MFMA Circular No. 55

Municipal Finance Management Act No. 56 of 2003

Municipal Budget Circular for the 2011/12 MTREF

This circular provides further guidance to municipalities and municipal entities for the preparation of their 2011/12 Budgets and Medium Term Revenue and Expenditure Framework (MTREF). It must be read together with MFMA Circular No. 54.

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1 National priority – creating decent employment opportunities

In his 2011 State of the Nation Address, the President signalled that government is primarily concerned about the continuing high levels of unemployment and poverty in the country.

To address these concerns, 2011 has been declared a year of job creation. Every sector and every business entity, regardless of size, is urged to focus on job creation. Every contribution counts in this national effort. All government departments will align their programmes with the job creation imperative. The provincial and local government spheres are requested to do the same.

As the President concluded:

> Our goal is clear. We want to have a country where millions more South Africans have decent employment opportunities, which has a modern infrastructure and a vibrant economy and where the quality of life is high.
>
> We all have a responsibility to work hard to make this a reality.
>
> Everyone must think of how they can contribute to the jobs campaign through creating opportunities for themselves and others.

In drafting their 2011/12 budgets and MTREFs all municipalities are urged to explore opportunities to mainstream labour intensive approaches to delivering services, and more particularly to participate fully in the Extended Public Works Programme.

However, municipalities should not just employ more people without any reference to the level of staffing required to deliver effective services, and what is financially sustainable over the medium term. The municipality ought to focus on maximizing its contribution to job creation by:

- Ensuring that service delivery and capital project use labour intensive methods wherever appropriate;
- Ensuring that service providers use labour intensive approaches;
- Supporting labour intensive LED projects;
- Participating fully in the Extended Public Works Programme; and
- Implementing interns programmes to provide young people with on-the-job training.

1.1 Additional allocations to local government

Government has again sought to insulate local government from the on-going impact of the economic downturn. Although the economy is recovering, the fiscal situation remains very tight. Direct transfers to local government grow by R21 billion over the medium term, of which R5.1 billion is additional to baseline. National transfers to local government grow by 14.7 per cent between 2010/11 and 2011/12, which is significantly higher than the growth in total government expenditure of 9.8 per cent for the same period. Details of national transfers to local government are discussed in Chapter 8 of the national *Budget Review 2011* and in Annexure W1 to the 2011 Division of Revenue Bill. These documents are available on National Treasury's website at:

http://www.treasury.gov.za/documents/national%20budget/2011/review/default.aspx

1.2 Procurement reforms and fighting corruption

Municipalities are again advised that the supply chain compliance unit will also be focusing on municipal procurement processes. Consequently, municipalities can expect requests for information relating to their tender committees and processes, as well as specific tenders and contracts.

Municipalities are also encouraged to introduce greater transparency to municipal supply chain processes.

2 Headline inflation forecasts

Municipalities must take the following inflation forecasts into consideration when preparing their 2011/12 budgets and MTREF.

Fiscal year	2009/10	2010/11	2011/12	2012/13	2013/14
	Actual	Estimate		Forecast	
Headline CPI Inflation	6 .3%	4.2%	4.8%	5.3%	5.5%

Source: Budget Review 2011

Municipalities must also take into account the *Salary and Wage Collective Agreement 2009/10 to 2011/2012*. The agreement provides for a wage increase based on the average CPI for the period 1 February 2010 until 31 January 2011, plus 2 per cent. The average CPI for this period is 4.08 per cent, plus the 2 per cent gives a wage increase of 6.08 per cent for the 2011/12 financial year, starting 1 July 2011.

3 Revising rates, tariffs and other charges

When municipalities and municipal entities revise their rates, tariffs and other charges for their 2011/12 budgets and MTREF, they need to take into account the labour (i.e. the wage agreements with unions) and other input costs of services provided by the municipality or entity, the need to ensure financial sustainability, local economic conditions and the affordability of services, taking into consideration the municipality's indigent policy. Municipalities should also take into account relevant policy developments in the different sectors.

Given the upcoming elections (to take place on 18 May 2011) municipal councils may be tempted to prepare an 'election friendly budget' – with unrealistically low tariff increases and an over-ambitious capital expenditure programme. Such an approach will result in the budget being unfunded, which will place the financial sustainability of the municipality at risk and impact negatively on service delivery.

Municipalities should continue to explore imaginative ways of structuring the tariffs for utility services to encourage more efficient use of these services and to generate the resources required to fund the maintenance, renewal and expansion of the infrastructure required to provide the services.

National Treasury continues to encourage municipalities to keep increases in rates, tariffs and other charges as low as practically possible. For this reason municipalities must justify in their budget documentation all increases in excess of the 6 per cent upper boundary of the South African Reserve Bank's inflation target.

3.1 Eskom bulk tariff increases

The Eskom price of bulk electricity supplied to municipalities will increase by **26.71 per cent** on 1 July 2011. Based on this price increase, and increases in the price of other inputs NERSA has set a guideline increase for municipal tariffs of **20.38 per cent**. The relevant guideline, as well as NERSA's Reasons for Decision document can be accessed at: www.nersa.org.za

Note that NERSA has set out an earlier timetable for receiving and reviewing tariff applications with a view to completing the process by the end of March 2011. National Treasury encourages all municipalities to submit their applications as soon as possible.

