



Non-Payment of Obligations

Introduction

The MFMA requires accounting officers to ensure that all money owing by the municipality and municipal entities are be paid within 30 days of receiving the relevant invoice or statement. It has been brought to our attention that municipalities are not making timely settlement of creditors as required by the legal framework. These creditors include the Auditor-General for audit fees, SARS for tax liabilities, Pension funds for staff benefits, Financial Institutions for loan obligations and Creditors for supplies of goods and services.

Non-payment

The scope of the problem

The Office of the Auditor-General, suppliers and other creditors have raised concerns over the timely payment for services rendered and other contractual obligations not being met on time, highlighting a sharp deterioration in payment for services rendered and other contractual obligations.

The National Treasury has communicated with municipalities and municipal entities regarding its failure to meet financial obligations as and when they become due, on a regular basis over the years. The communication clearly explained to municipalities and municipal entities the gravity of the situation in which many municipalities and municipal entities appeared unable to meet their financial commitments and was in breach of the MFMA, providing grounds for an investigation of financial misconduct and consequences to follow.

The failure to settle relevant invoices when due especially impact negatively on the economic viability of suppliers, especially small business that are unable to sustain their operations resulting from delays in payments for services provided. It has a knock-on effect, as it undermines job creation, economic growth, investments, and cash-flows, impacting directly on the ability to pay salaries. Many small businesses are often unable to absorb these costs. This also results in business failures and job losses that have devastating socio economic implications.

Accounting Officer fiduciary obligations

Section 65(2)(e) of the MFMA requires that accounting officers take all reasonable steps to ensure that all money owing by the municipality be paid within 30 days of receiving the relevant invoice or statement, unless prescribed otherwise for certain categories of expenditure.

Additionally, section 65(2)(f) of the MFMA states that *“the accounting officer of a municipality must... take all reasonable steps to ensure that the municipality complies with its tax, levy, duty, pension, medical aid, audit fees and other statutory commitments”*.

Similarly, sections 94 and 99 of the MFMA relate to municipal entities.

It is imperative, that the accounting officer take steps and enforce measures to ensure that the municipality timeously honour its obligations for payment of invoices, audit fees and other financial commitments, when such payments are due. For example, with regards to payment of audit fees, prior to the commencement of an audit, and where it is expected that costs in excess of budget provision may arise, the accounting officer should ensure that appropriate officials scope the requirements with the Auditor- General. If additional resources are required, then the accounting officer must ensure that this is taken up during the municipal adjustment budget process, which must be backed by cash and collections of revenues due. It is incumbent on the accounting officer of the municipality to ensure this happens.

In terms of section 171(1)(b) of the MFMA, the accounting officer of a municipality *commits an act of financial misconduct if that accounting officer deliberately or negligently fails to comply with a duty imposed by a provision of the MFMA on the accounting officer of a municipality*.

The failure to pay financial obligations within 30 days results in interests and/or penalties being levied against municipalities which then causes the incurrence of fruitless and wasteful expenditure. According to section 171(1)(c) of the MFMA, the accounting officer of a municipality *commits an act of financial misconduct if that accounting officer deliberately or negligently makes or permits or instructs another official of the municipality to make fruitless and wasteful expenditure, amongst others*.

Additionally, under section 173(1) of the MFMA the accounting officer is guilty of an offence if that accounting officer *“deliberately or in a grossly negligent way, contravenes or fails to comply with a provision of section 65(2)(f) (above)”*. Penalties for contravention of section 173 are clearly laid out in section 174 (Penalties).

Factors indicative of serious financial problems

Municipalities and Municipal entities are reminded that failure to make payments when they become due and defaulting on financial obligations, are both factors used to determine whether a municipality or municipal entity is experiencing serious financial problems. These are conditions to trigger a provincial intervention, amongst other measures.

Municipalities and municipal entities are reminded that if a municipality or municipal entity fails to make payments when due and such failures amount in total to 2% of the municipality's operating budget for that year, it indicates that the municipality is experiencing a serious breach of its obligations, which is a factor used when considering whether a mandatory intervention is necessary.

Measures to be instituted

Withholding of allocations

The failure of municipalities and municipal entities to meet their commitments can be regarded as a serious and persistent breach of the measures established in terms of section 216(1) of the Constitution. The National Treasury will, in terms of section 38 of the MFMA, consider withholding transfers until such time that the defaulting municipality or municipal entity addresses the matter satisfactorily.

Accounting officers are required to disclose the amount of funds that have been withheld and the reason for withholding such amounts, in the annual financial statements of the municipality and municipal entity.

