The meaning of "organ of state" as contemplated in section 110(2)(a) of the MFMA

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1. Purpose

The purpose of this Circular is to—

1.1 clarify the meaning of "organ of state" as contemplated in section 110(2)(a) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003 – 'MFMA');

1.2 explain the listing of Telkom SA SOC Ltd ("Telkom") as a public entity in Schedules 2 to the Public Finance Management Act, 1999 (Act No. 1 of 1999 – 'PFMA'); and

1.3 advise whether Telkom should be regarded as an "organ of state" for purposes of section 110(2)(a) of the MFMA.

2. Application

This Circular applies to municipalities and municipal entities.

3. Interpretation

This Circular should be read together with sections 217 and 239 of the Constitution of the Republic of South Africa, 1996 ('Constitution'), Chapter 11 of the MFMA, and the Municipal Supply Chain Management ('SCM') Regulations, 2005.

4. Background

The National Treasury has been receiving queries regarding whether Telkom is an "organ of state" and whether section 110(2)(a) of the MFMA applies when a municipality or municipal entity procures goods and services from Telkom. The issue arises particularly in cases where municipalities or municipal entities seek to apply the exemption provided for in section 110(2)(a) of the MFMA. This Circular accordingly serves to advise on the legal interpretation of the term "organ of state" as contemplated in section 110(2)(a) of the MFMA.

5. Interpretation of section 110(2)(a) of the MFMA

Section 110(2)(a) of the MFMA provides: "This Part, except where specifically provided otherwise, does not apply if a municipality or municipal entity contracts with another organ of state for the provision of goods or services to the municipality or municipal entity".

Section 110(2)(a) essentially exempts a municipality or municipal entity from the procurement processes set out in Part 1 of Chapter 11 of the MFMA and the SCM Regulations when a municipality or municipal entity enters into a contract with another organ of the state to provide goods or services to the municipality or municipal entity.

6. Rationale of section 110(2)(a) of MFMA

The rationale for section 110(2)(a) of the MFMA is to enhance efficiency and reduce administrative burdens when procurement is conducted between organs of state, which are all ultimately accountable within the same constitutional framework. When goods or services can be sourced from another organ of the state, it removes the need for a full-

scale SCM process. However, the municipality or municipal entity must ensure that all relevant accountability and oversight mechanisms remain in place within its SCM policy to mitigate risks. The core principle is not to circumvent good governance but to effectively leverage public-sector capacity and resources.

From a practical standpoint, municipalities or municipal entities must still exercise due diligence. It is advisable for SCM officials to confirm the credentials of the other organ of the state, evaluate the pricing or cost recovery structure, and verify alignment with the municipality's or municipal entity's strategic objectives and budgetary limits. Additionally, proper record-keeping and clear documentation of the arrangement are crucial for oversight and audit purposes. This ensures that while municipalities and municipal entities benefit from the flexibility offered by section 110(2)(a) of the MFMA, they still adhere to accountability, transparency, and fairness objectives.

7. Meaning of "organ of state"

The MFMA does not define the term "organ of state", however, section 110(2)(a) of the MFMA must be read with the definition of "organ of state" as provided in section 239 of the Constitution.

Section 239 of the Constitution defines an "organ of state" as:

"(a) any department of state or administration in the national, provincial or local sphere of government; or

(b) any other functionary or institution—

> *(i) exercising a power or performing a function in terms of the Constitution or a provincial constitution; or*
>
> *(ii) exercising a public power or performing a public function in terms of any legislation."*

Paragraph (a) of the definition of "organ of state" encompasses all government departments and administrative structures operating in the national, provincial, or local spheres of government. These institutions are financed through the fiscus, and directly accountable for executing governmental policies and functions. Organisations falling under paragraph (a) of the definition of "organ of state" are organs of state, for purposes of section 110(2)(a) of the MFMA, and include municipalities, national and provincial departments.

Paragraph (b)(i) of the definition of "organ of state" applies to institutions whose authority is derived directly from the Constitution or provincial constitution. In the context of the Constitution, these are the so-called "Chapter 9 institutions," including the Public Protector and the Auditor-General of South Africa. Such institutions are recognised as "organs of state" in the context of section 110(2)(a) of the MFMA.

Paragraph (b)(ii) of the definition of "organ of state" includes institutions that derive their authority from ordinary legislation and are empowered to perform public functions or exercise public powers. The pivotal question in determining whether an institution is an "organ of state" under this paragraph is whether it performs a governmental role, such as regulation, licensing, enforcement, or public service delivery, and whether that role is expressly authorised by legislation. If an institution's powers or functions are derived from legislation, excluding the Constitution, that institution would still qualify as an "organ of state" as envisaged in section 110(2)(a) of the MFMA. A water board established in terms

of the Water Services Act, 1997 (Act 108 of 1997), is an example of an institution as contemplated in paragraph (b)(ii) of the definition of "organ of state".

