



The Implementation of Part 3 of Chapter 13 of the MFMA

1. Introduction

The aim of this circular is to provide guidance to provinces and municipalities on institutionalising measures relating to the role and conditions on debt relief, and restructuring in terms of Part 3 of Chapter 13 of the MFMA in the event that a municipality is unable to meet its financial commitments.

This will also ensure that the law is implemented in a way that gives effect to its original intent and spirit and is further to the Step-by-Step Guide issued to Provinces when considering intervention measures in terms of the MFMA and section 139 of the Constitution. This circular will also ensure a consistent understanding and application of this aspect of Chapter 13 of the MFMA.

2. Background

The object of the MFMA is to secure sound and sustainable management of the fiscal and financial affairs of municipalities and municipal entities by establishing norms and standards and other requirements for:

- Ensuring transparency, accountability and appropriate lines of responsibility in the fiscal and financial affairs of municipalities and municipal entities;
- The management of revenues, expenditures, assets and liabilities and the handling of financial dealings;
- Budgetary and financial planning processes and the coordination of those processes with the processes of organs of state in other spheres of government;
- Long and short term borrowing to fund municipal projects;
- Alternative service mechanisms and partnerships;
- Supply chain management;
- The handling of financial problems in municipalities; and
- Other financial matters.

Despite the object of the Act, summarised above, many municipalities continue to face financial and sustainability challenges due to poor planning, weak financial management practices, skills challenges, administrative and operational inefficiencies, weak leadership, and need to improve accountability.

Overall poor or non-implementation of administrative systems, procedures, processes, financial controls, poor budgeting techniques, over-spending, an inadequate delegation framework, weaknesses in governance and oversight, together with non-compliance with the relevant legislative framework, contribute to the current state of

affairs in many municipalities and if not addressed, might lead to further deterioration in the financial status and impact negatively on service delivery.

The continued weak forecasting, planning and development of budgets have resulted in unrealistic revenue estimates and weak expenditure management. It is important that provinces and municipalities implement changes to address the weaknesses identified in order for affected municipalities to become financially sustainable. Under collection of revenue and poor management of assets, amongst others, have had a significant impact on the current financial status of many municipalities and on service delivery in those municipalities.

Whilst section 135 of the MFMA places the primary responsibility to avoid, identify and resolve financial problems on the municipality itself, it also requires the municipality to notify the MEC for local government and the MEC for finance in the province if it encounters a serious financial problem or anticipates problems in meeting its financial commitments. Timely assessments of the situation will ensure improved compliance with this notification requirement.

If provincial government becomes aware that there is a serious financial problem in a municipality, section 136 of the MFMA provides for the provincial government to consult the mayor to determine the facts, conduct a thorough assessment of the seriousness of the situation and make a determination whether the situation justifies or requires a possible intervention in terms of section 139 of the Constitution.

Depending on the seriousness of the financial problems, an intervention can be instituted. Interventions in terms of Chapter 13 of the MFMA relate to the resolution of financial problems, which are of such a significant nature that the financial stability and ultimately the integrity, functioning and service delivery sustainability of the municipality may be threatened. If municipalities are in serious or persistent breach of financial commitments, the MFMA provides for mandatory intervention by the provincial executive and, in situations where the provincial executive cannot or does not adequately intervene, the national executive can intervene in municipalities that are experiencing persistent financial problems.

Sections 138 of the MFMA provides the criteria for determining serious financial problems and section 140 provides criteria for determining a serious or persistent material breach of financial commitments. These criteria will assist in determining the type (Discretionary or Mandatory) of interventions that must be instituted.

Section 151 of the MFMA preserves the legal rights of both creditors and the municipality, except as expressly provided in Part 3 of Chapter 13. It is therefore important that creditors and municipalities understand and take note that the MFMA does not limit or affect creditors from exercising their rights, unless and until an application to the High Court is made as provided in Part 3.

3. Debt Relief and Restructuring

Section 152(1) of the MFMA provides that if a municipality is unable to meet its financial commitments, it may apply to the High Court for an order to stay all legal proceedings, for a period not exceeding 90 days, including the execution of legal process by persons claiming money from the municipality or a municipal entity under the sole control of the municipality. This section therefore provides municipalities and

municipal entities with a remedy that will, albeit temporarily, assist with seeking alternative means of addressing or settling its financial commitments, including concluding realistic payment arrangements or initiating other processes to resolve or manage a financial crisis and limit its impact on the citizens and service delivery.

Seeking temporary relief in terms of section 152(1) of the MFMA can also assist in providing a provincial government time to fulfil its constitutional responsibility in terms of section 139 of the Constitution, including allowing other stakeholders to fulfil their individual legislative mandates.

