NATIONAL TREASURY

MFMA Circular No. 66

Municipal Finance Management Act No. 56 of 2003

Municipal Budget Circular for the 2013/14 MTREF

This circular provides further guidance to municipalities and municipal entities for the preparation of their 2013/14 Budgets and Medium Term Revenue and Expenditure Framework (MTREF). It must be read together with MFMA Circulars No. 48, 51, 54, 55, 58 and 59.

CONTENTS

Key focus areas for the 2013/14 budget process

The *Medium Term Budget Policy Statement 2012* notes that the South African economy is projected to grow by 2.5 per cent in 2012. By 2014 GDP growth is expected to reach 3.8 per cent, supported by expanding public sector investment in infrastructure, the activation of new electricity-generating capacity, improving public sector confidence, relatively low inflation and interest rates and strong growth in the Southern African region.

Specific interventions to achieve this include: investing in strategic infrastructure programmes, including electricity generation and transport capacity needed to open up new mining and industrial opportunities. Linked to this is strengthening municipal finances and investing in residential development and urban infrastructure.

The proposed spending framework approved by Cabinet takes account of the need to control spending growth over the medium term while increasing the efficiency of existing allocations to improve public services. As a result, the fiscus does not increase available funds beyond the 2012 budget baseline.

The labour market has deteriorated. The official unemployment rate rose to 25.5 per cent of the labour force in the third quarter of 2012 from 24.9 per cent in the second quarter according to the latest Quarterly Labour Force Survey. The total number of unemployed people stood at 4.67 million in the three months up to September, from 4.47 million in the second quarter. By the expanded definition of unemployment (including those who have stopped looking for work) unemployment increased to 36.3 per cent, from 36.2 per cent.

Consequently, municipal revenues and cash flows are expected to remain under pressure in 2013/14 and ***so municipalities must adopt a conservative approach when projecting their expected revenues and cash receipts***. Municipalities will have to carefully consider affordability of tariff increases especially as it relates to domestic consumers while considering the level of services versus the associated cost. Municipalities should also pay particular attention to managing revenue effectively and carefully evaluate all spending decisions. In generating capacity for spending on key municipal infrastructure ***municipalities will have to identify inefficiencies and eliminate non-priority spending***.

National priority – Expanding public sector investment in infrastructure

The key priorities in the local government and housing function are the provision of basic services such as water and sanitation, human settlements development and local government infrastructure.

In addition, creating decent employment opportunities remains a national priority. In drafting their 2013/14 budgets and MTREFs all municipalities are urged to continue to explore opportunities to mainstream labour intensive approaches to delivering services, and more particularly to participate fully in the Expanded Public Works Programme. In this regard the Expanded Public Works Programme Grant (EPWP) has been reconfigured in the 2012/13 financial year to be a schedule 6 grant. Municipalities are required to reflect the EPWP allocation in their budget because the gazetted amounts of the programme will flow directly into their primary bank accounts. Municipalities should budget for the grant in the same way as it budgets for all other schedule 6 conditional grants. Allocations are based on past performance on the EPWP, potential to create work using baseline allocations, need for employment creation in their area and an adjustment factor for rural municipalities.

Municipalities should not just employ more people without any reference to the level of staffing required to deliver effective services, remuneration increases associated with bargaining council decisions 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 projects use labour intensive methods wherever appropriate;
- Ensuring that service providers use labour intensive approaches;
- Supporting labour intensive LED projects;
- Participating fully in the Expanded Public Works Programme; and
- Implementing interns programmes to provide young people with on-the-job training.

Municipalities also play a critical role in creating an enabling environment for investments and other activities that lead to job creation. It is important for municipalities to pay particular attention to:

- Ensuring the timely delivery of their capital programmes (eliminate under-spending of capital budgets) and to review all by-laws and development approval processes with a view to removing any regulatory bottlenecks to investment and job creation; and
- Act as a catalyst for local economic development by appropriately structuring capital programmes to address backlog eradication, asset renewal and development of new infrastructure; this will require carefully formulating the funding mix of the capital programme to include grants, borrowing and own funding (internally generated funding).

Image of Local Government

The Local Government Budgets and Expenditure Review highlighted the burgeoning crisis in the declining credibility of local government. Public perception at this time, as measured through various monitors and surveys reflected high levels of disenchantment with service delivery and perceived corruption at municipalities. Recent gauges of public opinion, evident in the outcome of recent surveys on corruption and fraud in government and increases in service delivery protests countrywide, confirm that this negative perception of local government persists.

In the medium to long term, these perceptions will improve as service delivery improves. In the short term, municipalities must demonstrate sound leadership and put in place measures to address mismanagement by implementing effective systems to measure, monitor and evaluate performance.

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. Key performance areas of this unit will include:

- The modernisation of the state procurement system to be in line with the prescripts of the Constitution;
- Ensure transparent use of resources for improved service delivery; and
- Exercise sound stewardship of government assets and resources.

Measures to counter supply chain management related fraud and corruption include preventative and enforcement measures. Measures will focus on, among others:

- Enhancing regulatory measures and compliance monitoring;
- Strengthening oversight;
- Further procurement reforms;
- Enforcement of the procurement of goods and services that are available in terms of Transversal Term Contracts;
- Consider the introduction of measures to evaluate the integrity and correctness on all major contracts;
- Strengthening the monitoring function of the provincial treasuries;
- Enforce the code of conduct/ethics in supply chain management for practitioners and bid committee members;
- Publication of all tender awards;
- Price benchmarking;
- Encourage the enforcement of remedial actions (penalties, litigations, restrictions etc.) on all suppliers that act fraudulently; and
- Refinement to the register for tender defaulters and the database of restricted supplies which must be checked prior to awarding of contracts in order to ensure that no restricted companies are awarded contracts.

