NATIONAL TREASURY

MFMA Circular No. 74

Municipal Finance Management Act No. 56 of 2003

Municipal Budget Circular for the 2015/16 MTREF

This circular provides further guidance to municipalities and municipal entities for the preparation of their 2015/16 Budgets and Medium Term Revenue and Expenditure Framework (MTREF). It must be read together with all previous MFMA Budget Circulars.

CONTENTS

Key focus areas for the 2015/16 budget process

The Medium Term Budget Policy Statement 2014

The MTBPS highlights that South Africa's economic performance has deteriorated over the past several years. Gross domestic product (GDP) growth of 1.4 per cent is estimated in 2014, down from 3.6 per cent in 2011. GDP growth is projected to improve over the medium term as infrastructure constraints ease, private investment recovers and exports grow. Economic growth is expected to rise gradually over the medium term, reaching 3 per cent by 2017.

Key priorities of government are to reshape South Africa's urban environment through integrated spatial planning, investment in dynamic city development, integrated housing and transport programmes, and support for business activity and job creation. The Medium Term Strategic Framework (MTSF) priorities for structural reform over the period ahead include:

- ***Building the capacity of local government through the "back to basics" approach*** which will focus on improving service delivery, accountability and financial management. Local government should be effective and efficient; and this will be measured by its ability to perform the basic mandate of service delivery.

- Reshaping South Africa's urban environment through **integrated spatial planning and an expansion of the municipal debt market**. Municipalities play a critical role in growing the economy through well-planned and well-managed urbanisation. In order to achieve this, large municipalities require massive investment to stimulate growth, maintain infrastructure and ensure that basic services are provided for growing populations. Over the next three years, the government will roll-out a new approach to local government infrastructure financing. Incentives will be introduced to encourage large urban municipalities to promote more compact, efficient and equitable cities. Planning will focus on developing mixed-use precincts that can help to catalyse economic activity, and on upgrading informal settlements.

Municipalities require capacity to be able to implement the MTSF's priorities for structural reform. This means that the state's capacity to plan, manage and maintain its programmes and infrastructure must improve. Government is providing the following support to enable cities to promote growth and urban spatial transformation:

- A project preparation facility which helps municipalities to build a robust pipeline of well-designed, catalytic projects for implementation;
- The infrastructure delivery management system is being expanded from provinces to large cities; and
- Technical assistance will support the review of borrowing strategies.

In addition, support will be provided to municipalities to improve revenue collection and the management of infrastructure financed from both own revenue and grants. National government will work with municipalities to expand their own contributions to local infrastructure investment, while reforms to the grant system will allow for more flexibility in the design of locally appropriate solutions; thereby facilitating more efficient use of available resources for social infrastructure. Greater integration between the capital investment plans of state-owned companies and city development strategies will also be encouraged.

Government will also work with private investors and development finance institutions to expand debt financing for municipal infrastructure. The Development Bank of Southern Africa (DBSA) is currently examining ways to encourage greater private investment in the municipal infrastructure market through infrastructure bonds, municipal bond underwriting, project finance and various contracting models. These initiatives will aim to improve liquidity and extend maturities in the municipal bond market – and to encourage, rather than crowd out, private investment. The policy objectives will seek to reshape the urban landscape, through the renewal of investment in affordable housing and lenders will be encouraged to expand the debt-finance market for municipal infrastructure in support of infrastructure investment.

As mentioned above, ***sustainable job creation*** remains a national priority and municipalities must ensure that in drafting their 2015/16 budgets and MTREFs they continue to explore opportunities to mainstream labour intensive approaches to delivering services, and more particularly to participate fully in the Expanded Public Works Programme.

The economic growth plays a critical role in job creation; therefore greater private sector investment in the economy is encouraged. Municipalities must continue to undertake joint planning with their communities and respective business sectors that drive the local economy.

Local government conditional grants and additional allocations

The division of available funds to Local Government has increased to R99.2 billion or 9.1 per cent for 2015/16. This is expected to increase to R110.0 billion by 2017/18. The *Medium Term Budget Policy Statement 2014* indicates that over the 2015 MTEF period, transfers to local government total R313 billion, with 61.4 per cent transferred as unconditional allocations such as the equitable share and sharing of the general fuel levy. The remainder is allocated through conditional grants. As an interim measure municipalities MUST ensure that their tabled budgets reflect the conditional grant allocations set out in the 2015 Division of Revenue Bill.

Municipalities are advised to use the indicative numbers as set out in the 2014 Division of Revenue Act to compile their 2015/16 Medium-term Revenue and Expenditure budgets. In terms of the outer year of the 2015/16 municipal MTREF (2017/18 financial year), it is proposed that municipalities conservatively limit funding allocations to the indicative numbers as proposed in the 2014 Division of Revenue Act for 2016/17. **These numbers should then be updated once the 2015 Medium-term Expenditure Framework (MTEF) is tabled by the Minister of Finance in Parliament towards the end of February 2015.** The 2015 Medium-term Expenditure Framework will be published the day after the Minister's budget speech on National Treasury's website at: http://www.treasury.gov.za/legislation/acts/2014/Default.aspx

The Medium Term Budget Policy Statement 2014 highlighted that the country's weaker-than-expected economic performance and outlook pose new fiscal challenges. Lowering the expenditure ceiling is one of the measures implemented. Therefore decreases in indicative baselines will be allocated proportionately across national, provincial and local government according to their share of national revenue.

