


**NATIONAL TREASURY**
**MFMA Circular No 68**
**Municipal Finance Management Act No. 56 of 2003**
**Unauthorised, Irregular, Fruitless and Wasteful Expenditure**

The purpose of this Circular is to provide clarity on the procedures when dealing with unauthorised, irregular, fruitless and wasteful expenditure (UIFW) as per the Municipal Finance Management Act, 2003 (MFMA). It will be updated from time to time.

Municipalities are organs of state within the local sphere of government that collect monies from the public in the form of rates, levies, surcharges, fees and service charges, receive grants from national and provincial government, invest surplus cash and borrow for capital expenditure for long-term purposes or bridging finance for short term needs. These resources are appropriated by Council for the purpose of fulfilling its powers and functions, primarily to deliver services, in accordance with their mandate as set out in sections 151, 153 and 156 of the Constitution.

In terms of section 4(2)(a) of the Municipal Systems Act, (MSA) the council has a duty to use the resources of the municipality in the best interest of the local community. This duty is extended to individual councillors through the Code of Conduct for Councillors, which states that a councillor must:

- i. “perform the functions of office in good faith, honestly and in a transparent manner, and
- ii. at all times act in the best interests of the community and in such a way that the credibility and integrity of the municipality are not compromised.”

Equally the Accounting Officer and other officials have specific responsibilities in terms of the MFMA. The Auditor-General has highlighted an escalating trend in unauthorised, irregular, fruitless and wasteful expenditure in municipalities over recent years. At the same time, some municipalities were uncertain about how UIFW expenditure should be treated and who has the legislative power to deal with such matters, the process to be followed and the manner in which expenditure should be recorded and disclosed in the annual financial statements.

This Circular aims to provide clarity in this regard and to create a common understanding on the process to be followed in dealing with these categories of expenditure. In order to assist officials and councillors, annexures A to D provide information that supports the effective implementation in addressing UIFW. This is also illustrated in the attached flowchart, (Annexure C), which sets out a step-by-step process to assist municipalities in dealing with irregular expenditure and also reduce the extent of historical irregular expenditure prior to the commencement of the next audit cycle. It requires proactive closer in-year monitoring, recommendations to be processed and actions to be taken by the Administration and Council.

The Circular is supported by a Register (Annexure A) which will assist municipalities in recording, keeping track and managing the categories of expenditure mentioned above in a more transparent and accountable manner. The Register will be a central source of information concerning the UIFW expenditure incurred for Council and relevant external stakeholders, by clearly recording the details of the transaction, the type of expenditure, the person liable for the expenditure and what measures were taken by the municipality to address the matter.

Each Council has a duty to introduce and adopt policies and processes to:

- a) Prevent unauthorised, irregular, fruitless and wasteful expenditure;
- b) Identify and investigate unauthorised, irregular, fruitless and wasteful expenditure;
- c) Respond appropriately in accordance with the law;
- d) To address identified instances of unauthorised, irregular, fruitless and wasteful expenditure conclusively, as required by section 32 of the MFMA; and
- e) Implement consequence management where instances require.

## **Defining unauthorised, irregular, fruitless and wasteful expenditure**

### **Unauthorised expenditure**

Unauthorised expenditure is defined in section 1 of the MFMA as follows:

“unauthorised expenditure”, in relation to a municipality, means any expenditure incurred by a municipality otherwise than in accordance with section 15 or 11(3), and includes—

- (a) overspending of the total amount appropriated in the municipality’s approved budget;
- (b) overspending of the total amount appropriated for a vote in the approved budget;
- (c) expenditure from a vote unrelated to the department or functional area covered by the vote;
- (d) expenditure of money appropriated for a specific purpose, otherwise than for that specific purpose;
- (e) spending of an allocation referred to in paragraph (b), (c) or (d) of the definition of “allocation” otherwise than in accordance with any conditions of the allocation; or
- (f) a grant by the municipality otherwise than in accordance with this Act.

Section 15 of the MFMA deals with appropriation of funds for expenditure and provides that a municipality may, except where otherwise provided in the MFMA, incur expenditure only in terms of an approved budget and within the limits of the amounts appropriated for the different votes in an approved budget. With reference to MFMA section 1(a) in the definition above, a municipality’s budget is divided into an operational budget and a capital budget. Overspending must be determined in relation to both the operational budget and the capital budget.

With reference to MFMA section 1(b) – a municipality’s operational and capital budgets are divided into ‘votes’ which represent those components of the budget that have amounts appropriated for the financial year, for different departments or functional areas. The Municipal Budget and Reporting Regulations (MBRR) prescribe the structure and formats of municipal budgets, including votes, in Tables A1 to A10. Votes are informed by Table A3 (Budgeted Financial Performance: revenues and expenditure by municipal vote) and Table A5 (Budgeted Capital Expenditure by vote, standard classification and funding). Budget Table A4 (Budgeted Financial Performance: revenue and expenditure) by implication is approved by the council and as such must also be taken into consideration when determining unauthorised expenditure. In other words, when considering unauthorised expenditure from an operating budget point of view, both Table A3 and A4 (read in conjunction with the supporting table SA1) of the MBRR would have to be considered. Overspending must also be determined in relation to each of the votes on *both* the operational budget and the capital budget. Where Council has approved a *virement policy* that allows the accounting officer to make limited shifts of funds between votes, this must also be considered.

With reference to MFMA section 1(c) – funds appropriated in a vote for a department may not be used for purposes unrelated to the functions of that department. In other words, an accounting officer or other official may not use funds allocated to one department for purposes of another department or for purposes that are not provided for in the budget. Where a Council has approved a *virement policy*, shifts made in accordance with that policy may be allowed, and must be considered when reviewing such expenditure.

With reference to MFMA section 1(d) – in addition to appropriating funds for a department’s vote, the Council may also appropriate funds for a specific purpose within a department’s vote, for example, for specific training initiatives or a capital project. Funds that have been designated for a specific purpose or project may not be used for any other purpose.