To this end the Supply Chain Management regulatory framework will be reviewed and updated. Municipalities are also encouraged to introduce greater transparency to municipal supply chain processes by publishing SCM process outcomes for each bid on their websites.

Taking the 2011 Local Government Budgets and Expenditure Review forward

One of the key outputs for National Treasury is the biennial production of the "Local Government Budgets and Expenditure Review". The purpose of such a review as suggested by the title is to highlight over a seven year period the trends in local government budgets and expenditure according to certain strategic and thematic areas. This enables National Treasury and other users of the publication, such as Parliament, to measure progress made by local government in the fulfilment of its mandate while at the same time highlighting those areas where challenges still exist.

In September 2011, National Treasury published the "*Local Government Budgets and Expenditure Review"*. Municipalities are urged to work through the document as part of their preparations for drafting their 2013/14 budgets and MTREF's.

The *Review* highlights the following areas as requiring particular attention by municipalities:

i. ***Revenue management*** – To ensure the collection of revenues, municipalities need to ensure that billing systems are accurate, send out accounts to residents and follow up to collect revenues owed. Municipalities are urged to take note of MFMA Circular No. 64 - Revenue Management, in the preparation of the 2013/14 budgets and MTREF's. The Circular can be accessed at:

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

ii. ***Collecting outstanding debts*** – This requires political commitment, sufficient administrative capacity, and pricing policies that ensure that bills are accurate and affordable.

iii. ***Pricing services correctly*** – The full cost of services should be reflected in the price charged to residents who can afford to pay. Many municipalities offer overly generous subsidies and rebates that result in services being run at a loss, resulting in funds being diverted away from other priorities.

iv. ***Underspending on repairs and maintenance*** – Often seen as a way to reduce spending in the short term, underspending on maintenance can shorten the life of assets, increase long-term maintenance and refurbishment costs, and cause a deterioration in the reliability of services.

v. ***Spending on non-priorities*** – Many municipalities spend significant amounts on non-priority items including unnecessary travel, luxury furnishings, excessive catering and unwarranted public relations projects. Consultants are often used to perform routine tasks. Considering the pressurised economic climate continued spending on non-priority wants cannot be sustained.

The *2011 Local Government Budgets and Expenditure Review* can be accessed at:

http://www.treasury.gov.za/publications/igfr/2011/lg/default.aspx

In line with the biennial nature of the publication, the next "Local Government Budgets and Expenditure Review" is scheduled for release towards the latter half of 2013. In the lead up to this publication, National Treasury needs to ensure that the database used to compile the review is updated and reflective of the latest available audited financial information for local government. National Treasury requires the assistance of municipalities to ensure that the information in respect of your municipality is correctly reflected in the LG database. Should any errors be detected, kindly update the information.

In addition, during the preparation of the publication, National Treasury will also be sending out several ad-hoc requests for information. National Treasury kindly requests your cooperation by ensuring that you provide the relevant information within the required timeframes. In the previous publication, the cooperation received from municipalities was generally positive and we hope that this can be sustained in the lead up to the 2013 publication.

Lastly, the database used in the compilation of the previous Local Government Budget and Expenditure Publications contained information at a very high level limiting the extent of the analysis that needs to be undertaken. In the 2013 publication, National Treasury will be aligning the database to the Municipal Budget and Reporting Regulation formats to improve the analysis with the relevant budgeting framework; improving the level of analysis.

All updating of information will need to be completed by the end of March 2013. The equivalent of the budget verification process will have to be completed by the end of March 2013 by focusing on the audited annual financial statements for 2006/07, 2007/08, 2008/09, 2009/10, 2010/11 and 2011/12. All previous year's figures should also be corrected and perfectly aligned to the audited financial statements of the municipality; this must include any restatement of figures. This process will assist municipalities in the compilation of their 2013/14 budgets and MTREF's as the audited actuals figures will provide a historical performance perspective; a valuable management planning and budgeting tool.

As a start it will assist if all outstanding input forms are lodged as matter of urgency with the LG database in support of the AFS (OSAA, CAAA, BSA and CFAA). This should ideally be done by the 14 December 2012. Once we have received all the inputs forms from all municipalities, the national and provincial treasuries will reconcile the information and provide municipalities with feedback by 10 January 2013. Municipalities will then have until 31 January 2013 to correct and resubmit the revised information to the LG database. MM's and CFO's will be requested to sign off on the revised numbers by 28 February 2013. The National treasury will then correct the dataset taking into account the demarcation process to reclassify the historical numbers and finally lock the financial database on 20 March 2013.

It is recommended that an official be permanently dedicated and assigned to this process to avoid a repetition of the challenges experienced with the previous budget verification process.

Local government equitable share formula review and 2011 Census

Local government's equitable share of nationally raised revenue is distributed between the country's 278 municipalities by means of a formula. This formula has been reviewed by the National Treasury, the Department of Cooperative Governance and the South African Local Government Association, with assistance from the Financial and Fiscal Commission and Statistics South Africa. The proposed structure of a new formula has been endorsed by the Budget Forum – the Budget Forum is the formal structure through which local government finance issues are consulted on as part of the national budget process. The Budget Forum is chaired by the Minister of Finance and includes SALGA and the MECs for Finance of the nine provinces.