In the case of local government, reductions will only be made to conditional grants and not to the local government equitable share. Reductions will be spread across the grants and larger reductions will be applied to grants that have a history of underspending and non-infrastructure grants. This translates to a reduction in baseline allocations for local government conditional grants of R920.6 million in 2015/16 and R1.4 billion in 2016/17.

The ***Municipal Human Settlements Capacity Grant*** was introduced in 2014/15 to facilitate the development of capacity to manage human settlements programmes in Cape Town, Ekurhuleni, eThekwini, Johannesburg, Nelson Mandela Bay and Tshwane Metropolitan Municipalities. While the process of assigning the housing function is being reviewed, strengthening the capacity of these cities to manage the built environment remains a priority.

Allocations in terms of this grant will be reduced and the structure and conditions of the grant will be amended to reflect these changes. Details will be announced in the 2015/16 Budget.

A new grant is also proposed to fund the anticipated administrative costs of municipalities in KwaZulu-Natal and Gauteng that will be affected by mergers after the 2016 local government elections.

Additions are also proposed for the ***Regional Bulk Infrastructure Grant*** and ***Municipal Water Infrastructure Grant****.* These allocations are intended to allow government to accelerate the provision of clean water to households.

While the review of local government infrastructure grants will continue in 2015, two changes emerging from the review's recommendations so far are proposed for 2015/16:

- Rationalising four grants administered by the Department of Water and Sanitation. These grants, which have overlapping objectives, are the *Municipal Water Infrastructure Grant, Water Services Operating Subsidy Grant, Rural Households Infrastructure Grant* and *Regional Bulk Infrastructure Grant*; and
- Merging the *Public Transport Infrastructure Grant* and the *Public Transport Network Operations Grant* into a single grant that provides more flexibility to cities in choosing public transport solutions.

Changes in the 2014 Division of Revenue Amendment Bill

The Minister of Finance tabled the 2014 Division of Revenue Amendment Bill on 22 October 2014. The details of the changes to municipal allocations and the reasons for these changes are discussed in the explanatory memorandum to the Bill, available on the National Treasury's website at: http://www.treasury.gov.za/documents/mtbps/2014/default.aspx

The 2014 Division of Revenue Amendment Bill includes a rollover of R80.2 million on Municipal Infrastructure Grant for projects in nine municipalities where transfers were stopped in 2013/14. These municipalities are in the Eastern Cape, KwaZulu-Natal, Northern Cape, North West and Western Cape. An amount of R157 million will be transferred to municipalities through the Municipal Disaster Recovery Grant in response to requests for post disaster funding. This is to repair and replace infrastructure damaged as a result of declared disasters that occurred in 2013 and 2014. The changes will be gazetted in December 2014.

The explanatory memorandum to the 2014 Division of Revenue Amendment Bill also sets out technical corrections to the conditional grant frameworks for the Rural Households Infrastructure Grant and the Municipal Human Settlements Capacity Grant.

Strengthening procurement to obtain value for money and combating corruption

A large share of the national budget is spent to build infrastructure, and to procure goods and services. This expenditure contributes to production and jobs throughout the economy. Government must ensure that its procurement processes are prudent, deliver value for money and help to improve service delivery.

An objective of the Office of the Chief Procurement Officer that was established within the National Treasury in April 2013 is to minimise waste and corruption, and ensure that government derives maximum social and economic benefits from every Rand spent.

This centralised oversight of public procurement will also improve efforts to root out tender fraud. Over the next three years, the Office of the Chief Procurement Officer will build a foundation for more cost-effective procurement operations in the public sector. The range and scope of nationally negotiated contracts will be expanded, a national price-referencing system will be introduced, and government will draw on private-sector expertise and best practice in procurement systems. The fight against corruption also depends on an active citizenry, which the National Development Plan stresses is a precondition for South Africa to achieve its ambitious social and economic objectives.

Local government budget and financial management reforms

Regulation of a 'Standard Chart of Accounts' (SCOA) for local government

The Minister of Finance promulgated the Municipal Regulations on the Standard Chart of Accounts (SCOA) on 22 April 2014. The Municipal Regulations on the Standard Chart of Accounts, Project Summary Document and Detailed Classification Framework of the 7 Segments (SCOA Version 5) can be accessed at:
http://mfma.treasury.gov.za/RegulationsandGazettes/MunicipalRegulationsOnAStandardChartOfAccountsFinal/Pages/default.aspx

Similarly to that of national and provincial government, the municipal SCOA essentially provides for a uniform and standardised financial classification framework by which municipalities are required, at a transactional level, to record all expenditure, revenue, assets and liabilities. While the overall objective and benefits of the municipal SCOA vary, the introduction of the municipal SCOA across all 278 municipalities will undoubtedly improve the ability of municipalities and councils to take informed decisions and improve service delivery outcomes through improved evidence based financial management. Importantly, it will also facilitate the aggregation of budgets and financial performance to ensure 'whole of government' reporting.