Immediate measures to be instituted by municipalities and municipal entities

Initiating payment and fulfilling current commitments

Whilst actions are being considered, the enforcement of the MFMA will be implemented progressively, hence it is critical that all municipalities and municipal entities observe the enabling provisions in the MFMA to secure sound and sustainable management of the financial affairs of municipalities and to act in the interest of good governance. Therefore, to avoid actions to be taken by provincial and national government, those municipalities who are in contravention of the MFMA are urged to take immediate steps to address unresolved matters, including disputes with all creditors, big or small, and to make the necessary payments to settle outstanding amounts due. Such arrangements must be realistic, achievable, and implementable, and must not result in promises being made to pay which cannot be fulfilled.

It has been suggested that some municipal officials are deliberately not processing invoices or withholding payments to creditors as they seek inducement or gratification before making such payments. In those instances, accounting officers must take immediate actions to strengthen internal controls and root out such corrupt practices by implementing consequence management as provided for in the MFMA and councils policies.

Those municipalities affected by this Circular are strongly urged to take the appropriate action as an urgent priority. Failure to do so will be considered a direct contravention of the provisions of the MFMA and will necessitate further action by provincial and national government, including withholding of funds.

Measures to be initiated by Creditors

Implementing extensive and thorough credit control measures

Creditors must implement normal credit control and debt collection procedures against municipalities and municipal entities that remain long-term debtors who fail to attempt to remedy the situation. This will include those municipalities and municipal entities who fail to institute any of the remedial measures described above and persist in poor payment practices.

Creditors that have unpaid invoices for a period longer than 30 days must first approach the accounting officer of the municipality or municipal entity directly. If no satisfactory responses are provided within 15 days, then submit such request with full details relating to the outstanding payment to the relevant provincial treasury in that province for assistance. Lastly, these matters can then be escalated to the National Treasury via email to MFMA@treasury.gov.za for additional assistance. Any communication from creditors must be accompanied by the relevant invoices and an explanation of the circumstances and reasons provided by the municipality or municipal entity for continued non-payment.

Whilst creditors may report matters relating to outstanding invoices to the National Treasury, it remains their responsibility to implement their credit control and debt collection procedures against the relevant municipalities and municipal entities as well as to ensure that any contracts entered between the municipality and the municipal entity with the creditor, contain specific dispute resolution mechanisms along with timeframes.

Future considerations for municipalities

Before undertaking any procurement processes municipalities and municipal entities must first confirm that sufficient funds have been allocated and cash is available for the procurement of the required goods, works or services. This must be confirmed in writing by the Chief Financial Officer. If this is not confirmed, then no orders must be placed, or no such procurement must be allowed to proceed. Accordingly, it is incumbent on the accounting officer, chief financial officer and head of procurement to ensure municipal officials are aware of the control measures and service providers informed before any orders are placed or approved.

For example, municipalities and municipal entities that find themselves in situations in which actual payments cannot be made, such as in the instance of audit fees, that may vary considerably from budgeted provisions, are urged to engage with the Auditor-General to develop an audit plan of action and effective scoping of the audit procedures, including costs and timeframes. These exercises should be completed prior to finalisation of the annual budget of the municipality.

Accounting officers, chief financial officers, and supply chain managers or those with delegated authority to place orders or commit to any procurement must be made aware that if the above is not adhered to then they will be held personally liable for any expenditures incurred, if the necessary approvals have not been received in writing relating to availability of cash resources to honour such commitments.

Payment of other statutory and non-statutory financial obligations

As stated, section 65(2)(f) of the MFMA holds the accounting officer responsible for ensuring that the municipality complies with its commitments relating to any tax, levy, duty, pension, medical aid, audit fees and other statutory commitments. Section 65(2)(e) holds the accounting officer responsible to ensure that all monies owing by the municipality are paid within thirty days of receipt of the invoice or statement. Similarly, accounting officers of municipal entities have such fiduciary responsibilities in terms of the MFMA.

It has been observed that in many instances, municipalities or municipal entities have failed to meet their statutory financial commitments and, in the requirement, to pay creditors on time, including payments to bulk service providers of electricity and water, payments to contractors under a contract which specifies payment arrangements, repayments of loan installments, payment of pension funds. Medical contributions and payments to other creditors.

Municipalities and municipal entities are aware that the practice of prolonging payments to creditors, beyond the stipulated timeframe contravenes provisions of the MFMA. Often this is also used to boost available working capital and cash flows. This practice is unsustainable and not recommended and is also contrary to sound principles of cash management and investment. Regular reviews of cash flow projections, tabling of reports to management and council, and publishing such reports on the actual financial status, focusing on available and unencumbered cash will assist in decision making.

The non-payment of creditors will be regarded as financial misconduct, and such serious or persistent breach will result in action being taken in accordance with section 38 of the MFMA. Depending on the nature of the breach of the Act, other actions may be considered.

Summary of actions and review of all internal processes

A step-by-step approach

The following step-by-step approach adopted by municipalities and municipal entities will ensure that they consistently meet their financial obligations as they arise. This process should be adopted for the prompt payment of all creditors.