The formula review process has included two rounds of consultations with municipalities, as well as the circulation of three discussion papers which can be accessed at:

http://mfma.treasury.gov.za/Media_Releases/LGESDiscussions/Pages/default.aspx

The formula will provide a subsidy for the provision of free basic water, electricity, sanitation and refuse removal services for every poor household. The formula will also provide funds for the institutional costs of municipalities and, for the first time, will explicitly allocate funds for non-trading services, such as municipal roads and fire services. To ensure that the funds for institutional costs and non-trading services are targeted at poorer municipalities, the proposed formula will apply a revenue-adjustment factor reflecting municipalities' ability to generate their own revenue.

The formula will use data from the 2011 Census and will be updated annually to reflect estimates of population growth and projected increases in the cost of services such as water and electricity. The formula will also include explicit funding for the maintenance of basic services funded through the equitable share.

Details of the new formula are being finalised to take into account inputs received from municipalities. The final formula will be presented as part of the Division of Revenue Bill tabled with the national budget on 27 February 2013.

Impact of the new formula on municipal budgets

The new formula will use data from the 2011 Census that will reflect substantial changes since the 2001 Census which was the source of most of the data used in the current equitable share formula. The change to the formula as well as the updating of the data will both result in changes to the allocations to individual municipalities.

In order to provide predictability and stability in equitable share allocations, national government provides a guarantee that municipalities will receive at least 90 per cent of the allocation for 2013/14 published in the 2012 Division of Revenue Bill. In addition to this guaranteed minimum, the new equitable share allocations will also be phased in over a period of three to five years to provide municipalities time to absorb adjustments to allocations.

The detailed structure of the formula, as well as the phase-in process for the new allocations will be agreed to at a meeting of the Budget Forum in January 2013. Providing predictability and stability is one of the principles agreed to in the development of the new formula. The phase-in process for the new allocations will therefore be designed to minimize any instability and disruptions caused by the changes to the equitable share formula.

Municipalities are therefore advised to take a conservative approach in the compilation of their 'tabled' 2013/14 MTREF's pending finalisation of the allocations as part of the 2013 Division of Revenue Bill tabled with the national budget on 27 February 2013; this will provide municipalities a final opportunity to adjust their 2013/14 budgets and MTREF's to accurately reflect the gazette allocations prior to tabling for consideration and approval by the municipal council.

Local government conditional grants and additional allocations to local government

Local government conditional grants are being reformed to provide targeted support to different types of municipalities. The human settlements and public transport functions are being devolved to urban municipalities, and greater technical support will be provided to rural municipalities. In 2013/14, a new direct grant for water infrastructure administered by the Department of Water Affairs will enable the department to help municipalities deliver clean drinking water to households.

Over the medium term, funds will be made available to expand the integrated national electrification programme. Reprioritised funds will also be used to improve the sustainability of municipal services by subsidising critical refurbishment projects, and combating wastage of water and electricity.

National government has already made substantial investments in the construction of local government infrastructure, committing over R100 billion for this purpose through direct and indirect conditional grants from 2007/08 to 2011/12, allowing municipalities to expand infrastructure and deliver free basic services to the poor. These transfers have made a significant difference to the lives of South Africans who did not previously have access to municipal services. However, there are still areas where households do not have access to basic services.

The 2011 Census data will be used to identify areas where progress has been made and where it has not. During 2013, the effectiveness of conditional grants in facilitating the rollout of infrastructure will be reviewed by the National Treasury, other national departments, the South African Local Government Association and municipalities. This review could result in changes to the structure of conditional grants from 2014/15.

Census data will also be used to update the backlog figures in the formulas used to allocate funds for infrastructure grants. This will ensure that funds are targeted at areas that need them most. All changes will be phased in to avoid disruption to existing infrastructure plans.

The *Medium Term Budget Policy Statement 2012* indicates that over the 2013 MTEF, transfers to local government grow by R12.3 billion, including direct and indirect transfers.

This means the baseline allocations to local government for 2013/14 are set to remain largely unchanged from the amounts published in the 2012 Division of Revenue Act totalling R34.3 billion for conditional grants. The final allocations to municipalities will be announced in the 2013 Division of Revenue Bill, which will be tabled by the Minister of Finance on 27 February 2013. This information will be communicated to municipalities in a further Budget Circular for the 2013/14 financial year to be issued shortly after the tabling of the National Budget.

Municipalities MUST ensure that their tabled budgets reflect the conditional grant allocations set out in the 2013 Division of Revenue Bill.

Municipalities are advised to use the indicative numbers for 2013/14 in the 2012 Division of Revenue Act to compile their capital budgets. This document is available on National Treasury's website and can be assessed at:

http://www.treasury.gov.za/legislation/acts/2012/Default.aspx

Council oversight over the budget process

A municipal council is elected to direct and exercise oversight of how a municipality raises revenue, plans the use of funds through its budget and spends the funds in accordance with the council approved budget. In terms of section 4(2)(a) of the Municipal Systems Act the council has a duty **"to use the resources of the municipality in the best interests of the local community"**. This duty is extended to individual councillors through the *Code of Conduct for Councillors*, which states:

2. **General conduct of councillors**. – A councillor must –
   (a) perform the functions of office in good faith, honestly and in a transparent manner; and
   (b) at all times act in the best interests of the municipality and in such a way that the credibility and integrity of the municipality are not compromised.