In preparation for SCOA implementation by all 278 municipalities by 01 July 2017, the National Treasury has commissioned SCOA Project Phase 4. SCOA Project Phase 4 incorporates various activities including the piloting of the SCOA classification framework in selected municipalities (across all financial systems currently operational in municipalities) with the implementation of the 2015/16 budget (01 July 2015). In addition, as a lead-up to the SCOA implementation by 01 July 2017, there will be a host of change management initiatives including the introduction of a formal training programme.

The selection of pilot municipalities have been finalised and forms part of the SCOA Integrated Consultative Forum. This is a stakeholder engagement forum that was established to oversee and assist stakeholders, vendors and municipalities with the transition to the SCOA classification framework and to date three meetings have taken place. Pilot sites should from 01 July 2015 implement the 2015/16 MTREF in accordance with SCOA classification framework and report accordingly. **Non-piloting municipalities are advised to start comparing their chart of accounts to SCOA in preparation for the implementation in July 2017**.

While non-piloting municipalities do not formally partake in the SCOA ICF, there are a host of immediate activities that need to be undertaken by all municipalities concurrently to the piloting process in preparation for implementation in July 2017. These include, among others:

- Tabling the Municipal Regulations on Standard Chart of Accounts in the municipal council to bring about broader awareness;
- Studying the Regulation, SCOA Project Document, associated Segments and Frequently Asked Questions which can be accessed at the above mentioned website;
- Compilation of a high level project plan and associated activities, including:

- ✓ Identification of a project manager / coordinator within the municipality which should preferably be within the finance department at a senior manager level;
- ✓ Matching the SCOA classification framework to the current chart of accounts (general ledger) currently operational in the municipality and the identification of any anomalies;
- ✓ Matching the Function Segment of the SCOA classification framework to the current vote and cost centre structures and identification of any anomalies;
- ✓ Incorporating all senior managers across the municipality into the project through internal awareness and information sharing;
- ✓ Incorporating the project plan and associated milestones as part of a standing agenda item at the monthly senior manager team meetings; and
- ✓ Tabling a progress report, including a risk matrix at the municipal council on a quarterly basis.

- Attendance of, among others, the provincial CFO Forums which will be used to provide feedback with the piloting process. In addition, there will be sessions scheduled, such as the recent provincial one day SCOA introductory sessions, which will provide further clarity as it relates to the SCOA classification framework. Attendance of these sessions by relevant officials, including the municipal SCOA project manager / coordinator, will be essential if the municipality is to proactively manage any hurdles to ensuring SCOA compliance.

The National Treasury is in the process of finalising a MFMA Circular that will specifically deal with guidance as it relates to the SCOA and SCOA Project Phase 4. The Circular will be released early in 2015 and all municipalities are urged to diligently study the Circular in preparation for full SCOA implementation.

In addition, all queries, clarty seeking questions, challenges and associated issues relevant to SCOA can be directed to the following email address: lgscoa@treasury.gov.za

Financial applications (systems) and the impact of SCOA

Municipalities are reminded that MFMA Circular No. 57 is still in effect and the guidance, processes and procedures provided in the Circular are still applicable. **Currently no system vendor (financial systems) could demonstrate SCOA compliance** and municipalities are therefore strongly advised not to proceed with any configuration or upgrades to their current core financial systems as this could potentially lead to fruitless and wasteful expenditure not to mention exposing the municipality to unnecessary risk as it relates to SCOA compliance. As indicated above, as part of SCOA Project Phase 4 all system vendors have been included in the piloting process and are currently undertaking reconfiguration and upgrades to their system functionality in support of the multidimensional chart as prescribed by the SCOA Regulations.

Only once the piloting process has been finalised will the National Treasury be in a position to issue a follow-up MFMA Circular to MFMA Circular No. 57. It is envisaged that the objectives of the piloting process will be finalised towards the end of the first quarter of the 2015/16 financial year subsequent to which the follow-up MFMA Circular will be issued.

Notwithstanding the abovementioned facts, municipalities continue to replace their current financial applications against the guidance supplied in MFMA Circular No. 57. While it is acknowledged that in some cases municipalities feel that limitations associated with their current financial system functionality is impeding overall performance improvements, municipalities are advised to proceed with the outmost caution. Municipalities should follow the procedures and processes as outlined in MFMA Circular No. 57 and attempt to keep any decisions relating to changing financial systems in abeyance until the finalisation of the piloting process. In the interim, the National Treasury is of the opinion that each case should be managed based on the unique circumstances and challenges experienced by each municipality.

Furthermore, municipalities are advised that in many cases the implementation of the SCOA classification framework could be considered a reimplementation of a financial system as it relates to take on balances of previous financial years and setting up of a new general ledger. Consequently the opportune time to change financial applications would in most cases be with the implementation of the SCOA classification framework and will undoubtedly be the most cost efficient approach. Further guidance in this regard will be provided in the MFMA Circular that will be issued in early in 2015.

Headline inflation forecasts

Municipalities must take the following inflation forecasts into consideration when preparing their 2015/16 budgets and MTREF. This information will be updated in a further Budget Circular to be issued after the tabling of the National Budget.