3.2 Introduction of Inclining Block Tariffs

On 24 February 2010, the Energy Regulator approved the implementation of Inclining Block tariffs (IBT). On 25 November 2010, NERSA issued its '*Guideline on municipal price increase for 2011/12*', which requires all municipalities to implement the IBT specified by NERSA for all municipalities' domestic / residential customers on 01 July 2011.

National Treasury has taken note of the concerns raised by SALGA and its member municipalities, together with Eskom, regarding the implementation of the IBT proposed by NERSA. At a meeting on 7 March 2011, NERSA agreed with the different stakeholders that there is a need for further research on the IBT and that NERSA will engage extensively with stakeholders to develop a revised IBT proposal in preparation for the 2012/13 municipal budgets.

National Treasury's primary concern is that the current 'one-size-fits-all' approach does not take into account the diversity in municipal electricity undertakings, and so has the potential to undermine the financial sustainability of many municipalities. National Treasury is of the view that a revised IBT proposal for domestic customers needs to be practical and sustainable, and ideally adopt a differentiated framework approach, rather than prescribing a specific IBT tariff structure. It is also important that any proposed IBT is fully aligned to the principles set out in the South African Electricity Supply Industry: Electricity Pricing Policy (EPP) issued on 19 December 2008, including the principle that electricity tariffs must be cost reflective and that any cross-subsidies should be explicit.

At the 7 March 2011 meeting, it was further agreed that municipalities should regard NERSA's current proposals on IBT as a guideline. And that when a municipality applies to NERSA for the approval of its electricity tariffs (in line with the normal process), it should indicate to what extent it is able to implement an IBT structure. Where municipalities experience difficulties in this regard, they should liaise with NERSA who will provide the necessary assistance. It was further agreed that NERSA would not enforce the current IBT proposal, but that municipalities should nevertheless start restructuring their electricity tariffs to accommodate an IBT structure appropriate to the municipality's circumstances.

3.3 Water tariffs must be cost-reflective

Municipalities are reminded to review the level and structure of their water tariffs carefully, with a view to ensuring:

- Water tariffs are fully cost-reflective – including the cost of maintenance and renewal of purification plants and water networks, and the cost of new infrastructure;
- Water tariffs are structured to protect basic levels of service; and
- Water tariffs are designed to encourage efficient and sustainable consumption (e.g. through increasing block tariffs).

If a municipality's water tariffs are not fully cost reflective, the municipality should develop a pricing strategy to phase-in the necessary tariff increases in a manner that spreads the impact on consumers over a period of time. However, all municipalities should aim to have appropriately structured, cost-reflective water tariffs in place by 2014.

To mitigate the need for water tariff increases, municipalities must put in place an appropriate strategy to limit water losses to acceptable levels. In this regard municipalities must ensure that water used by its own operations is charged to the relevant service, and not simply attributed to water 'losses'.

Municipalities not already calculating and reporting water losses in accordance with the International Water Association (IWA) standards as required by the Department of Water Affairs (DWA) should contact DWA for assistance in this regard.

4 Funding choices and management issues

The national *Budget Review 2011* notes that domestic economic activity has gathered pace in recent months, with a pickup in business confidence and private-sector fixed-capital formation. However, the demand for labour is only expected to grow moderately, and it will be some time before employment levels recover from the loss of 1 million jobs during 2009 and 2010.

Consequently, municipal revenues and cash flows are expected to remain under pressure in 2011/12 and so municipalities should adopt a conservative approach when projecting their expected revenues and cash receipts. Municipalities should also pay particular attention to managing all revenue and cash streams effectively, by paying particular attention to their revenue management processes and procedures.

Given the ongoing constraints on the revenue side, municipalities will again need to make some very tough decisions on the expenditure side this year. Priority ought to be given to:

- Ensuring that drinking water meets the required quality standards at all times;
- Protecting the poor from the worst impacts of the economic downturn;
- Supporting meaningful local economic development (LED) initiatives that foster micro and small business opportunities and job creation;
- Securing the health of their asset base (especially the municipality's revenue generating assets) by increasing spending on repairs and maintenance; and
- Expediting spending on capital projects that are funded by conditional grants.

Municipalities must pay special attention to controlling unnecessary spending on nice-to-have items and non-essential activities, such as foreign travel, conferences and training other than accredited training, councillor and staff perks, advertising and public relations activities. Attention should also be given to ensuring value for money is obtained when using consultancy and other outsourced services.

Municipalities must also ensure that their capital budgets reflect consistent efforts to address the backlogs in basic services and the renewal of the infrastructure of existing network services.

4.1 Hand-over reports for the newly elected councils

Each municipal manager, working together with the CFO and senior managers, is encouraged to prepare a hand-over report that can be tabled at the first meeting of the newly elected council. The aim of this hand-over report is to provide the new councils important orientation information regarding the municipality, the state of its finances, service delivery and capital programme, as well as key issues that need to be addressed.