Over the last few years, an escalating trend in unauthorised, irregular and fruitless and wasteful expenditures has been observed by the Auditor-General in its annual reports on local government audit outcomes. Many municipalities have not dealt effectively with instances of unauthorised, irregular and fruitless and wasteful expenditure. Such matters must be dealt with decisively by council so to address any perceived fraud and corruption.

When municipal funds are used for inappropriate purposes it is not in the best interests of the municipality or the local community. Those funds should have been used to deliver services to communities. The consequence is that many households continue to live without access to water, electricity, decent sanitation and refuse removal services.

Therefore, each council has a duty to put in place policies and processes to:

(a) **Prevent** unauthorised, irregular and fruitless and wasteful expenditure;
(b) **Identify and investigate** unauthorised, irregular and fruitless and wasteful expenditure; and
(c) **Respond** appropriately, and in accordance with the law, to confirmed instances of unauthorised, irregular and fruitless and wasteful expenditure.

As part of the 2013/14 budget process municipalities are strongly advised to ensure that the necessary policies and processes are institutionalised in proactively curbing prohibited expenditure; poor policies, procedures and planning significantly contribute to this recurring phenomenon and require a demanding response by all councillors and municipal officials.

Regulation of a 'Standard Chart of Accounts' (SCOA) for Local Government

Section 216(1) of the Constitution states that:

National legislation must establish a national treasury and prescribe measures to ensure both transparency and expenditure control in each sphere of government, by introducing -

(a) Generally recognised accounting practice *(GRAP – Office of the Accountant General)*
(b) Uniform expenditure classifications *(Standard Chart of Accounts / General Ledger); and*

(c) Uniform treasury norms and standards *(MFMA, Regulations, Circulars and Guidelines).*

Furthermore Section 168 (1) of the MFMA states that:

The Minister (of Finance), acting with the concurrence of the Cabinet member responsible for local government, may make regulations for, among other things –

(a) any matter that may be prescribed; and
(p) any other matter that may facilitate the enforcement and administration of the Act

Considering the legislative mandate of National Treasury especially as it relates to a uniform expenditure classification, similarly to that of national and provincial government, National Treasury is in the process of finalising a 'standard chart of accounts' (SCOA) for local government. The SCOA is a detailed financial classification system incorporating government financial statistics (GFS), economic reporting framework (ERF), generally recognised accounting practice standards (GRAP standards) and the Municipal Budget and Reporting Regulations. Alignment of the Municipal Budget and Reporting Regulations and the format of the annual financial statements will require that consideration to be given to the current accounting standards (GRAP); this will require amendments to the current GRAP standards.

The project was commissioned by the Technical Committee on Finance (TCF) and has been in process since January 2010 of which progress to date has included three phases. Phase three of SCOA for local government involved, among others, extensive consultation with a wide audience including all municipalities between August and October 2012. The engagements were structured to provide a detailed understanding of the classification framework (SCOA) including the project summary document. All stakeholders were requested to provide comments and input based on Version III of SCOA for consideration and incorporation into the SCOA Version IV. The regulation of a SCOA for local government is currently in Phase IV, which includes:

- Finalisation of SCOA 2013 (Version IV) including consideration of comments and input;
- Drafting of the Regulation;
- 90 day legal consultation window – Envisage for March 2013;
- Wider consultation with all municipal stakeholders – District level engagements; and
- Concluding the Parliamentary processes.

It is anticipated that the regulatory processes will be finalised to the latter part of 2013 and municipalities will be given a two year preparation window prior to full implementation which is envisaged for 1 July 2016. In this regard, municipalities will be required to compile their 2016/17 budgets and MTREF's SCOA compliant during the 2015/16 financial year. In the lead up to full rollout of the SCOA for local government, municipalities need to be cognisant of concurrent processes and activities underway, including:

- Development of a SQL Database within the National Treasury by which typical municipal transactions will be tested (current and historical) as well as report extraction;
- Identification of potential municipalities for the piloting of SCOA; this will include a technical evaluation of municipal and financial application (system) capability to successfully pilot SCOA;
- Piloting at selected municipalities; and
- Wider consultation with municipalities in the lead up to full implementation.

Although not necessary for municipalities to compile their 2013/14 budgets and MTREF's in the SCOA format for local government, it will facilitate implementation if municipalities start familiarising themselves with the detail content of the SCOA for local government from a budgeting and planning perspective. This process will not only provide municipalities with a conceptual understanding of the SCOA but also provide municipalities with an understanding of alignment to their own chart (general ledger) and where anomalies might exist.

National Treasury will regularly communicate with all municipalities on progress during the process of finalising the SCOA for local government.

Financial applications (systems) and the impact of SCOA

As part of the SCOA project, National Treasury commissioned a parallel project to investigate financial applications (systems) in use by municipalities and compatibility of current financial applications (systems) in amongst others, accommodating the proposed segments of the SCOA for local government.

The implementation of SCOA is highly dependent on typical business processes to be accommodated in modules to standardise transactions in the application of the classification framework. Uniform business processes and typical transaction is a pre request for SCOA to achieve comparable results throughout local government.