Fiscal year	**2014**	**2015**	**2016**	**2017**	**2018**
	Actual	**Estimate**		**Forecast**	
CPI Inflation	5.6%	6.2%	5.8%	5.5%	5.3%

Source: Medium Term Budget Policy Statement 2014

Revising rates, tariffs and other charges

Operating Revenue

Municipal revenues and cash flows are expected to remain under pressure in 2015/16 due to the state of the economy; therefore 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.

Municipalities are therefore required to realistically provide for revenue as part of the statement of financial performance, cash flow and capital programme.

Another challenge identified was that municipalities are not able to set cost-reflective tariffs as advised in previous circulars because the cost drivers are not known. Municipalities are advised to determine the costs per service in determining tariffs. The use of tariff models will not yield positive results in municipalities that do not know their cost drivers as would any financial model based on incorrect information.

When municipalities and municipal entities revise their rates, tariffs and other charges for the 2015/16 budgets and MTREFs, they need to take into account the primary and secondary costs of services provided, local economic conditions and affordability of services to ensure financial sustainability.

National Treasury also continues to encourage municipalities to keep increases in rates, tariffs and other charges at levels that reflect an appropriate balance between the interests of poor households, other customers and ensuring the financial sustainability of the municipality. For this reason municipalities ***must justify in their budget documentation all increases in excess of the 6.0 per cent*** upper boundary of the South African Reserve Bank's inflation target in the budget narratives.

Management accounting and tariff setting

A costing guideline will be issued to respond to the demand by local government practitioners for guidance and tools in the costing of services rendered to consumers. The guideline is informed by the outcome of a pilot study that was undertaken. It addresses the inability to produce consistent data by municipalities on the cost of rendering a trading service.

This process will assist practitioners to improve their understanding of the principles and techniques of cost allocation. The adopted methodology is based on a consistent approach across municipalities, functions and projects, and so allow for cost comparisons and benchmarking. In addition, the information will be critical for tariff setting not only across main trading services but also in ensuring transparency in revenue generated across consumer categories. The process will also assist municipalities to better understand their costs and the factors that have the greatest influence on these costs (i.e. the cost drivers).

The rationale and concepts explained in this guideline envisage the establishment of a shared understanding among the various roleplayers involved.

Interpretation of section 43 of the MFMA

The municipal electricity tariff increase is regulated in terms of the Municipal Finance Management Act (MFMA) and the Electricity Regulation Act (ERA). ERA empowers NERSA to determine electricity tariffs to be charged by municipalities on an annual basis. The MFMA prescribes the timelines within which NERSA must finalise the process of determining the municipal tariff for a financial year.

Section 43 of the MFMA deals with the applicability of tax and tariff capping on municipalities

Section 43 of the MFMA requires an organ of state (NERSA) to make a determination of the municipal tariff increase on or before 15 March in a year for the tariff to be effective in 1 July of that year. If the determination is done after 15 March in a year, such determination will take effect 1 July in the next year. For example, if NERSA advises a municipality of its tariff determination by 15 March 2015, the tariff determination by NERSA with respect to the municipal electricity tariffs will be effective from 1July 2015 but if NERSA fails to inform a municipality of its determination by 15 March 2015, the tariff determination by NERSA will only be effective from 1 July 2016. This implies that municipalities must submit their tariff applications before 15 March to enable NERSA to comply with the stipulated deadline (15 March).

Municipalities are also required in terms of section 16(2) of the MFMA to table the municipal budget in council no later than 31 March. The annual budget must be accompanied by amongst others draft resolution for imposing any municipal tax and setting any municipal tariffs as may be required for the budget year. The tabled municipal budget must be published for consultation with their local community and their views must be considered before the municipal council approves the budget.

With respect to electricity tariffs, NERSA determines the maximum tariffs that should be imposed by each municipality and they can be adjusted downwards depending on the circumstances of each municipality and resolution taken by the municipal council. A municipality may not charge a customer a higher tariff than that approved by NERSA. Therefore the determination made by NERSA should be used as a basis for consultation with local community and may be adjusted downward depending on the outcomes of the consultations. In cases where the outcomes of the consultations necessitate upward adjustment of the tariffs, a municipality should apply to NERSA for the review of the tariffs through an appeal process which is provided for in the Electricity Regulation Act. This should also be done in time to ensure that the processes are finalised before the approval of budget by municipal council.

NERSA's process to approve electricity tariffs

Municipalities will submit tariff applications from December 2014 aligned with the requirements of section 43 of the MFMA and subsequently NERSA will endeavour to finalise and complete all municipal tariff applications by 15 March 2015.

NERSA held workshops and one-on-one interactions with municipalities per province in order to assist municipalities with the completion of the D-forms. This process ran parallel with the submission of the D-forms. Municipalities are urged to ensure that correct and accurate information is submitted timeously to NERSA in order to ensure that proper analysis is done, and approval of tariff applications is achieved timeously.

In this regard municipalities are reminded to submit all outstanding D-forms to NERSA as a matter of urgency as the deadline for submission was 31 October 2014. NERSA will not be in a position to evaluate municipal tariff applications in the absence of complete D-forms. It is important that municipalities and NERSA work together to ensure that the process of approving electricity tariffs are finalised before 30 June 2015.