With reference to MFMA section 1(e) – the items referred to in the definition of ‘allocation’ are national and provincial conditional grants to a municipality and other ‘conditional’ allocations to the municipality from another municipality or another organ of state. Any use of conditional grant funds for a purpose other than that specified in the relevant conditional grant framework is classified as unauthorised expenditure.

With reference to MFMA section 1(f) – section 67 of the MFMA regulates the transfer of municipal funds to organisations and bodies outside government. In terms of this section, a municipality may only provide grants to organisations and NOT individuals. Therefore, any grant to an individual is unauthorised expenditure, unless it is in terms of the municipality’s indigent policy or bursary scheme.

Therefore, valid expenditure decisions can only be made by council in terms of a budget or an adjustments budget. It follows that only the council may authorise instances of unauthorised expenditure and council must do so through an adjustment budget. This principle is further reiterated in section 32(2)(a)(i) of the MFMA read with regulation 25 of the MBRR which states that unauthorised expenditure must be authorised by the municipality in an adjustments budget that is approved by the municipal council. This is the rationale for the provisions in regulation 23(6) of the

MBRR which provides the legal framework for the authorisation of unauthorised expenditure.

### **Expenditures that are NOT classified as unauthorised expenditure**

Given the definition of unauthorised expenditure, the following are examples of expenditures that are NOT unauthorised expenditure:

- (i) Any over-collection on the revenue side of the budget as this is not an expenditure; and
- (ii) Any expenditure incurred in respect of:
  - any of the transactions mentioned in section 11(1)(a) to (j) of the MFMA;
  - re-allocation of funds and the use of such funds in accordance with a council approved virement policy;
  - overspending of an amount allocated by standard classification on the main budget Table A2 (Budgeted Financial Performance: revenue and expenditure by standard classification), as long as it does not result in overspending of a 'vote' on the main budget Table A3 (Budgeted Financial Performance: revenue and expenditure by municipal vote) and Table A4 (Budgeted Financial Performance: revenue and expenditure (read in conjunction with supporting Table SA1) of the MBRR; and
  - overspending of an amount allocated by standard classification on the main budget Table A5 (Budgeted Capital Expenditure by vote, standard classification and funding) of the MBRR so long as it does not result in an overspending of a 'vote' on the main budget Table A5.

### **Unauthorised expenditure on “non-cash” items**

Municipalities have raised concerns over non-cash items being classified as unauthorised expenditure owing to the total amount of the budget being exceeded. Such expenditure relates to debt impairment, depreciation, asset impairment, transfers and grants as appropriated in Table A4 (Budgeted Statement of Financial Performance: revenue and expenditure) of the MBRR.

Although these expenditures are considered non-cash items as there is no transaction with any service provider or supplier, an under provision during the budget compilation process is a material misstatement of the surplus or deficit position of the municipality. This could be the result of poor planning, budgeting or financial management, or unknown events that gave rise to the asset and debt impairment after adoption of the budget. In this regard Table A4 (Budgeted Statement of Financial Performance: revenue and expenditure) must be read in conjunction with supporting Table SA1 of the MBRR.

## Unforeseen and unavoidable expenditure

Unforeseen and unavoidable expenditure is discussed in section 29 of the MFMA and reads as follows:

- (1) The mayor of a municipality may in emergency or other exceptional circumstances authorise unforeseeable and unavoidable expenditure for which no provision was made in an approved budget.
- (2) Any such expenditure—
  - (a) must be in accordance with any framework that may be prescribed;
  - (b) may not exceed a prescribed percentage of the approved annual budget;
  - (c) must be reported by the mayor to the municipal council at its next meeting; and
  - (d) must be appropriated in an adjustments budget.
- (3) If such adjustments budget is not passed within 60 days after the expenditure was incurred, the expenditure is unauthorised and section 32 applies.

The framework referred to in section 29(2)(a) of the MFMA is prescribed in chapter 5 of the MBRR, and contained in regulations 71 and 72. The following shall apply:

- (i) the amount the mayor authorised as unforeseen and unavoidable expenditure exceeds the monetary limits set in regulation 72 of the MBRR, the amount in excess of the limit is unauthorised;
- (ii) the reason for the mayor authorising the unforeseen and unavoidable expenditure does not fall within the ambit of regulation 71(1) of the MBRR, the expenditure is unauthorised;
- (iii) the reason for the mayor not authorising the unforeseen and unavoidable expenditure falls outside the ambit of regulation 71(2) of the MBRR, the expenditure is unauthorised; and
- (iv) the council does not appropriate the expenditure in an adjustments budget that is passed within 60 days after the expenditure was incurred, the expenditure is unauthorised.

## Irregular expenditure

Irregular expenditure is defined in section 1 of the MFMA as follows:

- “irregular expenditure”, in relation to a municipality or municipal entity, means—
- (a) expenditure incurred by a municipality or municipal entity in contravention of, or that is not in accordance with, a requirement of this Act, and which has not been condoned in terms of section 170;
  - (b) expenditure incurred by a municipality or municipal entity in contravention of, or that is not in accordance with, a requirement of the Municipal Systems Act, and which has not been condoned in terms of that Act;
  - (c) expenditure incurred by a municipality in contravention of, or that is not in accordance with, a requirement of the Public Office-Bearers Act, 1998 (Act No. 20 of 1998); or

- (d) expenditure incurred by a municipality or municipal entity in contravention of, or that is not in accordance with, a requirement of the supply chain management policy of the municipality or entity or any of the municipality's by-laws giving effect to such policy, and which has not been condoned in terms of such policy or by-law, but excludes expenditure by a municipality which falls within the definition of "unauthorised expenditure".