In addition to the above, section 153 of the MFMA provides municipalities with the option to apply to the High Court for an order of extraordinary relief which could; -

- a) Stay, for a period not exceeding 90 days at a time, all legal proceedings, including the execution of legal process, by persons claiming money from the municipality;
- b) Suspend the municipality's financial obligations to creditors, or any portion of those obligations, until the municipality can meet those obligations; or
- c) Terminate the municipality's financial obligations to creditors, and settle claims in accordance with a distribution scheme as provided for in section 155.

The above measures are not to be taken lightly, and can impose significant discomfort on the municipality, read with the conditions for suspension and termination in terms of Sections 154 and 155 of the MFMA. Municipalities are cautioned not to abuse these relief measures, given wider implications and potential unintended consequences for the municipality, creditors and the sector more generally. In particular, suppliers will be reluctant to deal with municipalities with poor credit histories and those who do, may price services higher than they would otherwise do so. A negotiated resolution of debt issues should be the first option.

However, from recent observations relating to financially distressed municipalities it seems that the relief provided for in section 153 of the MFMA has not been sought by municipalities. This could explain why in some instances the judicial processes have progressed to the extent where municipal assets have been attached due to non-implementation of arrangements and court orders taken against municipalities.

It is important that municipalities and municipal entities take note and implement measures available to them by operating consistently with the legal framework. This should assist in understanding rights and obligations when remedies are discussed in instances where it is unable to meet its commitments due to financial sustainability issues or poor liquidity.

It is important that the remedies provided in sections 153 and 154 of the MFMA be understood in context. Section 153(2) very clearly spells out the instances when the relief provided for in section 153(1) may be granted:

- a) The provincial executive has intervened in terms of section 139 of the MFMA and a financial recovery plan to restore the municipality to financial health has been approved for the municipality;
- b) The financial recovery is likely to fail without the protection of such an order;

- c) Section 154 has been complied with, in the case of an application for an order referred to in section 153(1)(b); and
- d) Section 155(1) has been complied with, in the case of an application for an order referred to in section 153(1)(c).

From the above it is clear that the relief provided for in sections 153 and 154 of the MFMA is not automatic, but is dependent on rigorous requirements that have to be met. It is therefore critical that municipalities take note of the remedies they have at their disposal, and that the provincial government note the importance of their decision to invoke section 139 of the Constitution. Each of these steps has a sequence that has to be followed and this becomes important for the successful implementation of Chapter 13 of the MFMA.

Similarly, the relief provided for in section 153(1)(b) is not automatic but dependent heavily on the municipality demonstrating to the court the following in terms of section 154 of the MFMA:

- i. That it cannot currently meet its financial obligations to creditors; and
- ii. That all assets not reasonably necessary to sustain effective administration or to provide the minimum level of basic municipal services have been or are to be liquidated in accordance with the approved financial recovery plan for the benefit of meeting the creditors' claims.

The above will also be applicable when a municipality seeks to invoke the provisions of section 153(1)(c) of the MFMA and section 155 relating to the termination of financial obligations and which provides further measures for the distribution of funds generated from liquidation of assets of the municipality.

The important principle to understand is that the remedies provided in Chapter 13 are not automatic and are largely dependent on the municipality having taken all other possible measures to meet its financial commitments.

This therefore implies that the onus is on the municipality to demonstrate its inability to meet its financial obligations towards its creditors. Greater effort will have to be made by municipal management and councillors to engage and communicate with creditors and key stakeholders, including labour, to assist in getting the municipality back to a sound financial status. Failure to demonstrate compliance with the legislative requirements would likely result in the municipality forfeiting the legal protection that is afforded in terms of Chapter 13 of the MFMA. Municipalities are strongly advised to seek expert legal and accounting advice if they are contemplating an application for relief in terms of Part 3 of the Act.

4. Conclusion

It is understood that the financial management challenges differ between municipalities. However, responsibility for seeking the legal protection provided for in Chapter 13 of the MFMA rests with the municipality itself. This relief is not automatic and depends solely on the ability of municipalities and municipal entities to demonstrate their inability to meet their financial obligations towards creditors, despite

having taken significant and measurable steps to avoid this under a financial recovery plan.

It is requested that the content of this Circular be brought to the attention of the municipal council, board of directors of municipal entities and officials so that they can align their policies and procedures accordingly. This will ensure that they are aware of the provisions of Chapter 13 of the MFMA and the measures available. All comments can be sent to the MFMA helpdesk: mfma@treasury.gov.za.

Contact



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Fax
Email – General
Website

012 315 5230

[**mfma@treasury.gov.za**](mailto:mfma@treasury.gov.za)

[**www.treasury.gov.za/mfma**](http://www.treasury.gov.za/mfma)

TV PILLAY
CHIEF DIRECTOR: MFMA IMPLEMENTATION
01 June 2019