Eskom bulk tariff increases

Municipalities are advised to structure their 2015/16 electricity tariffs based on the **12.69 per cent** guideline and provide for a **14.24 per cent** increase in the cost of bulk purchases for the tabled 2015/16 budgets and MTREF. Any changes to these guidelines will be communicated to municipalities in a further Budget Circular for the 2015/16 financial year to be issued shortly after the tabling of the National Budget.

National Treasury supports the use of the following formula, proposed by NERSA, for calculating municipal electricity tariff increases:

MG = (B x BPI) + (S x SI) + (R x RI) + (C x CCI) + (OC x OCI)

Where:

MG = % Municipal Guideline Increase
B = % Bulk purchases
BPI = % Bulk purchase increase
S = % Salaries
SI = % Salaries increase
R = % Repairs
RI = % Repairs increase
C = % Capital charges
CCI = % Capital charges increase
OC = % Other costs
OCI = % Other costs increase

All cost shares and increases must relate to the electricity function of the municipality

The formula for calculating the guideline:

MG = (B x BPI) + (S x SI) + (R x RI) + (C x CCI) + (OC x OCI)

= (73 x 14.24) + (10 x 7.3) + (6 x 6.3) + (4 x 6.3) + (7 x 6.3)

= 10.40 + 0.73 + 0.38 + 0.25 + 0.54

= 12.20%

Municipalities are urged to examine the cost structure of their electricity undertakings and apply to NERSA for electricity tariff increases that are cost reflective and ensure continued financial sustainability.

Where a municipality's evaluation of its cost structure results in a lower or higher tariff increase to that proposed by NERSA, the municipality must structure its tariffs accordingly and ensure it provides the necessary motivation and information in its tariff application to NERSA. Municipalities must refer to NERSA's 'Consultation paper for municipal tariff guideline benchmarks for 2015/16 financial year' for requirements on approving tariffs above the guideline, which can be accessed at www.nersa.org.za.

Water and sanitation tariffs must be cost-reflective

If a municipality's water and sanitation 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. ***As per the guidance in various previous Budget Circulars, municipalities were expected to apply cost reflective tariffs in the 2014/15 MTREF for both water and sanitation***. Should this not be the case, municipalities will be required to clearly articulate the reasons and remedial actions to rectify this position in their budget document.

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.

Funding choices and management issues

Employee related costs

The *Salary and Wage Collective Agreement* for the period 01 July 2012 to 31 June 2015 has come to an end. In the absence of other information from the South African Local Government Bargaining Council, municipalities are advised to budget for a 5.8 per cent cost-of-living increase adjustment to be implemented with effect from 01 July 2015 (in line with the increase proposed in the 2014 MTBPS). Municipalities must further use the inflation forecast to project increases in the outer years.

General –Expenditure (Cost-containment measures and non-priority spending)

Building on cost containment guidelines approved by Cabinet in October 2013, government at all levels will need to identify opportunities to increase efficiency and reduce waste. At a national level, the 2015 budget will pay particular attention to reducing line items that are not critical to service delivery to reinforce cost containment. Municipalities are still urged to implement the cost containment measures on six focus areas namely, consultancy fees, no credit cards, travel and related costs, advertising, catering, events costs and accommodation.

Related to cost-containment measures is the elimination of non-priority spending. The National Treasury has continuously through circulars provided advice to municipalities to eliminate non-priority spending. It was noted that there are municipalities that continue to excessively sponsor music festivals and arts festivals. With the implementation of cost-containment measures, municipalities must control unnecessary spending on nice-to-have items and non-essential activities. Municipalities are urged to refer to MFMA Circular 70 on examples of non-priority expenditure that must be eliminated.

The use of consultants

The National Treasury (Office of the Chief Procurement Officer) has observed that many municipalities make use of consultants and other service providers in the course of daily operations. Owing to the fact that that there are no standardised tariffs and rates currently regulated as it relates to professional service providers and consultants, many municipalities are charged exorbitant fees for such services.

The response received from municipalities on the VAT reconciliation questionnaire indicates that most municipalities use consultants to review and submit these returns to the South African Revenue Services (SARS). Municipalities are advised to refrain from the use of consultants and other service providers in completing or reviewing their VAT returns. It is the responsibility of the Chief Financial Officer to review the VAT returns.

Budgeting for unfunded/ underfunded mandates

In previous budget years, it was noted that a number of municipalities are budgeting for unfunded/underfunded mandates. The South African Cities Network (SACN, 2007:78) defines an unfunded/underfunded mandate as when municipalities perform the functions of other spheres of government and bear significant costs out of their own revenue sources. These unfunded/underfunded mandates pose an institutional and financial risk to the municipality as substantial amounts of own funding is being allocated to non-core functions at the expense of basic service delivery.