In this context 'expenditure' refers to any use of municipal funds that is in contravention of the following legislation:

- Municipal Finance Management Act, Act 56 of 2003, and its regulations;
- Municipal Systems Act, Act 32 of 2000, and its regulations;
- Public Office-Bearers Act, Act 20 of 1998, and its regulations; and
- The municipality's supply chain management policy, and any by-laws giving effect to that policy.

### **Fruitless and wasteful expenditure**

Fruitless and wasteful expenditure is defined in section 1 of the MFMA as follows:

"fruitless and wasteful expenditure" means expenditure that was made in vain and would have been avoided had reasonable care been exercised.

The concept of *fruitless and wasteful expenditure* is founded on public administration and accountability principles, to promote "efficient, economic and effective use of resources and the attainment of value for money". The idea is also founded on the fact that the council, the mayor and the accounting officer have a fiduciary responsibility to ensure that municipal resources are used in the best interests of the municipality and the local community.

In this context 'expenditure' refers broadly to processes that must be followed, transactions with service providers or suppliers and the use of other resources belonging to the municipality. The phrase 'made in vain' indicates that the municipality derived no value for money from the expenditure or the use of other resources. Fruitless and wasteful expenditure must fulfil both the conditions in the definition, namely, that it was made in vain and it would have been avoided had reasonable care been exercised. The treatment of such expenditure is dealt with later in this Circular.

### **Process to be followed when dealing with unauthorised, irregular, fruitless and wasteful expenditure**

#### **Unauthorised expenditure**

In considering the authorisation of unauthorised expenditure, council must consider the following objective factors:

- (i) Has the matter been referred to Council for a determination and decision?
- (ii) Has the nature, extent, grounds and value of the unauthorised expenditure been submitted to Council?

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- (iii) Has the incident been referred to a council committee for investigation and recommendations?
  - (iv) Has it been established whether the accounting officer or official or public office bearer that made, permitted or authorised the unauthorised expenditure acted deliberately or in a negligent or grossly negligent manner?
  - (v) Has the accounting officer informed Council, the mayor or the executive committee that a particular decision would result in an unauthorised expenditure, as per section 32(3) of the MFMA?
  - (vi) Are there good grounds shown as to why an unauthorised expenditure should be authorised? For example:
    - the mayor, accounting officer or official was acting in the best interests of the municipality and the local community by making and permitting unauthorised expenditure;
    - the mayor, accounting officer or official was acting in good faith when making or permitting unauthorised expenditure; and
    - the municipality has not suffered a loss as a result of the action.

In these instances, the council should authorise the unauthorised expenditure. Depending on the responses received in relation to each question, municipal councils are advised to also include the element of consequence management as part of the above consideration. In this regard, municipalities are referred to the Municipal Regulations on Financial Misconduct Procedures and Criminal Proceedings, 2014 in assessing whether or not acts of financial misconduct were committed.

### **Adjustments budgets to authorise unauthorised expenditure**

Section 15 of the MFMA provides that a municipality may incur expenditure only in terms of an approved budget. This is confirmed by section 32(2)(a)(i) of the MFMA that provides that council may only authorise unauthorised expenditure in an adjustments budget.

Sections 28(2)(c) and 28(2)(g) of the MFMA, read together with regulations 23(1), 23(2), 23(4) and 23(6) of the MBRR, discusses when council may authorise unauthorised expenditure in an adjustments budget. This can be addressed in three different adjustments budgets as follows:

- (a) **Adjustments budget for unforeseen and unavoidable expenditure:** An adjustments budget to allow council to provide *ex post* authorisation for unforeseen and unavoidable expenditure that was authorised by the mayor in terms of section 29 of the MFMA must be tabled in council at the “first available opportunity” or within the 60 days after the expenditure was incurred (see section 29(3) of the MFMA). Should either of these timeframes be missed, the unforeseen and unavoidable expenditure must be treated in the same manner as any other type of unauthorised expenditure as set out in section 32(2)(a)(ii) of the MFMA.

- (b) **Main adjustments budget:** In terms of regulation 23(6)(a) of the MBRR, council may authorise unauthorised expenditure in the adjustments budget which may be tabled in council “at any time after the mid-year budget and performance assessment has been tabled in the council, but not later than 28 February of the current year”. Therefore, unauthorised expenditure that occurred in the first half of the current financial year may be authorised by council in this adjustments budget. Where unauthorised expenditure from this period is not identified or investigated in time to include in this adjustments budget, it must be held over to the following adjustments budget process noted below.
- (c) **Special adjustments budget to authorise unauthorised expenditure:** In terms of regulation 23(6)(b) of the MBRR, council may authorise unauthorised expenditure in a special adjustments budget tabled in council when the mayor tables the annual report in terms of section 127(2) of the MFMA. Kindly refer to MFMA Circular 63 for clarification in terms of the time period referred to in section 127(2) of the MFMA. This special adjustment budget “may only deal with unauthorised expenditure from the previous financial year which the council is being requested to authorise in terms of section 32(2)(a)(i) of the Act.” This special adjustment budget therefore deals with:
- unauthorised expenditure that occurred in the first half of the previous financial year that was not included in the main adjustments budget or that was included but referred back for further investigation or further information;
  - unauthorised expenditure that occurred in the second half of the previous financial year, and
  - any unauthorised expenditure identified by the Auditor-General during the annual audit process.

The timing of this special adjustments budget requires:

- the municipality to report all the unauthorised expenditure in its annual financial statements (thus ensuring transparency regarding its performance with implementing the budget);
- the Auditor-General to audit the municipality’s disclosure of its unauthorised expenditure and to add any further unauthorised expenditure identified in the audit process; and
- sufficient time (but also places a time limit given the date of tabling the Annual Report) for instances of unauthorised expenditure to be properly investigated before being presented to council for a decision on whether or not to authorise it; the investigation is normally done by a council committee. If the above timelines are not met, then such matter must be addressed during the following mid-year adjustment budget process.