It is proposed that the hand-over report should include:

- An overview of the demographic and socio-economic characteristics of the municipality;
- An overview of the organisational structure of the municipality, with the names and numbers of senior managers;
- An overview of key municipal policies that councillors need to be aware of, and where they can obtain the full text of such policies;
- An overview of issues that still need to be addressed in relation to the municipality's turnaround strategy;
- An overview of the municipality's financial health, with specific reference to:
    - Its cash and investments, and its funding of commitments (Table A8);
    - Cash coverage of normal operations (see Supporting Table SA10);
    - Creditors outstanding for more than 30 days, along with reasons for delayed settlement;
    - Current collection levels and debtors outstanding for more than 30 days; and
    - Extent of existing loans, and associated finance and redemption payments.
- The municipality's 2009/10 audit outcome, and its strategy to address audit issues;
- An overview of the provision of basic services, including plans to address backlogs;
- An overview of the state of the municipality's assets, with particular reference to the asset management plan, and repairs and maintenance requirements;
- A list of the main infrastructure projects planned for the 2011/12 budget and MTREF;
- A list of key processes requiring council input over the next six months, e.g. revision of the IDP, approval of specific policies etc. and
- Any other information deemed to be important.

In addition to the hand-over report, each new councillor should be given the municipalities' revised IDP, the adopted 2011/12 budget (if already passed), the mid-year budget and performance assessment report for 2010/11, and the latest monthly financial statement, and the annual report for 2009/10.

Municipal managers should submit their municipality's hand-over report to the relevant provincial department responsible for local government, to the Department of Co-operative Governance and to National Treasury.

4.2 Renewal and repairs and maintenance of existing assets

The *Local Government Budgets and Expenditure Review 2003/04 – 2009/10* highlighted the serious repairs and maintenance and renewal backlogs that exist in relation to municipal infrastructure, particularly municipalities' electricity, water reticulation, sewage, storm water and roads systems. It is noted that these backlogs are impacting negatively on the financial sustainability of municipalities and on the reliability and quality of municipal services, as well as municipalities' contribution to supporting economic growth.

National Treasury is very concerned about the low levels of expenditure on repairs and maintenance and the renewal of existing infrastructure in most municipalities. Municipal councils, Mayors and municipal managers are therefore urged to ensure that allocations to repairs and maintenance, and the renewal of existing infrastructure are prioritised. In this regard:

- Where the municipality allocates less than 40 per cent of its 2011/12 Capital Budget (as reflected on Table A9) to the renewal of existing assets it must provide a detailed explanation and assurance that the budgeted amount is adequate to secure the ongoing health of the municipality's infrastructure supported by reference to its asset management plan;
- Where the budgeted amounts for repairs and maintenance reflected on Table A9 are less than 8 per cent of the asset value (write down value) of the municipality's Plant Property and Equipment (PPE) as reflected in the municipality's 2009/10 annual financial statements, the municipality must provide a detailed explanation and assurance that the budgeted amount is adequate to secure the ongoing health of the municipality's infrastructure supported by reference to its asset management plan; and
- In the case of a municipality that received an audit qualification related to its assets register, where the budgeted amounts for repairs and maintenance reflected on Table A9 are less than 10 per cent of the municipality's operating expenditure on Table A4, the municipality must provide a detailed explanation and assurance that the budgeted amount is adequate to secure the ongoing health of the municipality's infrastructure supported by reference to its asset management plan.

More generally, all municipalities should provide narrative information in their budget documents on how they are planning, managing and financing repairs and maintenance and asset renewal, with particular reference to what the municipality has done to assess its repairs and maintenance backlog, its estimate of its repairs and maintenance backlog and the strategy it has put in place to progressively deal with the backlog.

National Treasury, along with provincial treasuries, will assess what each municipality has budgeted for repairs and maintenance, and renewal projects as part of the overall assessment of municipal budgets.

4.3 Budgeting for an operating deficit

National Treasury has received a number of enquiries as to whether a municipality may budget for an operating deficit or whether the operating budget has to balance.

There is no legal requirement that the operating budget (i.e. the Financial Performance Budget as reflected in Tables A2, A3 and A4) of a municipality must be balanced or be in surplus.

Section 18 of the MFMA requires that an annual budget must be 'funded', and identifies three possible funding sources: (a) realistically anticipated revenues to be collected, (b) cash-backed accumulated funds from previous years' surpluses not committed for other purposes, and (c) borrowed funds, but only for the capital budget. The Municipal Budget and Reporting Regulations prescribe budget Tables A7 and A8 which, if completed correctly by the municipality, provide most of the information required to evaluate whether a municipality's operating and capital budgets are 'funded' or not:

- *Table A7 Budgeted Cash Flows* shows how the municipality's operations are expected to impact on its cash position. If a municipality's cash position at year end is negative it is a strong indication that the overall budget is not funded; and
- *Table A8 Cash-backed reserves / accumulated surplus reconciliation* shows whether the municipality has 'cash-backed accumulated funds from previous years' surpluses not committed for other purposes' that can be used to fund a deficit on the Financial Performance Budget or to fund 'internally generated funds' on the Capital Budget.

In addition, Supporting Table SA10 sets out the measures for the 'funding compliance procedure' outlined in MFMA Circular 42 which is a further assessment as to whether the municipal budget is funded and sustainable.

Over the medium term, a municipality should budget for a moderate surplus on its Financial Performance Budget so as to be able to contribute to the funding of the Capital Budget. However, there may be temporary circumstances that make this difficult; for instance the current implementation of GRAP 17, which may result in increased 'depreciation and asset impairment' that is not fully accommodated in the municipality's tariffs and as a result drives the operating budget into deficit.