One of the main objectives of local government is to ensure the provision of basic services to communities. Section 153 of the Constitution requires that budgeting processes must prioritise the basic needs of the community. Municipalities must therefore prioritise the provision of basic services such as electricity, water, sanitation and refuse removal in their MTREF budgets. Municipality may only budget for non-core functions such as crèches, sports fields, libraries, museums, health services, etc. if:

- The function is listed in Schedule 4B and 5B of the Constitution;
- The function is assigned to municipality in terms of national and provincial legislation;
- The municipality has prioritised the provision of basic services; and
- It does not jeopardise the financial viability of the municipality.

Municipalities are urged to sign service level agreements and recover costs where unfunded/underfunded mandates are performed on behalf of other spheres of government. However it will not constitute an unfunded / underfunded mandate if the municipality provides services beyond what is stipulated in the service level agreement.

Budget management issues dealt with in previous MFMA Circulars

Municipalities are reminded to refer to MFMA Circulars 48, 51, 54, 55, 66, 67 and 70 with regards to the following issues:

1. *<u>Mayor's discretionary funds and similar discretionary budget allocation</u>* – National Treasury regards allocations that are not designated for a specific purpose to be bad practice and discourage them (refer to MFMA Circular 51).
2. *<u>Unallocated ward allocations</u>* – 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. *Virement policies of municipalities* – Municipalities are reminded of the principles that must be incorporated into municipal virements policies (refer to MFMA Circular 51).
5. *Providing clean water and managing waste water* – Municipalities were reminded to include a section on 'Drinking water quality and waste water management' in their budget document (refer to MFMA Circular 54).
6. *Renewal and repairs and maintenance of existing assets* – Allocations to repairs and maintenance, and the renewal of existing infrastructure must be prioritised. Municipalities must provide detailed motivations in their budget documentation if allocations do not meet the required benchmarks set out in MFMA Circular 55 and 66.
7. *Credit cards and debit cards linked to municipal bank accounts are not permitted* – On 02 August 2011 National Treasury issued a directive to all banks informing them that as from 01 September 2011 they are not allowed to issue credit cards or debit cards linked to municipal bank accounts (refer to MFMA Circular 55).
8. *Water and sanitation tariffs must be cost reflective* - refer to MFMA Circular 66.
9. *Solid waste tariffs* – refer to MFMA Circular 70.
10. *Variances between 4th Quarter section 71 results and annual financial statements* – refer to Circular 67.
11. *Additional In-Year reporting requirements* – refer to MFMA Circular 67.
12. *Appropriation statement (reconciliation: budget and in-year performance)- reference is made to circular 67.* It came to the attention of National Treasury that a number of municipalities did not include the appropriation statement as part of their 2012/13 or 2013/14 annual financial statement. In terms of the Standards of GRAP 24 on the Presentation of Budget Information in Financial Statements, municipalities are required to present their original and adjusted budgets against actual outcome in the annual financial statements. This is considered an appropriation statement and the comparison between the budget and actual performance should be a mirror image of each other as it relates to the classification and grouping of revenue and expenditure as has been the case in a national and provincial context. This statement is subject to auditing and accordingly supporting documentation would be required to substantiate the compilation of this statement.
13. *Eliminating non-priority spending* – The 2013 MTBPS emphasised the need for government to step-up its efforts to combat waste, inefficiency and corruption (refer to MFMA circular 70).
14. *Council oversight over the budget process* – refer to MFMA Circular 70.

Conditional Grant transfers to municipalities

As indicated above, National Treasury will issue a further Budget Circular for the 2015/16 financial year shortly after the tabling of the National Budget. This Circular will deal with any new conditional grant issues and processes related to the management of conditional grants.

Conditional grant issues dealt with in previous MFMA Circulars

Municipalities are reminded to refer to MFMA Circulars 48, 51, 54, 55 and 67 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://mfma.treasury.gov.za/Guidelines/Pages/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 grant transfers* – the 2015 Division of Revenue Bill contained a provision that allows municipalities to pledge their conditional grants. The end date for the pledges is extended to 2017/18. The process of application as set out in MFMA Circular 51 remains unchanged.
6. *Separate reporting for conditional grant roll-overs* – National Treasury has put in place a separate template for municipalities to report on the spending of conditional grant roll-overs. Municipalities are reminded that conditional grant funds can only be rolled-over once, so if they remain unspent in the year in which they were rolled-over they MUST revert to the National Revenue Fund.
7. *Payment schedule* – National Treasury has instituted an automated payment system of transfers to municipalities in order to ensure appropriate safety checks are put in place. Only the primary banking details verified by National Treasury will be used for effecting transfers.
8. *Conditional grant transfers/payments, the responsibilities of transferring and receiving authorities and the criteria for the rollover of conditional grants –* It is important that the transfers made to municipalities' are transparent, and properly captured in the municipalities' budgets. MFMA Circular no: 67 in this regard refers. The criterion for the rollover of conditional grants is stipulated in MFMA Circular no: 51.

The Municipal Budget and Reporting Regulations

National Treasury has released Version 2.7 of Schedule A1 (the Excel Formats). This version incorporates minor changes (see Annexure A). Therefore ALL municipalities MUST use this version for the preparation of their 2015/16 Budget and MTREF.

Download Version 2.7 of Schedule A1 by clicking HERE

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

Since 01 July 2009, all municipalities and municipal entities must prepare their annual budgets, adjustments budgets and in-year reports for the 2015/16 financial year in accordance with the Municipal Budget and Reporting Regulations. In this regard, municipalities must comply with both:

- The formats set out in Schedules A, B and C; and
- The relevant attachments to each of the Schedules (the Excel Formats).