With regard to the accounting disclosure of unauthorised expenditure in the books of the municipality in terms of section 125 of the MFMA, we are aware that not all of the unauthorised expenditure for a specific period relates to cash transactions. This therefore result in a distorted picture when reporting is done on this particular item in that the readers of the annual financial statements more often than not see unauthorised expenditure relating to non-cash items as money that was lost by the municipality. It is for this reason that we advise municipalities to distinguish in their



annual financial statements between unauthorised expenditure relating to cash and non-cash items. This will provide readers with a clear picture of expenditure that was not in terms of the council approved annual budget (cash items) and those instances where incorrect estimations were made which resulted in unauthorised expenditure (non-cash items).

In all instances where there is a clear overspending on the budget, i.e. the actual expenditure exceeds the budget, the municipality must pass an adjustment budget to authorise the over-expenditure within the timelines as legislated in regulation 23 of the MBBR.

However, in accordance with the definition of unauthorised expenditure in paragraphs (b), (c) and (d), these instances may not necessarily result in over-expenditure (i.e. actual may not exceed budget). In such an instance, an investigation in terms of section 32(2)(a)(ii) of the MFMA will suffice to address the unauthorised expenditure. Therefore, whilst municipalities will investigate and decide to write off the unauthorised budget (where it actual exceeds the budget), there must be an adjustment budget passed to authorise the unauthorised expenditure in cases where there was clear over expenditure in the budget. However, this must be done within the timelines as noted above.

Where a municipality fails to pass an adjustment budget to authorise the unauthorised expenditure, then such expenditure must be dealt with in accordance with section 32(2)(a)(ii) of the MFMA.

### **Recovery of unauthorised expenditure**

All instances of unauthorised expenditure that resulted in a financial loss to the municipality or misuse of public resources must be recovered from the liable official or political office-bearer, unless the unauthorised expenditure has been certified as irrecoverable by the council after an investigation by a council committee in terms of section 32(2)(a)(ii) of the MFMA.

Once it has been established who is liable for the financial loss resulting from the unauthorised expenditure, the accounting officer must, in writing, request that the liable official or political office-bearer pay the amount within 30 days or in reasonable instalments. If the person fails to comply with the request, the matter must be handed to the municipality's legal division for the recovery of the debt through the normal debt collection process.

Municipalities and municipal entities are reminded to incorporate consequence management processes as part of the expenditure recovery assessment. In other words, whenever unauthorised expenditure is incurred and it is referred to the council committee for investigation in terms of section 32(2)(a)(ii) of the MFMA, the committee must also assess whether or not the action or failure to act by any official constitute financial misconduct, as defined in sections 171 and 172 of the MFMA and make an appropriate recommendation to council for further action in terms of chapter 15 of the MFMA read with the Municipal Regulations on Financial Misconduct Procedures and Criminal Proceedings, 2014.

## Irregular expenditure

In terms of section 32(2)(b), irregular expenditure may only be written-off by Council if, after an investigation by a council committee, the irregular expenditure is certified as irrecoverable. In other words, writing-off is not a primary response, it is subordinate to the recovery processes, and may only take place if the irregular expenditure is certified by Council as irrecoverable.

With reference to section 1(a) as defined - in terms of section 170 of the MFMA, only the National Treasury may condone non-compliance with a regulation issued in terms of the MFMA or a condition imposed by the Act itself.

Municipal Councils therefore have no power in terms of the MFMA to condone any act of non-compliance in terms of the MFMA or any of its Regulations. Section 32(2)(b) of the MFMA provides the council only with the power to consider and resolve on the expenditure. Municipal Councils are, therefore, advised to ensure that the wording of their council resolutions is consistent with the wording in section 32(2)(b) of the MFMA i.e. "council hereby certify the expenditure as irrecoverable and resolve that it be written-off or for recovery of the funds". Municipal councils should note that its ability to resolve on the irregular expenditure is not dependent on National Treasury's decision in relation to the municipality's application for condonation in terms of section 170.

It is solely dependent on the investigation and recommendation from the council committee. Whatever the municipal council resolves is sufficient for the municipality to adjust its annual financial statements from an accounting disclosure perspective. The treatment of expenditure associated with the non-compliance is, therefore, the responsibility of the Council and is elaborated on later in this Circular.

With reference to section 1(b) as defined – there is no provision in the Municipal Systems Act (MSA) that allows for a contravention of the Act to be condoned. Nevertheless, should a municipality wish to request that an act of non-compliance with any provision of the MSA be condoned, then the accounting officer should address the request to the Minister of Co-operative Governance and Traditional Affairs, who is responsible for administering the MSA. The resultant expenditure should, however, be dealt with in terms of section 32(2) of the MFMA.

With reference to section 1(c) as defined – there is no provision to allow irregular expenditure resulting from a contravention of the Public Office-Bearers Act to be condoned. This is consistent with section 167(2) of the MFMA, which provides that such irregular expenditure cannot be written-off and must be recovered from the political office-bearer concerned.

With reference to section 1(d) as defined – a council may condone a contravention of the council approved SCM policy or a by-law giving effect to such policy, provided that the contravention is not also a contravention of the MFMA or the SCM regulations, in which case (a) applies and then only National Treasury can condone a contravention of the SCM regulations. Any such requests must be accompanied by a full motivation and submitted to [mfma@treasury.gov.za](mailto:mfma@treasury.gov.za) for consideration.

Municipalities and municipal entities are cautioned that this is an onerous process that should not be taken lightly, and is generally discouraged, as a practice.

Once the Accounting Officer or Council becomes aware of any allegation of irregular expenditure, such allegation must be referred to the municipality's disciplinary board or any other appropriate investigative body for investigation, to determine whether or not grounds exist for a charge of financial misconduct to be laid against the official liable for the expenditure. Such referrals must be time-bound to ensure outcomes of investigations are not unduly delayed. Further guidance on the processes to follow in investigating allegations of financial misconduct can be found in the Municipal Regulations on Financial Misconduct Procedures and Criminal Proceedings read with MFMA Circular 76.