To this end National Treasury issued MFMA Circular No.57 – Municipal Financial Systems and Processes which can be accessed at:

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

The objective of the circular was to inform municipalities of the investigation into local government financial systems and processes and to outline the procedure that municipalities need to comply with when considering a replacement of their core financial systems.

Municipalities are reminded that MFMA Circular No. 57 is still applicable and that the replacement of the core financial system prior to the regulation of the SCOA for local government could result in potential fruitless and wasteful expenditure for municipalities.

In the lead up to the regulation of a SCOA for local government and subsequent implementation by municipalities, National Treasury will continue with its research into local government financial applications (systems) and engage with relevant stakeholders in ensuring a conducive and enabling environment is created which will accommodate and facilitate the implementation of the SCOA for local government.

Municipalities are strongly advised not to proceed with any configuration or upgrades to their current core financial systems in anticipation of SCOA; any configuration or upgrades at this stage must be considered premature as the SCOA for local government has not been finalised. As the research and other concurrent projects are undertaken National Treasury will regularly update municipalities on progress and other requirements impacting on municipalities from a financial application (systems) perspective.

Management accounting and tariff setting

In addition to the special project on financial applications (systems) and processes (as discussed above) National Treasury commissioned a further project dealing specifically with management accounting (costing) and the subsequent impact on tariff setting.

Municipalities are increasingly under recovering the cost associated with trading services i.e. electricity, water, waste management and waste water management and this position is further exacerbated by the fact that no consideration is given to overhead costing and the influence on the total cost of providing the service. This in turn impacts on tariff setting and in many instances municipalities are cross subsidising a trading service from property rates revenue; a totally defective approach to pricing and tariff setting of municipal trading services.

The Technical Committee on Finance (TCF) endorsed a pilot project to be undertaken at a local municipality in reviewing and researching an appropriate cost management methodology for local government. The project involved unpacking the adopted municipal budget for the 2012/13 financial year, evaluating cost distribution tools and methodologies and testing appropriateness of applications. The first phase of the project is nearing completion and a guideline will be distributed early in 2013 providing municipalities with a generic management accounting methodology.

In addition to the guideline, the research work has informed the design principles for a segment within the SCOA for local government. This will provide municipalities with not only pure accounting functionality as part of SCOA but also the key dimension of management accounting. In finalisation of SCOA for local government and ensuring the alignment between the Municipal Budget and Reporting Regulations, in-year reporting and annual financial systems National Treasury envisages additions to the Municipal Budget and Reporting Regulations going forward.

Further guidance around tariff setting for main trading services is supplied in the section of this Circular dealing with revising of rates, tariff and other charges.

Municipal Budget and Benchmark Engagements and timeframes for tabling MTREF'S

National Treasury has institutionalised two formal annual engagements with the 17 non-delegated municipalities, namely the Mid-year Budget and Performance Assessment Review and the Municipal Budget and Benchmark Engagement.

The Municipal Budget and Benchmark Engagements are intended to provide a platform by which the tabled budgets are independently analysed and assessed by National Treasury and the respective provincial treasuries. These formal engagements conclude with findings and recommendations being supplied to the respective municipalities in a formal report which must be considered by the budget steering committee prior to the finalisation of the budget to be tabled in council for consideration and approval to the end of May.

Although the 17 non-delegated municipalities have welcomed these engagements and are of the opinion that it strengthens the overall municipal budgeting process, concern has been raised over the scheduling of the engagements; engagements historically scheduled starting middle of April and subsequently municipalities find it difficult to incorporate key findings and recommendations into their final budgets prior to consideration and approval by the municipal council.

Municipalities are advised to consider earlier tabling of the 2013/14 budgets and MTREF's; ***last week of February, first week of March 2013***. The request for early tabling will have the following advantages by:

- Provide for a lead-time for municipalities to incorporate the findings and recommendations of the engagements by the National Treasury and respective provincial treasuries on the 2013/14 budgets and MTREF's into their final budgets and MTREF's prior to tabling for considered and approval by the municipal council;

- Provide for a wider engagement window for the National Energy Regulator of South Africa (NERSA) to consider the proposed electricity tariff structures within their regulatory processes prior to adoption by the municipality; early tabling will empower municipalities to incorporate any comments and recommendations received by NERSA prior to finalisation of the 2013/14 budgets and MTREF's for consideration and approval (further guidance around tariff setting and the NERSA process is supplied in the section of this Circular dealing with revising of rates, tariff and other charges); and
- Provide for a wider window for public participation as required by the MFMA; an area where municipalities are generally weak and needs specific attention and improvement.

Headline inflation forecasts

Municipalities must take the following inflation forecasts into consideration when preparing their 2013/14 budgets and MTREF. Again this information will be updated in a further Budget Circular to be issued after the tabling of the National Budget on 27 February 2013.

Fiscal year	2011 Actual	2012 Estimate	2013	2014 Forecast	2015
CPI Inflation	5.0%	5.7%	5.5%	5.1%	4.9%

Source: Medium Term Budget Policy Statement 2012

Revising rates, tariffs and other charges

When municipalities and municipal entities revise their rates, tariffs and other charges for their 2013/14 budgets and MTREF's, 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 (such as the *inclining block tariff* (IBT) proposals from the National Energy Regulator of South Africa (NERSA)).

Municipalities should continue to explore appropriate 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 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 per cent upper boundary of the South African Reserve Bank's inflation target.