If the municipality's operating budget shows a deficit it is indicative that there are financial imbalances that need to be addressed. These problems may be related to a failure to collect revenues, tariffs that are too low or expenditures that are too high. Whatever the main cause of the deficit, the municipality needs to put in place appropriate strategies to address the problem, and explain these measures in its budget document.

It is also important to establish whether a deficit on the operating budget is a 'cash deficit' or a 'non-cash deficit'. If it is a cash deficit, and the municipality has no or only limited cash reserves, then it would be absolutely necessary to explore strategies to both improve revenue and cut cash expenditures.

Generally the municipality should explain in its budget document how the budget surplus / (deficit) on its operating budget relates to the municipality's longer term financial management strategy.

4.4 Credit cards and debit cards linked to municipal bank accounts

A bank, or any other institution, may not issue credit cards or debit cards linked to a bank account of a municipality or a municipal entity to any councillors, entity board members, municipal or entity officials or any other person.

The issuing and use of such cards, even for official purposes:

- Contravenes section 11 and 85 of the MFMA as there is no way of ensuring that all purchases made on the card are in accordance with the items listed in the sections or as prescribed;
- Contravenes section 167 of the MFMA which provides that any bursary, loan, advance or other benefit paid to a municipal councillor otherwise than in accordance with the provisions of the Remuneration of Public Office Bearers Act constitutes irregular expenditure;
- Runs the risk of non-compliance with section 164 of the MFMA which provides that no municipality or municipal entity may make loans to councillors or officials of the municipality, directors or officials of the entity or members of the public;
- Runs the risk of non-compliance with the supply chain management regulations; and
- Undermines efforts to safeguard municipal funds, and combat fraud and corruption, as well as other irregular practices.

The issuing of petrol cards or garage cards in relation to municipal vehicles is permitted, provided the municipality has in place the necessary policies and procedures to prevent abuse.

Where officials or councillors make expenditures in relation to the official municipal business, they should use their personal credit cards or cash, and request reimbursement from the municipality in accordance with the relevant municipal policy and processes. Alternatively, the municipality should make arrangements with the service provider that the required expenditures be settled directly by the municipality.

4.5 Budget management issues dealt with in previous MFMA Circulars

Municipalities are reminded to refer to MFMA Circulars 48, 51 and 54 with regards to the following issues:

1. *Mayor's discretionary funds and similar discretionary budget allocations* – National Treasury regards these allocations to be bad practice and discourages them (refer to MFMA Circular 51).
2. *Unallocated ward allocations* – National Treasury does not regard this to be a good practice, because it means that the tabled budget does not reflect which ward projects are planned for purposes of public consultation and council approval (refer to MFMA Circular 51).
3. *New office buildings* – Municipalities are required to send detailed information to National Treasury if they are contemplating building new main office buildings (refer to MFMA Circular 51).
4. *Pledging of conditional grant transfers* – the 2011 Division of Revenue Bill again contains a provision that allows municipalities to pledge there conditional grants. The

end date for the pledges is extended to 2013/14. The process of application as set out in MFMA Circular 51 remains unchanged.

5. *Virement policies of municipalities* – Municipalities are reminded of the principles that must be incorporated into municipal virements policies (refer to MFMA Circular 51).
6. *Providing clean water and managing waste water* – Municipalities are reminded to include a section on 'Drinking water quality and waste water management' in their 2011/12 budget document supporting information (refer to MFMA Circular 54).

5 Conditional transfers to municipalities

Section 216 of the Constitution provides for national government to transfer resources to municipalities in terms of the annual Division of Revenue Act (DoRA) to assist them in exercising their powers and performing their functions. These allocations are announced annually in the national budget. Transfers to municipalities from national government are supplemented with transfers from provincial government. Further, transfers are also made between district municipalities and local municipalities.

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

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

In support of regulation 10, the 2011 Division of Revenue Bill provides that –

- In terms of section 14, National Treasury is required to publish in the Government Gazette the allocations or indicative allocations for all national grants to municipalities;
- In terms of section 29, each provincial treasury is required to publish in the Government Gazette the indicative allocation per municipality for every allocation to be made by the province to municipalities from the province's own funds; and
- In terms of section 28, each category C municipality must indicate in its budget all allocations from its equitable share and conditional allocations to be transferred to each category B municipality within the category C municipality's area of jurisdiction.

The Government Gazette reflecting the allocations and indicative allocations for all national grants to municipalities will be available at:

http://www.treasury.gov.za/legislation/bills/2011/Default.aspx

In addition, National Treasury publishes a payment schedule that sets out exactly when equitable share and national conditional grant funds are to be transferred to municipalities:
http://www.treasury.gov.za/legislation/mfma/media_releases/Municipal%20Payment%20Schedule/

The payment schedules that provincial treasuries are required to submit to National Treasury in terms of section 29(5) of the 2011 Division of Revenue Bill will be published on National Treasury's website, along with the national payment schedule.

5.1 Timing of municipal conditional grant transfers

In order to facilitate synchronisation of the national / provincial financial year (01 April to 31 March) with the municipal financial year (01 July to 30 June), the 2011 Division of Revenue Bill requires that all conditional allocations to municipalities must be transferred to municipalities within the period 01 July 2011 to 31 March 2012.