If a municipality fails to prepare its budget, adjustments budget and in-year reports in accordance with the relevant formats,

- The municipality will be required to resubmit their documentation in the regulated format by a date determined by the National Treasury;
- The municipality's non-compliance with the required formats will be reported to the Auditor-General; and
- A list of municipalities that fail to comply with the required formats will be tabled in Parliament and the provincial legislatures.

Assistance with the compilation of budgets

If you require advice with the compilation of your budgets, the budget documents or Schedule A1 please direct your enquiries as follows:

	Responsible NT officials	**Tel. No.**	**Email**
Eastern Cape	Templeton Phogole Matjatji Mashoeshoe	012-315 5044 012-315 6567	Templeton.Phogole@treasury.gov.za Matjatji.Mashoeshoe@treasury.gov.za
Free State	Vincent Malepa Katlego Mabiletsa	012-315 5539 012-395 6742	Vincent.Malepa@treasury.gov.za Katlego.Mabiletsa@treasury.gov.za
Gauteng	Kgomotso Baloyi Nomxolisi Mawulana	012-315 5866 012-315 5460	Kgomotso.Baloyi@treasury.gov.za Nomxolisi.Mawulana@treasury.gov.za
KwaZulu-Natal	Bernard Mokgabodi Johan Botha Walter Munyai	012-315 5936 012-315 5171 012-395 6793	Bernard.Mokgabodi@treasury.gov.za Johan.Botha@treasury.gov.za Walter.Munyai@treasury.gov.za
Limpopo	Una Rautenbach Sifiso Mabaso	012-315 5700 012-315 5952	Una.Rautenbach@treasury.gov.za Sifiso.Mabaso@treasury.gov.za
Mpumalanga	Jordan Maja Anthony Moseki	012-315 5663 012-315 5174	Jordan.Maja@treasury.gov.za Anthony.Moseki@treasury.gov.za
Northern Cape	Willem Voigt Mandla Gilimani	012-315 5830 012-315 5807	Willem.Voigt@treasury.gov.za Mandla.Gilimani@treasury.gov.za
North West	Sadesh Ramjathan Makgabo Mabotja	012-315 5101 012-315 5156	Sadesh.Ramjathan@treasury.gov.za Makgabo.Mabotja@treasury.gov.za
Western Cape	Vuyo Mbunge Kevin Bell Mlungisi Mthembu	012-315 5661 012-315 5725 012-395 6554	Vuyo.Mbunge@treasury.gov.za Kevin.Bell@treasury.gov.za Mlungisi.Mthembu@treasury.gov.za
Technical issues with Excel formats	Elsabe Rossouw	012-315 5534	lgdataqueries@treasury.gov.za

Addressing gaps identified in municipalities budgets

It is the sixth year of the implementation of the Municipal Budget and Reporting Regulations and it is acknowledged that there is improvement in the number of municipalities complying with the required formats. However the quality of data contained in the A schedules and supporting table is still a challenge. Municipalities should consider the following when compiling the 2015/16 MTREF budgets:

Budgeting for revenue on Table A2

Municipalities must include capital transfers and contributions in total operating revenue budgeted for on table A2. The total revenue will reconcile to operating revenue plus capital transfers and contributions as on table A4.

Budgeting for Asset Register value on Table A9

The total asset register summary – PPE (WDV) must include the capital budget expenditure for the budget year. e.g. 2015/16 total asset register summary should include the capital expenditure for 2015/16. Municipalities must ensure that the capital expenditure aligns to Table a5.

Completion of service delivery information on Table A10

It was observed that the completion of table A10 is still a challenge to most municipalities. During the assessment of the 2014/15 MTREF, it was observed that the table lacked credibility and municipalities were requested to make amendments and resubmit.

Municipalities must ensure that the table is correctly completed and accurate to depict their actual position. The information on the cost of providing free basic services and the revenue cost of providing services must be completed. In completing table A10 care must be given to the required unit of measure i.e. kilolitres, kilowatt-hour etc.

Budgeting for revenue foregone and free basic services to indigents

Regardless of the guidance provided on MFMA Circular 51 in relation to budgeting for revenue foregone, it was evident during the 2014/15 budget assessment process that municipalities are struggling to distinguish between revenue foregone and transfers and grants expenditure on table A4.

The key concept in determining the difference between revenue foregone and grants expenditure, is that a rates rebate that is 'generally available to all' is in practice an adjustment to the rates tariff. Therefore, the revenue was never there to be collected (the revenue was foregone), and should therefore not be considered to be revenue in the first instance. This is why it is deducted on Table SA1 - and the net amount is reflected on Table A4.

The provision of free basic services to the indigents must be budgeted for as non-cash flow grant expenditure on Table A4 supported by Table SA21. Since the municipality will not collect any revenue from indigents and free basic services to indigents are funded through the Equitable Share, this constitutes grant expenditure.