NERSA's process to approve electricity tariffs

It is important that municipalities and NERSA work together to ensure that the process of approving electricity tariffs does not disrupt the process of compiling municipal budgets or compromise community consultations on the budget. It is for this reason that section 43 of the MFMA reads:

43 (1) If a national or provincial organ of state in terms of a power contained in any national or provincial legislations determines the upper limits of a municipal tax or tariff, such determination takes effect for municipalities on a date specified in the determination.

(2) Unless the Minister on good grounds approves otherwise, the date specified in a determination referred to in subsection (1) may-

(a) if the determination was promulgated on or before 15 March in a year, not be a date before 1 July in that year; or

(b) if the determination was promulgated after 15 March in a year, not be a date before 1 July in the next year.

Owing to the delay in Eskom's tariff increase application, NERSA has indicated that they will only be in a position to finalise Eskom's application by 28 February 2013. NERSA has indicated that this would affect the decision on the determination of the municipal tariffs and limit the ability of NERSA to meet the 15 March 2013 deadline. NERSA has subsequently applied to the Minister for extension of the deadline as contained in Section 43 of the MFMA.

Considering the pending extension application by NERSA, municipalities are advised as follows as it relates to NERSA's regulatory process over municipal electricity tariff determination:

i. Municipalities are to formulate their electricity tariff structures for the 2013/14 budgets and MTREF's based on the indicative 14.4 per cent increase as detailed below and NERSA guidelines. This must inform the tabled 2013/14 budgets and MTREF prior to community consultation;
ii. submit a tariff application to NERSA containing all the required information by 28 February 2013; and
iii. NERSA to finalise the municipal electricity determination process by the 26 April 2013, including formal feedback to municipalities for incorporation into the final 2013/14 budgets and MTREF.

Municipalities are reminded to submit all outstanding D-forms to NERSA. The deadline for submission was 30 October 2012. NERSA will not be in a position to evaluate municipal tariff applications in the absence of complete D-forms.

NERSA will have to consider the fact that the municipal electricity tariff structure was based on the indicative 14.4 per cent increase and adjust their comments to individual municipalities based on the actual tariff determination to be made available on 28 February 2013; municipalities will in turn, have to incorporate NERSA's comments in the finalisation of their 2013/14 budgets and MTREF's prior to the MFMA deadline of 31 May 2013 for tabling, consideration and approval by the municipal council.

Where a municipality can demonstrate that it has complied with (i), (ii) and (iii) above, and that NERSA did not issue a final determination by 26 April 2013, the municipality will be entitled to use the tariffs for 2013/14 set out in its original application to NERSA.

To facilitate NERSA's regulatory processes as it relates to reviewing the proposed municipal electricity tariff structures, municipalities are advised to consider earlier tabling of the 2013/14 budgets and MTREF's; ***last week of February, first week of March***. Adherence to earlier tabling directly implies that municipalities will be in a position to submit their municipal electricity tariff structures to NERSA by the latest 28 February 2013; earlier tabling would mean that municipalities would be in the finalisation stages of their budget compilation process, and subsequently the proposed municipal electricity tariffs should be finalised.

It needs to be noted that the outlined process is an exception and will not be repeated in subsequent financial years; NERSA will be approving a five-year multi-year price determination (MYPD) from the 2013/14 financial year.

Eskom bulk tariff increases

Eskom submitted a 16 per cent bulk electricity price increase application to NERSA for the 2013/14 financial year. Should this bulk electricity price increase be approved the indicative increase for municipalities is 14.4 per cent for the 2013/14 financial year.

Municipalities are advised to structure their 2013/14 electricity tariffs based on the 14.4 per cent guideline and provide for a 16 per cent increase in the cost of bulk purchases for the tabled 2013/14 budgets and MTREF. Once the final bulk electricity price is available the information will be communicated to municipalities in a further Budget Circular for the 2013/14 financial year to be issued shortly after the tabling of the National Budget, including a multi-year Eskom bulk electricity price increase.

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.

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

$$MG = (B \times BPI) + (S \times SI) + (R \times RI) + (C \times CCI) + (OC \times OCI)$$

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

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.

Inclining block tariffs (IBT) for electricity

Municipalities are urged to design an IBT structure that is appropriate to its specific circumstances, and ensures an appropriate balance between 'low income customers' and other domestic, commercial and business customers, and the financial interests of the municipality.

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), including the principle that electricity tariffs must be cost reflective and that any cross-subsidies should be explicit.

A municipality must structure its IBT tariff according to its own specific circumstances and ensure that it provides the necessary motivation and information to NERSA in its tariff application. In this regard, municipalities need to pay careful attention to determining an appropriate level of cross-subsidisation between the different IBT blocks given the profile of its customer base, and also have regard to the price elasticity of the demand for electricity.

Water and sanitation tariffs must be cost-reflective

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

- Water and sanitation tariffs are on aggregate fully cost-reflective – including the bulk cost of water, the cost of maintenance and renewal of purification/treatment plants and network infrastructure, and the cost of new infrastructure;
- Water and sanitation tariffs are structured to protect basic levels of service; and
- Water and sanitation tariffs are designed to encourage efficient and sustainable consumption (e.g. through inclining block tariffs).

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. However, all municipalities should aim to have appropriately structured, cost-reflective water and sanitation 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 non-revenue water 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. National Treasury is working with DWA to publish this information in the near future.