### **Ratification of minor breaches of the procurement process**

In terms of regulation 36(1)(b) of the Municipal Supply Chain Management Regulations, the supply chain management policy of a municipality may allow the accounting officer to ratify any minor breaches of the procurement processes by an official or committee acting in terms of delegated powers or duties which are purely technical in nature. Where a municipality's supply chain management policy does not include this provision the accounting officer cannot exercise this ratification power. It is important to note that the accounting officer can only rely on this provision if the official or committee who committed the breach had the delegated authority to perform the function in terms of the municipality's adopted System of Delegations, which must be consistent with the MFMA and its regulations. The process to deal with minor breaches of the SCM policy is contained in a flowchart, refer to Annexure B.

Regulation 36(2) states that the accounting officer must record the reasons for any deviations and report to the next Council meeting, and disclose this in a note to the annual financial statements. The emphasis is on recording the "reasons for any deviations and the associated expenditure".

In terms of regulation 36 of the SCM Regulations, the accounting officer is responsible for deciding whether a particular breach of procurement processes is minor or material. In exercising this discretion, the accounting officer must be guided by:

- a) the specific nature of the breach: is it simply technical in nature, not impacting in any significant way on the essential fairness, equity, transparency, competitiveness or cost effectiveness of the procurement process?
- b) the circumstance surrounding the breach: are the circumstances justifiable?
- c) the intent of those responsible for the breach: were they acting in good faith?
- d) the financial implication as a result of the breach: what was the extent of the loss or benefit?

All the factors above must be considered before the accounting officer exercises his or her discretion. The accounting officer would have to consider the merits of each breach of the procurement processes and take a decision as to whether it should be classified as a minor or material breach.

Whether the resultant expenditure will be irregular is dependent on when the minor breach was identified. If the minor breach was identified before the award of the tender, such instance should be dealt with purely as a non-compliance matter through the ratification of a minor breach process. There will be no irregular expenditure since no expenditure had been incurred up to that point in time and the accounting officer will be authorised to address the matter conclusively. The relevant documentation supporting this decision should be maintained for audit purposes.

Should the minor breach be detected after the award was made and expenditure had been incurred for services rendered, there will be non-compliance and the resultant expenditure, will be regarded as irregular. In this instance, the accounting officer may ratify the minor breach provided that the breach in question is not simultaneously also a breach of the Municipal Supply Chain Management Regulation or the Act itself. The associated expenditure will have to be processed in terms of section 32(2)(b) of the MFMA. Note that the ratification of the minor breach by the accounting officer does not automatically regularise the expenditure as the legislative authority in this regard vests with the municipal council, after an investigation by a council committee. Refer to MFMA Circular 92 and the MPAC guide and toolkit for assistance on the process to be followed to address the irregular expenditure.

Note that this category only covers breaches of procurement processes in the municipality's SCM policy and not breaches of other legislation or regulations.

It is important to highlight that, in terms of the regulation 36 of the SCM Regulations, only the accounting officer can consider the ratification of minor breaches of procurement processes that are purely of a technical nature.

It is advisable that the accounting officer implement appropriate processes in the municipality's SCM policy to investigate the nature of the breach so that he/she can make an informed decision on corrective action. In the event that a breach falls outside the classification of a minor breach, the accounting officer cannot follow the remedy contained in regulation 36(1)(b).

It is recommended that accounting officer investigate the nature of the breach through its Internal Audit Unit or any other investigation body and adopt corrective action as recommended.

The SCM regulation 36(2) specifies a separate process for reporting the ratification of minor breaches to Council, after they have been ratified by the accounting officer. The findings of any investigation must be reported to the accounting officer for consideration when taking a decision in this regard. It is important to maintain documentary evidence for audit purposes.

### **Disciplinary and criminal charges for unauthorised, irregular, fruitless and wasteful expenditure**

If, after having followed a proper investigation, the Council concludes that the political office-bearer or official responsible for making, permitting or authorising unauthorised, irregular, fruitless and wasteful expenditure did not act in good faith or committed an act of financial misconduct, then the municipality must consider instituting disciplinary

action and criminal charges against the liable person/s in terms of chapter 15 of the MFMA read with the Municipal Regulations on Financial Misconduct Procedures and Criminal Proceedings.

If the action of the person(s) liable falls within the ambit of the above description, then the Council, mayor or accounting officer (as may be relevant) must institute disciplinary charges as follows:

- (i) *Financial misconduct in terms of section 171 of the MFMA read with the Municipal Regulations on Financial Misconduct Procedures and Criminal Proceedings*: in the case of an official that deliberately or negligently:
  - contravened a provision of the MFMA which resulted in unauthorised, irregular, fruitless and wasteful expenditure; or
  - made, permitted or authorised an irregular expenditure (due to non-compliance with any of legislation mentioned in the definition of irregular expenditure);
- (ii) *Breach of the Code of Conduct for Municipal Staff Members*: in the case of an official whose actions in making, permitting or authorising unauthorised, irregular, fruitless and wasteful expenditure constitute a breach of the Code; and
- (iii) *Breach of the Code of Conduct for Councillors*: in the case of a political office-bearer, whose actions in making, permitting or authorising unauthorised, irregular, fruitless and wasteful expenditure constitute a breach of the Code. This would also include instances where a councillor knowingly voted in favour or agreed with a resolution before council that contravened legislation resulting in unauthorised, irregular, fruitless and wasteful expenditure when implemented, or where the political office-bearer improperly interfered in the management or administration of the municipality.

### **Investigation of irregular expenditure by the council committee referred to in section 32(2)(b) of the MFMA**

Section 32(2)(b) of the MFMA requires an investigation by a council committee before the Council can certify any irregular expenditure as irrecoverable. It is important to note that the aim of such an investigation is to establish whether the irregular expenditure must be recovered utilising the factors outlined in regulation 74 of the Municipal Budget and Reporting Regulations. This, therefore, means that the context of the investigations to be undertaken by the council committee referred to in section 32(2)(b) of the MFMA is of such a nature that it does not require a forensic investigation.