5.2 Payment schedule

National Treasury has instituted an automated payment system of transfers to municipalities during the 2010 financial year in order to ensure appropriate safety checks are put in place.

Section 21 of the 2011 Division of Revenue Bill requires transfers to municipalities to be made as per the approved payment schedule published by National Treasury. Through this system, any transfers not in line with the payment schedule will be rejected. In addition if the payment details of the municipality are not up-to-date the transfers will also be rejected.

Consequently, municipalities are advised to ensure that all their payment details (the municipality's primary banking account and payee details) are submitted to the National Treasury in terms of section 8 of Municipal Finance Management Act (Act No. 56 of 2003, MFMA) and section 10 of the 2011 Division of Revenue Bill for approval and verification by National Treasury before 14 April 2011.

Municipalities are requested to ensure that their account names in their banking details are the same as their gazetted municipal names. Any differences may result in transfers being rejected by the system, and consequent delays.

5.3 Responsibilities of transferring and receiving authorities

The legal obligations placed on transferring and receiving officers in terms of the 2011Division of Revenue Bill are very similar to previous requirements. National Treasury intends ensuring strict compliance in order to improve spending levels, and the quality of information relating to the management of conditional grants.

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

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

5.4 Unspent conditional grant funds for 2010/11

To bring legal certainty to the process of managing unspent conditional grant funds, the 2011 Division of Revenue Bill contains the following provisions:

Unspent conditional allocations

20. (1) Despite the provisions of the Public Finance Management Act or the Municipal Finance Management Act relating to roll-overs, any conditional allocation,excluding the Gautrain Rapid Rail Link Grant and the Expanded Public Works Programme Incentive Grant, that is, in the case of a province, not spent at the end of a financial year or, in the case of a municipality, at the end of a municipal financial year, reverts to the National Revenue Fund, unless the relevant receiving officer can prove to the satisfaction of the National Treasury that the unspent allocation is committed to identifiable projects.

(2) The National Treasury may, at the request of a transferring national officer, provincial treasury or municipality, approve—

(a) a roll-over from a conditional allocation to the next financial year; and

(b) spending of a portion of a conditional allocation on activities related to the purpose of that allocation, where the province or municipality projects significant unforeseeable and unavoidable over-spending on its budget.

(3) Any funds which must revert to the National Revenue Fund in terms of subsection (1), and which have not been approved by the National Treasury to be retained in terms of subsection (2), must be repaid to the National Revenue Fund.

(4) The National Treasury, in accordance with subsection (5), may offset any funds which must be repaid to the National Revenue Fund in terms of subsections (1) and (3), but which have not been repaid—

(a) in the case of a province, against future advances for conditional grant allocations to that province; and

(b) in the case of a municipality, against future advances for the equitable share or conditional grant allocations to that municipality.

(5) Prior to the National Treasury setting-off any amounts against allocations to provinces or municipalities in terms of subsection (4), the National Treasury must give the relevant transferring national officer, province or municipality—

(a) written notice of the intention to offset amounts against upcoming advances for allocations; and

(b) an opportunity, within 14 days of receipt of the notice referred to in paragraph (a), to—

(i) submit written representations that prove to the satisfaction of the National Treasury that the unspent allocation was either spent in accordance with the relevant framework, or is committed to identifiable projects;

(ii) propose alternative means acceptable to the National Treasury by which the unspent allocations can be repaid to the National Revenue Fund; and

(iii) propose an alternative payment schedule in terms of which the unspent allocations will be repaid to the National Revenue Fund.

(6) A notice contemplated in subsection (5) must include the intended amount to be offset against allocations, and the reasons for offsetting the amounts.

(7) Despite this section, the retention of funds which should revert to the National Revenue Fund in terms of subsections (1) and (3), and which have not been approved by the National Treasury to be retained in terms of subsection (2), constitutes financial misconduct in terms of section 34.

The process to ensure the return of unspent conditional grants for the 2010/11 financial year will be managed in accordance with section 20 set out above. The following practical arrangements will apply –

- When preparing their annual financial statements a municipality must determine what portion of each national conditional allocation it received remained unspent as at 30 June 2011.
- National Treasury will initiate the process outlined in section 20(4) and (5) of the Division of Revenue Act on 2 August 2011 based on the June 2011 conditional grant expenditure reports. If the receiving officer wants to motivate in terms of section 20(5)(b) that the funds have been spent or are committed to identifiable projects or wants to propose an alternative payment method or schedule the required information must be submitted to National Treasury by 31 August 2011.

- National Treasury will confirm in writing whether or not the municipality may retain as a rollover any of the unspent funds because they are committed to identifiable projects or whether it has agreed to any alternative payment methods or schedules by 30 September 2011.
- A municipality must return the remaining unspent conditional grant funds that are not subject of a specific repayment agreement with National Treasury to the National Revenue Fund by 17 October 2011. Failure to return these unspent funds by this date will constitute financial misconduct in terms of section 20(7) of the Division of Revenue Act.
- Any unspent conditional grant funds that should have been repaid to the National Revenue Fund by 17 October 2011 will be offset against the municipality's November equitable share allocation.