Solid waste tariffs

Municipalities are once again reminded that in many instances waste tariffs do not cover the cost of providing the different components of the service. Where this is the case, municipalities should aim to have appropriately structured, cost-reflective solid waste tariffs in place by 2015.

The tariffs for solid waste management must take into account that it is good practice to maintain a cash-backed reserve to cover the future costs of rehabilitating landfill sites.

Municipalities are encouraged to explore alternative methodologies to manage solid waste, including recycling and incineration in plants that use the heat energy to generate electricity.

Funding choices and management issues

Municipalities are once again reminded that given on-going economic pressures, the revenue side of municipal budgets will continue to be constrained, so they will again need to make some very tough decisions on the expenditure side this year. Priority still needs to be given:

- Ensuring that drinking water and waste water management meets the required quality standards at all times;
- Protecting the poor;

- 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;
- Expediting spending on capital projects that are funded by conditional grants; and
- Ensuring that borrowed funds are invested in revenue generating assets as part of the capital programme.

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.

Employee related costs

Municipalities must take into account the multi-year Salary and Wage Collective Agreement for the period 1 July 2012 to 30 June 2015. The agreement provides for a wage increase based on the average CPI for the period 1 February 2012 until 31 January 2013, plus 1.25 per cent for the 2013/14 financial year.

Considering that municipalities will be preparing and finalising their respective 2013/14 MTREF for tabling as per the MFMA prior to the announcement of the final CPI for the relevant period, municipalities will have to provide for assumed budget growth as it relates to employee related costs.

In this regard municipalities are advised that average CPI for the period November 2011 to October 2012 is 5.74 per cent which compares well to the estimate of 5.7 per cent for 2012 as provided for in the 2012 Medium Term Budget Policy Statement. Municipalities are therefore advised to provide for increases related to salaries and wages for the 2013/14 budget and MTREF as follows:

2013/14 Financial Year – 6.95 per cent (5.7 per cent plus 1.25 per cent)
2014/15 Financial Year – 6.5 per cent (5.5 per cent plus 1 per cent)

Once the final average CPI for the period 1 February 2012 until 31 January 2013 is available municipalities will be a position to adjust their 2013/14 budget and MTREF prior to tabling for consideration and approval to the end of May 2013; it is not envisaged that the actual CPI will be a significant deviation from the guidelines and should therefore not have a detrimental impact on the tabled budget prior to community consultation.

In addition to considering the actual salary and wage increases municipalities are reminded to accurately budget for actual positions and vacancies as per the organisational structure of the municipality and notch increments where applicable. Municipalities are also reminded that supporting tables SA22 (Summary councillor and staff benefits), SA23 (Salaries, allowances and benefits of political office bearers/councillors/senior managers) and SA24 (summary of personnel numbers) as part of the Municipal Budget and Reporting Regulations need to be accurately completed. Municipalities are urged to provide a narrative to the budget document explaining the numbers and budget appropriations.

Excessive expenditure on overtime has been increasingly observed in National Treasury's analysis of municipal budgets. In certain instances overtime can account for as much as 8 per cent of the employee related costs. Although overtime is considered acceptable, as it relates to essential services; an excessively high allocation could be an indication of performance inefficiencies. Overtime is an expensive form of remuneration and can easily be abused. Should excessive overtime be found to be legitimate it could be an indication that the organisational structure is insufficiently funded and hence would require funds being rather appropriated against vacancies. Based on the most recent Budget and Benchmark Engagements with the non-delegated municipalities, overtime as a percentage of total remuneration averaged 4.5 per cent. As a guideline, municipalities are advised that a percentage above 5 per cent would require further investigation; it needs to be noted that this percentage is based on total municipal remuneration and individual functions will differ owing to the nature of the service rendered.

Debt impairment, depreciation, and other non-cash expenditure items

Municipalities have recently raised concern over the classification of non-cash flow expenditure being classified as unauthorised owing to overspending; such expenditure relates to debt impairment, depreciation and asset impairment, and transfers and grants as appropriated in Table A4 (Budgeted Statement of Financial Performance: revenue and expenditure) of the MBRR.

Although these expenditures are considered non-cash items as there is no transaction with the 'outside world', an under provision during the budget compilation process is a material misstatement of the surplus/(deficit) position of the municipality. This could be associated with poor budgeting and financial management or events that gave rise to the asset and debt impairment were unknown at the time of budget finalisation and adoption. Nevertheless, the Auditor-General must express an opinion in relation to non-cash items as it relates to unauthorised expenditure resulting from overspending. In this regard Table A4 (Budgeted Statement of Financial Performance: revenue and expenditure) must be read in conjunction with supporting Table SA1 of the MBRR. Although National Treasury understands that budgeting for certain non-cash flow expenditure such as investment property impairment is extremely difficult owing to the nature of the transaction; other non-cash flow expenditure such as debt impairment and depreciation are more predictable and should be informed by actual municipal performance and intended capitalisation of property, plant and equipment during the budget year.

Municipalities are advised to carefully project and appropriate expenditure against non-cash items during the budget compilation process in proactively dealing with possible instances of unauthorised expenditure. Section 160(2) of the Constitution provides that a council may not delegate the approval of budgets or the imposition of rates, taxes, levies and duties. In other words, *only the council may make decisions related to the raising of municipal revenues and approving (or authorising) the spending of those revenues through the budget or an adjustments budget*.