Section 32(4) of the MFMA, requires the accounting officer to promptly inform the mayor, amongst others, in writing, of:

- (a) any unauthorised, irregular or fruitless and wasteful expenditure incurred by the municipality;
- (b) whether any person is responsible or under investigation for such unauthorised, irregular or fruitless and wasteful expenditure; and
- (c) the steps that have been taken:
  - (i) to recover or rectify such expenditure; and
  - (ii) to prevent a recurrence of such expenditure.

The report to the mayor, which will be tabled in Council and referred to the Municipal Public Accounts Committee (MPAC), to investigate the recoverability of the irregular expenditure, must address the considerations, as outlined in regulation 74 of the Municipal Budgets and Reporting Regulations.

The report must also address whether, despite the non-compliance that was detected, there was any value for money obtained by the municipality and any losses suffered due to the non-compliance so detected. The report must address the following questions:

- (a) whether the goods or services were received, and if received;
- (b) whether the goods or services were aligned to the specifications, and if aligned;
- (c) whether the price paid for the goods and services is/was market related.

Therefore, if the MPAC find that the municipality did not suffer any loss due to the non-compliance, it must recommend to the municipal council that the irregular expenditure be written-off. In terms of section 32(5) of the MFMA, the writing-off of any unauthorised, irregular or fruitless and wasteful expenditure as irrecoverable, is no excuse in criminal or disciplinary proceedings against a person charged with the commission of an offence or a breach of the MFMA relating to such unauthorised, irregular or fruitless and wasteful expenditure. Therefore, even if the municipal council resolve to write-off irregular expenditure as irrecoverable, the act of non-compliance must still be referred to the Disciplinary Board for further investigation in terms of chapter 15 of the MFMA read with the Municipal Regulations on Financial Misconduct Procedures and Criminal Proceedings, 2014.

Note that the same process as outlined above must be followed when municipalities and municipal entities must procedurally address and process historical irregular expenditure spanning back more than one year. For accounting related disclosure guidance, refer to Annexure D attached to this Circular. It is important to note the municipalities and municipal entities prepare their annual financial statements on the accrual basis of accounting. In relation to unauthorised, irregular and fruitless and wasteful expenditure, it means that transactions other events and conditions are recognised when they occur (and not only when cash or its equivalent is received or paid). When the accrual basis of accounting is used, items are recognised as assets, liabilities, net assets, revenue and expenses (the elements of financial statements) when they satisfy the definitions and recognition criteria for those elements in the *Framework for the Preparation and Presentation of Financial Statements*.

### **Irregular Expenditure incurred by Municipal Entities**

Section 102 of the MFMA read together with regulation 75 of the MBRR provides the framework within which a municipal entity will deal with irregular expenditure. Regulation 75(1) of the MBRR grants the board of directors, the power to investigate instances of irregular expenditure in the municipal entity and upon the conclusion of such an investigation, it must decide whether or not the expenditure is irrecoverable. Therefore, the board of directors will take the final decision on the recoverability of irregular expenditure and report to the municipal council of the parent municipality for noting.

Further to the above, in terms of regulation 75(2)(a) of the MBRR, the board of directors may certify irregular expenditure as irrecoverable if it finds that, the expenditure is indeed irrecoverable. After the board of directors has certified the irregular expenditure as irrecoverable, it must submit the certification of recoverability to the mayor of the parent municipality in terms of regulation 75(2)(a) of the MBRR. The submission to the mayor is for information purposes and not for the parent municipality to deal with the matter as the power to decide on the recoverability of a municipal entity's irregular expenditure vests with the board of directors of the relevant municipal entity. The board of directors therefore has the same powers as the municipal council (as outlined in section 32(2)(b) of the MFMA) when it comes to deciding whether to write-off or recover irregular expenditure.

Refer to annexure D to this circular for further guidance on the disclosure of the irregular expenditure for municipal entities.

### **Recovery of irregular expenditure**

All financial losses resulting from irregular expenditure must be recovered from the liable official or political office-bearer, unless the expenditure is certified by the municipal council, after investigation by a council committee, as irrecoverable and written-off by the council in terms of section 32(2)(b) of the MFMA. The National Treasury has issued an MPAC Guideline and Toolkit, supported by MFMA Circular 92. This can also be used to clarify the roles and responsibilities of MPAC and for training purposes. Members of the MPAC who would be considering the recoverability of all unauthorised, irregular, fruitless and wasteful expenditure are encouraged to use this Guide as they perform their responsibilities in terms of section 32 of the MFMA.

Irregular expenditure resulting from breaches of the Public Office-Bearers Act is an exception in that the irregular expenditure must be recovered from the political office-bearer to whom it was paid, who might not have been responsible for making, permitting or authorising the irregular expenditure.

Once it has been established who is liable for the irregular expenditure, the accounting officer must in writing request that the liable political office-bearer or official pay the amount within 30 days or in reasonable instalments. If the person fails to comply with the request, the matter must be recovered through the normal debt collection process of the municipality. The municipality can also institute measures to recover monies paid from suppliers of assets, goods or services not received, as may be appropriate.

Municipalities and municipal entities must take note of the amendments to the Public Audit Act, and the regulations issued, which amongst others provides for the Auditor-General to issue a certificate of debt where an accounting officer or accounting authority has failed to recover losses from a responsible person and to instruct the relevant executive authority to collect the debt.

The accounting treatment of the recovery of the irregular expenditure is set out in annexure D to this circular.

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## Quantifying the full extent of irregular expenditure

The municipality must quantify the total amount of irregular expenditure and record it in the register of irregular expenditure for disclosure in the financial statements for the period under review, as required by section 125(2) of the MFMA. Complete, accurate and relevant documentation should be readily available and easily accessible for audit purposes.

