant revenue is allocated by the provincial department to the municipality and the province must gazette the allocations in favour of municipalities. In this regard Scenario 2 above will be applicable and municipalities are required to recognise the grant as revenue from non-exchange transactions in terms of GRAP 23. The municipality must also account for RDP houses as inventory after completion but before the transfer to beneficiaries take place.

Level three accreditation – Housing function

Level three accreditation includes budget planning, allocation and priority programme management and administration. This includes housing subsidy budgetary planning across programmes and projects, planning of subsidy/fund allocations, and project identification. As set out in the Housing Act, municipal responsibilities for local beneficiary management, local housing priorities and the management of public stock remain municipal responsibilities against this accreditation level. An important distinction between level 1, 2 and 3 accreditation is that with level 3 accreditation, the grant revenue is allocated by the national department to the municipality. Considering that the municipality is exposed to significant risks and rewards associated with the execution of the function, the municipality are classified as the principle entity and must account for revenue, expenditure and assets in terms of GRAP.

Determining between an agency and principal agreement requires judgement and consideration of all relevant facts, agreements and circumstances. Municipalities are strongly advised to review all existing contracts and where necessary either correct the accounting methodology in use or review the agreement between the parties to reflect actual intention of the agreement. If there is any uncertainty as to what constitutes an agency versus principal agreement and the subsequent accounting treatment thereof, municipalities are advised to contact the National Treasury (Office of the Accountant-General).

Annexure C

Observations from the Mid-year Performance Engagements: Informal Settlements

During the recent mid-year performance engagements conducted by the National Treasury with the 17 non-delegated municipalities leading practice was observed by several metropolitan municipalities as it relates to formalisation of informal settlements. As part of the formalisation process, all sites (plot/erf) are serviced and metered. They subsequently form part of the revenue value chain of the municipality in that the meters are consistently read on a monthly basis. Benefits of this leading practice include:

- Correlation between this leading practice and revenue improvements, places management in a position to actively manage consumption patterns and not only report this consumption as part of revenue foregone or non-revenue water and electricity;
- Improved management of the Indigent Registers; and
- Targeting of the indigent in terms of indigent exist strategies.

In addition, the title deed of the property (plot/erf) is immediately made available to the owners once serviced and formalised regardless if there is a top structure (RDP) on the property (plot/erf). This instils a sense of ownership and responsibility on the part of the owner.