When applying to retain unspent conditional allocations committed to identifiable projects or requesting a rollover in terms of section 20(2) of the Division of Revenue Act, municipalities must supply National Treasury with the following information –

1. Details of each of the projects to which funds are committed;
2. A progress report on the state of implementation of each of the projects;
3. The amount of funds committed to each project, and the conditional allocation from which the funds come from; and
4. An indication of the time-period within which the funds are to be spent.

All the calculations of the amounts to be surrendered to the National Revenue Fund (NRF) will be subject to scrutiny by the Office of the Auditor-General and will therefore be audited.

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

Section 20 of the 2010 Division of Revenue Act requires that any conditional allocations, excluding the Expanded Public Works Programme Incentive Grant, which is not spent at the end of the municipal financial year must revert to the National Revenue Fund, unless the receiving officer proves to the satisfaction of National Treasury that the unspent allocation is committed to identifiable projects, in which case the funds will be rolled over (refer to MFMA Circular 51 for more information in this regard).

In terms of the allocations that have already been transferred to the municipalities, and are not spent by the end of the municipal year, reporting of these funds must be done separately but concurrently with the reporting for the 2011 conditional allocations. National Treasury will for purposes of DoRA reporting, provide a reporting template to facilitate monitoring of these conditional grant roll-overs.

5.6 Municipal Disaster Grant

Section 8 of the 2011 Division of Revenue Bill provides for a new schedule 9 type of grant. The purpose of this grant is to enable government to respond immediately to any disasters. The allocation for this grant will be managed by the National Disaster Management Centre in the Department of Co-operative Governance. Funds will be transferred to municipalities after a disaster is declared without the need to Gazette the transfers beforehand.

5.7 Budgeting for the EPWP Incentive Grant

Even though the EPWP Grant is an incentive grant, it is within the municipal management's control as to whether they fulfil the conditions that will entitle them to receive it. The municipality should therefore budget for the grant in the same way as it budgets for all other conditional grants.

5.8 Conditional grant issues dealt with in previous MFMA Circulars

Municipalities are reminded to refer to MFMA Circulars 48, 51 and 54 with regards to the following issues:

1. *Accounting treatment of conditional grants* – Municipalities are reminded that in accordance with accrual accounting principles, conditional grants should only be treated as 'transfers recognized' revenue when the grant revenue has been 'earned' by incurring expenditure in accordance with the conditions of the grant.
2. *VAT on conditional grants:* SARS has issued a specific guide to assist municipalities meeting their VAT obligations – ***VAT 419 Guide for Municipalities***. To assist municipalities accessing this guide it has been placed on the National Treasury website at: http://www.treasury.gov.za/legislation/mfma/guidelines/default.aspx.
3. *Interest received and reclaimed VAT in respect of conditional grants:* Municipalities are reminded that in MFMA Circular 48, National Treasury determined that:
   - Interest received on conditional grant funds must be treated as 'own revenue' and its use by the municipality is not subject to any special conditions; and
   - 'Reclaimed VAT' in respect of conditional grant expenditures must be treated as 'own revenue' and its use by the municipality is not subject to any special conditions.
4. *Appropriation of conditional grants that are rolled over* – As soon as a municipality receives written approval from National Treasury that its unspent conditional grants have been rolled-over it may proceed to spend such funds (refer to MFMA Circular 51 for other arrangements in this regard).
5. *Pledging of conditional grants* – Applications by municipalities to pledge conditional grants allocated to municipalities in the 2011 Division of Revenue Bill must be in accordance with the requirements set out in MFMA Circular 51 MFMA. The only difference is that the timeframe for the pledges will extend to 30 June 2014, as provided for in the Bill.

6 The Municipal Budget and Reporting Regulations

As noted in MFMA Circulars 51 and 54, the Municipal Budget and Reporting Regulations are designed to achieve a range of objectives, including improving the local government sphere's ability to deliver services by facilitating improved financial sustainability and better medium term planning. The regulations, formats and associated guides etc are available on National Treasury's website at:

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

Of the 283 municipalities, 272 used the prescribed budget schedules to prepare their 2010/11 annual budgets. This is a tremendous achievement. Roll-out to municipal entities, however, was less satisfactory. **Municipalities are reminded that the regulations apply to all municipalities and municipal entities as from 1 July 2009.**

Municipalities must refer to previous MFMA Circulars 48, 51 and 54 for guidance relevant to the implementation of the Municipal Budget and Reporting Regulations and the associated Excel formats.

As indicated in MFMA Circular 54, National Treasury has released Version 2.3 of the Excel Formats. Given the ongoing improvements in the accuracy of the formats it would be in municipalities' best interests to move to this new version.

Please refer to MFMA Circular 54 for details regarding the changes that have been introduced with the new version of the Excel Formats.

6.1 Consolidated budgets and reports for municipalities with entities

A municipality that has one or more municipal entities is required to produce:

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

*With effect from 1 July 2011, municipalities that have municipal entities must submit their **consolidated** annual budget, **consolidated** adjustment budgets and **consolidated** quarterly financial information to the National Treasury Local Government Database.*

In addition, the Schedule A1 that the municipality submits to National Treasury must be the consolidated budget for the municipality (plus entities) and not the budget of the parent municipality.