The process of quantifying irregular expenditure identified or discovered in the reporting period includes all irregular expenditure identified during and after reporting date, but before those financial statements are authorised for issue. Such irregular expenditure must then be included in the irregular expenditure register and AFS disclosure notes.

The quantification exercise also extends to irregular expenditure relating to prior period that are sometimes not discovered until a subsequent period. In this regard, it must be noted that all expenditure relating to multi-year contracts found to be non-compliant with the formal procurement framework and processes, will be regarded as irregular expenditure over the term of the contract.

For example, in the current period, the municipality identified non-compliance on a multi-year contract relating to a prior period that gave rise to irregular expenditure. The resultant irregular expenditure on that specific contract must be quantified from inception of the contract and recorded in the current period as irregular expenditure, identified in the current period, relating to the prior period(s). It follows that any expenditure incurred in subsequent years on such an irregular multi-year contract will also be regarded as irregular expenditure, which should be quantified and recorded in the period under review.

If the municipality was qualified on the completeness of irregular expenditure, the municipality must quantify the full extent of the irregular expenditure so that it can correct the error from the earliest date possible.

This will allow for corrective measures to be taken, after investigation by a council committee as required by section 32(2)(b) of the MFMA. The council committee to recommend recovery or write-off, including any irregular expenditure incurred on a multi-year contract that is accounted for in the financial period in which that irregular expenditure has been incurred. Once that is concluded, the Council can take a decision. Such decisions form part of the resolutions which will serve as the basis to regularise the matters from a recording, reporting and disclosure perspective. It will then be reflected as such corrective actions or regularisation, supported by appropriate explanations. The result will be the reduction of irregular expenditure balances as disclosed.

Refer to annexure D for the presentation and disclosure of the irregular expenditure on a multi-year contract.



Municipalities are encouraged to make every reasonable effort to quantify (Rand value) the full extent of the irregular expenditure and ensure that complete, accurate and relevant documentation is available. Where necessary, the municipality may need to create or reconstruct such data or information to quantify the full extent of the irregular expenditure. Municipalities must note any missing documents, as a result of deficiencies in the record keeping, system of internal control and other unforeseen events.

Where impracticability impairs a municipality's ability to quantify the full extent of irregular expenditure, the municipality must disclose for a particular prior period, the circumstances that led to the existence of that condition and a description of how and from when, to the extent practical, the amount of irregular expenditure has been quantified.

In the case of a disagreement with the auditors', the municipality or municipal entity is encouraged to also consult with its Internal Audit Units and Audit Committee, and to use the existing formal dispute resolution mechanisms to address the matter. Such disagreements between a municipality and the auditors should ideally be resolved before the conclusion of the audit and the signing of the auditor's report.

### **The Disclosure of Irregular Expenditure VAT inclusive**

A number of municipalities requested clarification in relation to disclosure of irregular expenditure from a VAT perspective.

Municipalities are advised to record their irregular expenditure in the irregular expenditure register and consequently disclose it in the annual financial statements (AFS) inclusive of VAT. The latter is due to the amount of the transgression from the provisions of the applicable legislation as contained in the definition of the irregular expenditure is the full value of the transaction involved and not just a portion of the transaction. It is therefore important to include VAT in the register and the AFS disclosure note for them to also be complete. It therefore follows that should the irregular expenditure need to be recovered or written off at a later stage (once all the due processes have been followed as stipulated in the MFMA), the total amount to be recovered or written off would be the full value of the transaction involved. VAT would not be an issue at that stage either, as the normal VAT rules would apply accordingly.

Recording irregular expenditure in the register and in the disclosure of the AFS inclusive of VAT is not in contravention of any GRAP standard nor the reporting framework and is also not in contravention of the VAT Act, since the entity is expected to continue accounting for the underlying transactions in terms of the applicable GRAP standards. For example, the underlying transaction refers to the acquisition of the item of PPE and the irregular expenditure refers to the non-compliance to the SCM procurement processes in acquiring that item of PPE. The disclosure of the irregular expenditure in the AFS (and resultantly having a register to support this disclosure) represents just the quantification of the amount of transgression as a result of non-compliance with the relevant legislation to enhance accountability and therefore should not be construed as an "underlying accounting transaction". Hence, with this background in mind fair presentation in the AFS should not be negatively affected.

Recording irregular expenditure this way enhances accountability. i.e. why the MFMA and not GRAP standards require the irregular expenditure to be disclosed in the AFS.

### **Unauthorised expenditure and municipal entities**

The definition of unauthorised expenditure in section 1 of the MFMA makes specific reference to a municipality and does not incorporate a municipal entity in the definition. It therefore follows that a municipal entity cannot incur unauthorised expenditure for purposes of the MFMA.

In terms of section 87(8) of the MFMA, a municipal entity may incur expenditure only in accordance with its approved budget or adjustment budget. Therefore, where a municipal entity overspends its budget, such expenditure will be irregular expenditure as the municipal entity incurred expenditure in contravention of a provision of the MFMA.

When disclosing this expenditure, the parent municipality will disclose it as unauthorised expenditure, with a clear explanation and disaggregation of such disclosures, since council approves a consolidated budget and annual financial statements, incorporating allocations for both the parent municipality and the municipal entity.

Refer to annexure D to this circular for guidance on the disclosure of the irregular expenditure for municipal entities.

### **Fruitless and Wasteful expenditure**

The processes to respond appropriately to fruitless and wasteful expenditure are similar to the following three processes outlined for irregular expenditure:

- (i) *disciplinary charges* against officials and political office bearers;
- (ii) *criminal charges* against officials and political office-bearers; and
- (iii) *recovery* of the fruitless and wasteful expenditure from the liable persons.

The description of the categories of irregular expenditure in the above three instances can be applied directly to fruitless and wasteful expenditure. The difference is that fruitless and wasteful expenditure can arise in any circumstance and is not dependent on non-compliance with any legislation.