Tabling funded budgets

In MFMA Circular no. 72 it was highlighted that municipalities must budget for a surplus operating budget. National Treasury received enquiries from municipalities highlighting that the circular is in contradiction with MFMA Circular no. 55 which referred to budgeting for operating deficit. It should be noted that MFMA Circular no. 55 encouraged municipalities to budget for a moderate surplus on its Financial Performance Budget so as to be able to contribute to the funding of the Capital Budget. When the circular was issued, it was highlighted that there may be temporary circumstances that make this difficult; for instance the 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.

MFMA Circular no. 59 was accordingly issued during March 2012, whereby table SA1 was amended to include under the detail of 'depreciation and asset impairment' 'depreciation resulting from the revaluation of PPE'. The effect is that the depreciation resulting from the revaluation of PPE will be deducted from the total depreciation on PPE, resulting in only the depreciation on the cost price being reflected in the statement of financial performance as an expense. Therefore, 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. The municipality needs to put in place appropriate strategies to address the problems causing a deficit, and explain these measures in its budget document.

It is critical that municipalities adopt and implement funded budgets as per Section 18 of the MFMA. Tables A7 and A8 which if completed correctly by the municipality, it will 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 sufficient cash and investments available to finance commitments and short term provisions and reserves. If the net results reflect a shortfall, this is an indication that the budget is not funded.

MBRR issues dealt with in previous MFMA Circulars

Municipalities are reminded to refer to MFMA Circulars 48, 51, 54, 55 with regards to the following issues:

1. *<u>Budgeting for revenue and 'revenue foregone'</u>* – The 'realistically anticipated revenues to be collected' that must be reflected on the Budgeted Statement of Financial Performance (Tables A2, A3 and A4) must exclude 'revenue foregone'. The definition of 'revenue foregone' and how it is distinguished from 'transfers and grants' is explained in MFMA Circular 51.
2. *<u>Preparing and amending budget related policies</u>* – 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).
3. *<u>2013/14 MTREF Funding Compliance Assessment</u>* – All municipalities were required to perform the funding compliance assessment outlined in *MFMA Funding Compliance Guideline* and to include the relevant information outlined in MFMA Circular 55 in their 2015/16 budgets (refer to MFMA Circular 55).

Budget process and submissions for the 2015/16 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 previous and current MFMA Circulars.

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

Submitting budget documentation and schedules for 2015/16 MTREF

To facilitate oversight of compliance with the 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, **10 April 2015**.
- 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 2015, the date for such a submission is Tuesday, **14 July 2015**, 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;
- the draft service delivery and budget implementation plan in both printed and electronic format;
- in the case of approved budgets, the council resolution;
- Signed Quality Certificate as prescribed in the Municipal Budget and Reporting Regulations; and

Municipalities are required to send electronic versions of documents and the A1 schedule to lgdocuments@treasury.gov.za.

If the budget documents are too large to be sent via email (exceeds 4MB) please submit to lgbigfiles@gmail.com and inform the National Treasury official responsible for your province that the budget was submitted to this address to ensure that National Treasury is aware of your submission. Any problems experienced in this regard can be addressed 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. Please review the municipality's previous year performance and ensure that the gaps are addressed.

In addition to the above mentioned budget documentation, metropolitan municipalities must submit the Built Environment Performance Plan (BEPP) approved by council on 31 May 2015 to Yasmin.coovadia@treasury.gov.za.

Budget reform returns to the Local Government 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. All returns are to be sent to lgdatabase@treasury.gov.za.

The 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.

Reporting in terms of section 71

Performance reporting template – all 278 municipalities must complete the quarterly SDBIP performance reports on the prescribed template as circulated with the request to verify the S71 quarterly reports and submit to lgdocuments@treasury.gov.za as it forms part of quarterly reporting.

Unbundling of debt – the debtors age analysis return makes provision for municipalities to select the category of the government department owing them. However municipalities capture the figures without selecting the relevant government department when completing the return. As the database stores the figures against a department, these unidentified departmental figures can therefore not be stored which results in discrepancies on the amount owed by individual government departments when compared to the total.

Municipalities must ensure that all figures are captured against a selected national or provincial department on the Age Debtors Analysis for Government (ADG) worksheet and are balanced.

Publication of budgets on municipal websites

In terms of section 75 of the MFMA all municipalities are required to publish their tabled budgets, adopted 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

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Post	Private Bag X115, Pretoria 0001
Phone	012 315 5009
Fax	012 395 6553
Website	http://www.treasury.gov.za/default.aspx

JH Hattingh
Chief Director: Local Government Budget Analysis
12 December 2014

Annexure A – Changes to Schedule A1 – the 'Excel formats'

As noted above, National Treasury has released Version 2.7 of Schedule A1 (the Excel Formats). It incorporates the following changes:

No.	Sheet	Amendment	Reason
1	A5	Insertion of a validity check formula.	Ensure that funding and expenditure balances.
2	A6	Insertion of a validity check formula.	Ensure that net assets and total community wealth balances.
3	A7	Insertion of receipts from property rates and service charges line items. Insertion of formulae linking A7 to SA30 for the MTREF.	Simplification of data gathering for determining the collection rate from main services.
4	A10	Insertion of new footnote.	Improve reporting of services provided including informal settlements.