If an institution does not satisfy the requirements to be classified as an "organ of state" under section 239 of the Constitution, a municipality or municipal entity cannot rely on section 110(2)(a) of the MFMA for the procurement of goods or services from that institution. This restriction applies even if the state holds shares in the institution, as partial or full state ownership alone does not confer the automatic status of an "organ of state" as per the definition of "organ of state" under section 239 of the Constitution.

8. Goods or services that can be procured from an organ of state as contemplated in section 110(2)(a) of the MFMA

Although section 110(2)(a) of the MFMA allows a municipality or municipal entity to contract with an "organ of state" to provide goods or services, these goods or services must fall within the functions and powers of the "organ of state", as defined under section 239 of the Constitution and its enabling legislation that qualifies an organisation to be an "organ of state". Essentially, an organ of the state is established to perform specific public functions and powers, and any procurement arrangement must align with those mandates as constitutionally and legislatively assigned to the organ of state.

Section 110(2)(a) of the MFMA accordingly does not empower a municipality or municipal entity to procure goods and services from an "organ of state", which is not in terms of its legislatively mandated powers and functions. Before procuring goods or services from an organ of state, municipalities and municipal entities should determine whether the goods or services they intend to procure fall within the organ of state's functions and powers under its enabling legislation. Municipalities and municipal entities should, where there is any doubt of the scope of the functions and powers of an "organ of state" from which they contemplate procuring goods and services, request the organ of state to provide documentary evidence to confirm their functions and powers under which the goods and services will be provided, and if their powers and functions qualifies the institution to be classified as an organ of state in terms of section 239 of the Constitution.

If a municipality or municipal entity procures services or goods not in the scope of an organ of the state's mandated powers and functions, they must follow the necessary procurement processes as contemplated in Chapter 11 of the MFMA and the SCM Regulations, 2005, and cannot use the exemption in terms of section 110(2)(a) of the MFMA.

9. Clarification of Telkom's “organ of state” status

Although the State is a shareholder in Telkom, Telkom does not meet any of the criteria in the definition to be an “organ of state” as contemplated in section 239 of the Constitution. Therefore, the exemption in section 110(2)(a) of the MFMA does not apply to Telkom. A municipality or municipal entity can therefore not invoke section 110(2)(a) of the MFMA to procure goods and services from Telkom. Telkom, instead, must, like other potential suppliers to a municipality or municipal entity, be subjected to an SCM procurement process before goods or services can be procured from Telkom.

Telkom is currently listed as a public entity in Schedule 2 to the PFMA despite no longer meeting the requirements for such listing. Telkom, for this reason, has been exempted, in terms of section 92 of the PFMA, from the PFMA's provisions pending its de-listing through an amendment to the PFMA.

10. Public disclosure of procurement in terms of section 110(2)(a) of the MFMA

Section 110(2)(a) of the MFMA, read with regulation 11(3) of the SCM Regulations provides that where the SCM exemption in terms of section 110(2)(a) of the MFMA is applied, the municipality or municipal entity must publicly disclose the type of goods or services procured and the name of the organ of state from whom the goods or services were obtained. This requirement confirms that procurement from an organ of state is an exception to competitive bidding, not a waiver of public oversight.

11. Irregular expenditure, financial misconduct and financial offences

Municipalities and municipal entities are reminded that section 110(2)(a) of the MFMA applies only where goods or services are procured from an organ of state. If this provision is applied incorrectly, specifically if the institution in question is not an organ of the state, such irregular expenditure must be reported to and investigated by the Municipal Public Accounts Committee (MPAC) in accordance with section 32(2)(b) of the MFMA. In the case of a municipal entity, any irregular expenditure incurred must be reported to the board of directors for investigation in terms of section 102 of the MFMA.

The irregular expenditure incurred must also be referred to the disciplinary board for a financial misconduct investigation in line with sections 171 and 172 of the MFMA, read with the Municipal Regulations on Financial Misconduct Procedures and Criminal Proceedings, 2014. If there is suspected fraud or the conduct of the officials amounts to a criminal offence under section 173 of the MFMA, the matter must also be reported to the South African Police Service for investigation. Moreover, section 34 of the Prevention and Combating of Corrupt Activities Act, 2004 (Act No. 12 of 2004) requires municipalities and municipal entities to report suspected corruption above R100,000 to the Directorate for Priority Crime Investigation (HAWKS).

12. Conclusion

Municipality accounting officers and municipal entities' chief executive officers must ensure that this Circular is tabled at the next municipal council or board of directors meeting. The contemplated council or board item should explain the Circular and the impact of the Circular on the municipality's or municipal entity's operations and policies. The Circular must also be brought to the attention of municipal officials, including the municipality's and municipal entity's disciplinary board and the audit committee.

All clarification requests concerning this Circular should be emailed to mfma@treasury.gov.za.

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