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

6.2 Dummy Budget Guide

National Treasury has issued a *Dummy Budget Guide* to assist municipalities with the compilation of their annual budget documents in accordance with the format prescribed in Schedule A of the Municipal Budget and Reporting Regulations. The *Dummy Budget Guide* consists of the following four components:

1. The *MFMA Dummy Budget Guide*
2. The *Annual Budget of Batho Pele City* – the Annexure to the *Guide*
3. The Schedule A1 for Batho Pele City – the 'Excel' budget format schedule
4. The Schedule A1 Graphs and Figures Template.

The *Annual Budget of Batho Pele City* is intended to be a template that municipal officials can use as a basis and guide for producing their own municipality's budget documents. Therefore National Treasury fully intends that officials will copy the format and be guided by the explanations, the tables, graphs and figures in this document. The *Guide* and associated templates and documents can be downloaded from:
http://mfma.treasury.gov.za/Guidelines/Pages/default.aspx

6.3 Municipal budgets and internal charges

The aim of the municipal budget is to reflect only the planned actual (or primary) revenues and expenditures of the municipality or municipal entity – so that the budget reflects the planned actual financial performance and planned actual financial position of the municipality, so as to provide a consistent basis of comparison for the compilations of annual financial statements. This means that the municipality must reflect only revenue and expenditure transactions 'with the outside world' on its budget, on the same basis as when compiling its annual financial statements.

Consequently, no internal charges may be reflected on either the revenue side or the expenditure side of a municipality's Financial Performance Budgets as set out in Tables A2, A3 or A4 of the prescribed budget tables.

A municipality that has a municipal entity must ensure that all material 'internal charges' between it and its entity are eliminated when it compiles its consolidated budget and monthly financial statements.

MFMA Circular 48 indicated that when compiling budgets by function and vote municipalities should reflect revenues and expenditures under the primary function or vote responsible for earning the revenue or incurring the expenditure. Some municipalities have interpreted this guidance as requiring them to budget for internal charges, recharges or secondary charges, which is definitely NOT the intention. Rather the intention is that all material *primary revenues and expenditures* (i.e. transactions with the outside world) related directly to a particular function or vote should be budgeted for under that function and vote. This anticipates that the municipality will have an underlying management budget that provides for internal charges *from* the primary functions *to* the support functions that reflects how the support functions 'earn' their budgets by delivering support services to the primary functions.

However, discussions with municipalities have revealed (a) that municipalities are using divergent methodologies to calculate and reflect internal charges, and (b) that budgeting for expenditures under a vote or cost centre that are then incurred under another vote or cost centre complicates lines of accountability, and may undermine budget control.

To address this situation:

- National Treasury will undertake a review of internal charging methodologies being applied by municipalities with a view to issuing either a Circular or a guideline in this regard; and
- In the interim, National Treasury advises that municipalities should budget for revenues and expenditures under the function / vote that is directly responsible for managing the 'transaction with the outside world', i.e. in accordance with the principles of financial accounting.

This will mean that until there is clarity on how to introduce certain principles of management / cost accounting into the compilation of municipal budgets, those municipal budgets will not provide an accurate statement of the true revenues and costs associated with particular functions / votes, and therefore not provide the information necessary to explain the municipality's rates and tariffs' structures. To address this issue, municipalities may consider providing supporting information in the budget document on the revenues and costs attributed to different functions / votes taking into account internal charges.

6.4 Phasing in of formats and tables

This will be the second year that all municipalities are required to prepare their annual budget in accordance with the Municipal Budget and Reporting Regulations. National Treasury therefore expects there to be a significant improvement in the completeness and quality of information presented by municipalities in their annual budget tables (Schedule A1).

National Treasury, working with the provincial treasuries, will carry out a compliance check, and where it is evident that municipalities have not made an 'honest effort' to comply, or the completeness and quality of the information has not improved relative to last year, the budgets will be referred back to the municipalities, and an appropriate letter will be addressed to the Mayor and municipal manager. Municipal managers are reminded that the annual budget must be accompanied by a 'quality certificate' in accordance with the format set out in item 27 of Schedule A in the Municipal Budget and Reporting Regulations.

It was evident that last year, many municipalities struggled to fill in Table A10. You are referred to the Dummy Budget Guide for guidance in this regard. If you require any further assistance please contact Ilze Baron (email: Ilze.Baron@treasury.gov.za) or Conrad Barberton (email: Conrad.Barberton@treasury.gov.za).

Municipalities should not underestimate the importance that government places on the information contained in this table as it provides key information on the roll-out of basic services, and whether targets are being achieved.

Also refer to MFMA Circular 54 for information regarding budgeting for repairs and maintenance.

6.5 2011/12 MTREF Funding Compliance Assessment

Municipalities are expected to prepare three-year budgets that are, among other things, sustainable in terms of being funded from realistically anticipated revenues to be collected. Consequently, municipalities must assess their revenue situation and financial health for purposes of determining whether or not they have sufficient revenue and adequate financial stability to fund and deliver on their proposed budgets. This is an explicit requirement of the MFMA.

In addition, municipalities are urged to objectively examine the credibility of their proposed budgets in terms of their spending and institutional capacity. For example, it makes no sense for a municipality to adopt an annual capital budget when it only has spending capacity to spend far less than the amount budgeted.

To enable municipalities to assess whether their budgets are funded in compliance with section 18 of the MFMA, National Treasury developed the Funding Compliance Assessment procedure, described in MFMA Circular 42 dated 30 March 2007. Further guidance is given in the *MFMA Funding Compliance Guideline*, which is available at:

http://www.treasury.gov.za/legislation/mfma/guidelines/default.aspx.