Council should follow section 32(2)(b) of the MFMA when dealing with instances of fruitless and wasteful expenditure.

### **Registers of unauthorised, irregular, fruitless and wasteful expenditure**

All instances of unauthorised, irregular, fruitless and wasteful expenditures must be reported to the mayor, the Council, the MEC for finance and local government in the province, the Auditor-General and disclosed in the annual financial statements. This disclosure will assist in addressing challenges relating to expenditure control and transparent reporting in order to strengthen accountability and give full effect to the

oversight, compliance, monitoring, reporting and support measures introduced by the relevant treasury, as required in the MFMA.

All municipalities and municipal entities must maintain full and proper records of their affairs, as required by sections 62(1)(b) and 95(b) of the MFMA. Accordingly, the accounting officers must ensure that the municipality and municipal entity have proper processes in place to record and manage unauthorised, irregular, fruitless and wasteful expenditure should it occur. Therefore, as part of complying with these provisions of the MFMA, accounting officers (who may delegate the task to the chief financial officer) must set-up and maintain a *Register of Unauthorised, Irregular, Fruitless and Wasteful Expenditure*. Ideally, a separate register should be maintained for each type of expenditure to facilitate easier management, tracking and reporting.

The introduction of a 'register' to capture unauthorised, irregular, fruitless and wasteful expenditure incurred, as set out in annexure A, will assist municipalities and municipal entities to maintain a complete and accurate record thereof. The register will further assist to prevent audit findings on the completeness of unauthorised, irregular, fruitless and wasteful expenditure incurred, as reported by the Auditor-General. The register is also useful in tracking the progress of dealing with the consequences flowing from such expenditures until all the issues that gave rise to the expenditures have been resolved properly in accordance with the section 32 of the MFMA.

Annexure A sets out the minimum information that should appear in such a register. Municipalities and municipal entities are free to add more detail to the register should they deem this necessary. This includes disaggregating into different categories for better understanding by municipal management, councillors and the general public. Using such information to explain in communications to council, the public and other stakeholders can assist in addressing perceptions.

The accounting officers should implement appropriate controls to ensure that the unauthorised, irregular, fruitless and wasteful expenditure registers are updated at least monthly, including controls to ensure that the registers are accurate and complete. The registers should be supported by complete, accurate and relevant supporting documentation that is easily accessible and available for verification purposes. To this extent, the accounting officer should clearly assign responsibilities for updating, maintaining, reviewing and monitoring of the registers of unauthorised, irregular, fruitless and wasteful expenditure to individuals with the right level of authority, experience and skill.

### **Disclosure of unauthorised, irregular, fruitless and wasteful expenditure in the annual financial statements**

In terms of section 125(2) of the MFMA, the notes to the annual financial statements of a municipality and municipal entity must include, amongst others, particulars of any material losses and any material irregular, fruitless and wasteful expenditure, including in the case of a municipality, any material unauthorised expenditure that occurred during the financial year, and whether these are recoverable.

The section also requires disclosure of any criminal or disciplinary steps taken as a result of such losses or such unauthorised, irregular, fruitless and wasteful expenditure, and any material losses recovered or written-off.

When it comes to disclosure of irregular expenditure due to non-compliance with section 87(8) of the MFMA by municipal entities, refer to GRAP 24 which is an accounting standard that deals with budget vs actual amounts, and it requires a separate line item and material variances to be explained. Therefore, there should be a separate line item disclosure and explanations of material variance rather than just showing total amounts when municipal entities disclose irregular expenditure due to non-compliance with section 87(8) of the MFMA.

Annexure D describes the accounting treatment and disclosure requirements of irregular, fruitless and wasteful expenditure.

### **Conclusion**

This MFMA circular provides for a basis by which municipalities and municipal entities can define, identify and respond to instances of unauthorised, irregular, fruitless and wasteful expenditure.

National Treasury strongly recommends that municipalities and municipal entities implement and maintain registers of unauthorised, irregular, fruitless and wasteful expenditure.

All unauthorised, irregular, fruitless and wasteful expenditure must be investigated, as required by the MFMA. The municipal councils should implement appropriate measures to monitor the implementation of its recommendations emanating from such investigations to promote effective accountability. Given the extent of the incidents relating thereto, it is also expected that this be addressed in both municipal official's performance agreements and councillor's performance.

Municipal councils should take adequate steps to reduce the growing balances of historical unauthorised, irregular and fruitless and wasteful expenditure by ensuring the investigation thereof within a reasonable period of time, while strengthening preventative measures, which will have a positive impact on the municipality's performance. This applies equally to the accounting officers and board of directors of municipal entities.

The consequence management framework, as set out in Chapter 15 of the MFMA and the Municipal Regulations on Financial Misconduct Procedures and Criminal Proceedings has been strengthened, as it relates to financial misconduct with the requirement to establish of disciplinary boards and clarifying the roles and responsibilities of municipal public accounts committees and other functionaries involved in consequence management.

This Circular should be shared with the internal audit units, audit committees and municipal public accounts committees.

As part of the accountability process, it is incumbent upon municipalities and municipal entities to explain the context of any unauthorised, irregular, fruitless and wasteful expenditure to the community and to provide information on how the municipality is implementing consequence management.

Municipalities and municipal entities must take note of the amendments to the Public Audit Act, which introduced the concept of material irregularities and which also provide measures to address matters not dealt with timeously and conclusively by the Municipal administration and Council, as they relate to non-compliance with legislation that resulted in or is likely to result in a material financial loss, the misuse or loss of a material public resource or substantial harm to a public sector institution.



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Annexure A: Register of Unauthorised, Irregular, Fruitless and Wasteful Expenditure

Annexure B: Process Flow to address Minor Breaches of the SCM Policy

Annexure C: Process Flow to address Irregular Expenditure

Annexure D: Disclosure and Accounting Treatment for Unauthorised, Irregular, Fruitless and Wasteful Expenditure