Table: Process for payment of all creditors

MATTERS TO BE ATTENDED TO WITHIN THIRTY DAYS OF RECEIPT OF INVOICE

Before committing to any procurement, Municipalities and Municipal entities must receive confirmation in writing from the Chief Financial Officer that cash is available to honour obligations created by placing orders or approving procurement from suppliers, whether it is for goods, services, or works.

- Step 1 **Confirm scope of project and monitor progress**
Prior to order, ensure CFO confirms cash available for the payment of creditor, arrangement of receiving the good / service/works, where appropriate, confirm the scope of the project with service provider or contractor and monitor progress in terms of contractual obligation.
- Step 2 **Receive and check invoices immediately upon receipt**
Upon receipt of an invoice for payment, review to ensure it is in line with the quote, contract, contract price, that the good / service /works have been received in good order and in terms of the contract, and that all calculations in the invoice are accurate.
- Step 3 **Compile all supporting documentation for payment**
If all details are correct on the invoice, attach the requisition, order and other initiating documentation i.e. copy of authorisation for the good to be purchased / service to be performed; or copy of contract, or other legal agreement
- Step 4 **Authorise account for payment**
Once checked and verified, the responsible person must authorise the account for immediate payment by preparing supporting voucher and send for preparation of payment, signing and recording of payment or authorization by other payment means, such as EFT.
- Step 5 **Make payment**
Once approved or other payment means are authorised, pay the creditor within thirty days, and file the documents in a manner that can easily be assessed during the audit.

IF THERE IS A DISPUTE OVER THE TERMS OR AMOUNT TO BE PAID

- Step 6 **If grounds for dispute over service or costs refer immediately to a senior official or CFO**
If there are any grounds to question the amount on the invoice or the service performed, the matter with all accompanying documentation must be provided to a senior official or CFO to take up with the creditor within 7 days.
- Step 7 **Initiate formal dispute and communicate matter to creditor**
The senior official or CFO is required to immediately but within 7 days to contact by telephone, or other means, the creditor (or other service provider or contractor) to verbally explain the cause for the query or concern, and follow-up that query in writing immediately as proof of a dispute being raised – if necessary the parties may consider a meeting to discuss the matter at which minutes must be taken and circulated to both parties as confirmation of discussions and any recommendations/decisions taken.
- Step 8 **Withhold only portion subject to dispute**
If only part of the invoice is queried, arrangements must be made to pay that portion of the amount payable which is not subject to a dispute, and then separately take action to remedy the disputed amount. The dispute resolution process must be addressed in the contract terms and conditions.
- Step 9 **Decision to seek mediation**
Once the municipality has attempted to resolve any dispute by a) contacting the creditor, b) following up in writing, c) where necessary meeting the creditor, and those avenues prove unsatisfactory to the municipality, the municipality may seek remedies by requesting the provincial treasury for assistance. Legal action must be the last resort. In the case of fiscal disputes between organs of state, the municipality may approach the National Treasury for mediation, if this falls within the scope of the MFMA, and other approaches have failed (see Circular 21).

It will be important for municipalities and municipal entities to maintain either a manual or electronic system, processes and procedures that will enable the effective and efficient tracking of each invoice received by the institution. As a minimum, this must provide information related to the supplier, order number, date of order, date of receipt of an invoice, amount of the invoice, the status in the process, date on which payment is due, date paid and the number of days between the date of receipt of the invoice and the date of payment. If there is a dispute, it must also be recorded as such with the details of the dispute and who it was assigned to for a resolution.

Additionally, there should be delegations and assignment of the responsibility to an official within each municipal department or entity to receive and process invoices. Creditors must be made aware of who to contact, how, where and when to submit invoices, how to follow up directly, and what relevant supporting documents will expedite the processes of payments.

Creditors must also be made aware of control measures in place to mitigate fraud, corruption, inducements, or gratification and where to report any such instances without fear of favour.

We also draw your attention to MFMA Circular 87, which is accompanied by the standard operating procedures relating to expenditure management which also addresses the processes and procedures of receipt, recording and payment of invoices. MFMA Circular 87 can be accessed using the following link:
<http://mfma.treasury.gov.za/Circulars/Pages/default.aspx>.

The standard operating procedures can be accessed using the following link:
<http://mfma.treasury.gov.za/Guidelines/Pages/StandardOperatingProcedures.aspx>.

Conclusion

Whilst it is expected that municipalities, municipal entities and organs of state uphold the spirit of co-operative governance contained in the Constitution and the MFMA, there have been a number of instances where this does not appear evident. To negate the need for us to institute remedial action, municipalities and municipal entities that have amounts owing to creditors which remain unresolved for a period are requested to act urgently on the matter.

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