All municipalities must do a funding compliance assessment of their 2011/12 budgets in accordance with the guidance given in MFMA Circular 42 and the *MFMA Funding Compliance*

Guideline before tabling their budget, and where necessary rework their budget to comply so that they table a properly funded budget.

In this regard, and acting in terms of section 74 of the MFMA, National Treasury requests all municipalities to submit the following information along with their 2011/12 budgets:

- Supporting Table SA10 of the new formats;
- A narrative assessment of each of the funding compliance variables noted in the *MFMA Funding Compliance Guideline*; and
- An indication of any steps the municipality took in preparing its 2011/12 budget in response to its funding compliance assessment in order to ensure better compliance with section 18 of the MFMA.

National Treasury and / or the relevant provincial treasury will independently assess the funding compliance of each municipality's budget and compare the results to the self assessments done by the municipality.

In terms of the Constitution and Section 5 of the MFMA, the National Treasury and provincial treasuries will exercise their oversight roles by referring back to municipalities those budgets that are not funded in accordance with the MFMA.

6.6 MBRR issues dealt with in previous MFMA Circulars

Municipalities are reminded to refer to MFMA Circulars 48, 51 and 54 with regards to the following issues:

1. *Budgeting for revenue and 'revenue foregone'* – The 'realistically anticipated revenues to be collected' that must be reflected on the Financial Performance Budget (Tables A2, A3 and A4) must exclude 'revenue foregone'. The definition of 'revenue foregone' and how it is distinguished from 'transfers and grants' is discussed in MFMA Circular 51.
2. *Budgeting for Free Basic Services* – Table A10 requires information on the actual cost to the municipality of providing the free basic service (refer to MFMA Circular 51).
3. *Application of regulations to municipal entities* – Municipalities that have entities that do not provide normal municipal services or where budgeted amounts are immaterial and only comprise of funds transferred from a municipality may apply to National Treasury for an exemption in respect of those entities. The application process and deadlines for the 2011/12 process are set in MFMA Circular 54.
4. *Preparing and amending budget related policies* – Information on all budget related policies and any amendments to such policies must be included in the municipality's annual budget document. (refer to MFMA Circular 54).

7 Budget process and submissions for the 2011/12 MTREF

Over the past number of years there have been significant improvements in municipal budget processes. Municipalities are encouraged to continue their efforts to improve their budget processes based on the guidance provided in MFMA Circulars 10, 19, 28 and 31 as well as the new regulations.

Once more, municipalities are reminded that the IDP review process and the budget process should be combined into a single process.

7.1 Submitting budget documentation and schedules for 2011/12

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

- Section 22(b)(i) of the MFMA requires that ***immediately*** after an annual budget is tabled in a municipal council it must be submitted to the National Treasury and the relevant provincial treasury in both printed and electronic formats. The deadline for such submissions is Friday, 8 April 2011.
- Section 24(3) of the MFMA, read together with regulation 20(1), requires that the approved annual budget must be submitted ***within ten working days*** after the council has approved the annual budget. So if the council only approves the annual budget on 30 June 2010, the final date for such a submission is Thursday, 14 July 2011, otherwise an earlier date applies.

The municipal manager must submit:

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

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

If the budget documents are too large to be sent via email, arrangements for them to be downloaded from the municipality's website must be made with Elsabe Rossouw (email: Elsabe.Rossouw@treasury.gov.za).

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

For couriered documents	For posted documents
Ms Linda Kruger	Ms Linda Kruger
National Treasury	National Treasury
40 Church Square	Private Bag X115
Pretoria, 0002	Pretoria, 0001

After receiving tabled budgets, National Treasury will complete a compliance checklist. This checklist will indicate the level of compliance to the Municipal Budget and Reporting Regulations. A copy of the checklist will be sent to the municipality in order to facilitate improvements in the quality of tabled and approved budgets.

7.2 Submissions to the National Treasury database for publication

For publication purposes, municipalities are still required to use the Budget Reform Returns to upload budget and monthly expenditure to the National Treasury Local Government Database. These returns are available in the old formats as well as in versions aligned to the Municipal Budget and Reporting Regulations. Note that this will be the last year that National Treasury will permit municipalities to submit their budget information using the old return forms. As from 2012/13 all municipalities will need to have migrated to using the aligned version of the electronic returns. All returns are to be sent to lgdatabase@treasury.gov.za.

Note that four new electronic returns have been posted on the website as part of the Budget and Reporting Regulations formats:

- Statement of financial position actual (BSAC)
- Cash flow revised budget (CFR)
- Cash flow audited (CFAA)
- Quarterly borrowing monitoring (BM)

The first three forms mentioned above align the electronic returns with the C Schedule formats that municipalities are required to use when reporting to council. The Quarterly borrowing return has been completely revised to cater for bonds issued and must be implemented for the current financial year. Municipalities who have already submitted their BM return for the first and second quarter are requested to use the new format and to resubmit using the new format of the BM return. National Treasury will be publishing this information from the third quarter of 2010/11 as part of the section 71 process.

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

7.3 Publication of budgets on municipal websites

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

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

Contact

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07 March 2011