The council can only make valid expenditure decisions through a budget or an adjustments budget. It follows that ***only*** the council may authorise instances of unauthorised expenditure, and *council **must** do so through an adjustments budget*. This is the rationale for the provisions in regulation 23(6) of the Municipal Budget and Reporting Regulations (MBRR) governing when council may authorise unauthorised expenditure in an adjustments budget.

Renewal and repairs and maintenance of existing assets

It is observed that budget appropriations for renewal and operational repairs and maintenance of existing asset infrastructure is still not receiving adequate priority regardless of guidance supplied in MFMA Circular No. 55 – Municipal Budget Circular of the 2011/12 MTREF.

Municipalities are therefore once again reminded of the guidelines as supplied in MFMA Circular No. 55. For the 2013/14 budgets and MTREF's municipalities must take into consideration:

- Where the municipality allocates less than 40 per cent of its 2013/14 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 Property Plant and Equipment (PPE) as reflected in the municipality's 2011/12 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.

Municipalities are also reminded of the disclosure requirements of the Municipal Budget and Reporting Regulations as it relates to supporting table SA1; this table requires the disclosure of operational repairs and maintenance against employee related costs, other materials, contracted services and other expenditure. Municipalities are further reminded of the importance of supporting tables SA34 a, b, c and d which provide an analysis of capital asset renewal and operational repairs and maintenance; a strategically important expenditure for local government.

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.

Furthermore, municipalities are reminded that reporting on asset renewal and repairs and maintenance has been institutionalised as part of the in-year Section 71 reporting process and publication of municipal performance. It would be in the best interest of municipalities and the community to ensure they firstly prioritise expenditure against this strategic expenditure imperative and accurately and transparently appropriate expenditure in the budget compilation process.

Eliminating non-priority spending

The *2012 Medium-term Budget Policy Statement* (MTBPS) highlighted the need for resource allocation to be prioritised in expanding public-sector investment. The MTBPS further emphasises the need for government to step up its efforts to combat waste, inefficiency and corruption. Municipalities must therefore pay special attention to controlling unnecessary spending on nice-to-have items and non-essential activities.

To illustrate the point, it has come to the attention of National Treasury that municipalities are incurring excessive expenditure on membership and other related costs associated with ***The South African Municipal Sports and Recreation Association (SAMSRA)***. SAMSRA is an organisation catering for the physical, emotional and psychological well-being of local government practitioners, including councillors. Spending excessive amounts on travelling, accommodation and entertainment related to SAMSRA is totally unacceptable and could be classified as fruitless and wasteful expenditure. Municipalities have indicated that in certain instances they are forced to budget as much as R600 000.00 per annum for the municipal games hosted by SAMSRA. Furthermore, it has also come to our attention that municipalities apply for sponsorship in the name of the municipality and not SAMSRA - a practice that has significant implications from a supply chain management perspective and is tantamount to irregular expenditure. Municipalities are advised to halt this bad practice immediately and are reminded of the need for resource allocation to be prioritised in expanding public-sector investment, considering the challenging economic landscape.

The following additional examples of non-priority expenditure have been observed, and municipalities are reminded that they need to be eliminated:

i. excessive sponsorship of music festivals, beauty pageants and sporting events, including the purchase of tickets to events for councillors and/or officials;
ii. public relations projects and activities that are not centred on actual service delivery or are not a municipal function (e.g. celebrations; gala dinners; commemorations, advertising and voter education);
iii. LED projects that serve the narrow interests of only a small number of beneficiaries or fall within the mandates of other government departments such as the Department of Agriculture;
iv. excessive catering for meetings and other events, including the use of public funds to buy alcoholic beverages;
v. arranging workshops and events at expensive private venues, especially ones outside the municipality (as opposed to using the municipality's own venues);
vi. excessive printing costs (instead of maximising the use of the municipality's website, including providing facilities for the public to access the website);
vii. excessive luxurious office accommodation and office furnishings;
viii. foreign travel by mayors, councillors and officials, particularly 'study tours';
ix. excessive councillor and staff perks such as luxurious mayoral cars and houses, notebooks, IPADS and cell-phone allowances; travel and subsistence allowances. Municipalities are reminded that in terms of section 7 (1) of the Remuneration of Public Office-bearers Act, 1998 (Act No.20 of 1998) the Minister for Cooperative Governance and Traditional Affairs must determine the limit of salaries and allowances of the different members of municipal councils and any budget provision may not be outside this framework;
x. excessive staff in the office of the mayor – particularly the appointment of political 'advisors' and 'spokespersons';
xi. all donations to individuals that are not made in terms of the municipality's indigent policy or a bursary scheme; for instance donations to cover funeral costs (other than pauper burials which is a district municipality function);
xii. costs associated with long-standing staff suspensions and the legal costs associated with not following due process when suspending or dismissing staff, as well as payment of severance packages or 'golden handshakes'; and
xiii. the use of consultants to perform routine management tasks, and the payment of excessive fees to consultants.

Budget management issues dealt with in previous MFMA Circulars

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

1. *Mayor's discretionary funds and similar discretionary budget allocations* – National Treasury regards allocations that are not designated for a specific purpose 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. *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 are reminded to include a section on 'Drinking water quality and waste water management' in their 2013/14 budget document supporting information (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 benchmarks set out in MFMA Circular 55.
7. *Budgeting for an operating deficit* – Over the medium term, a municipality should budget for a moderate surplus on its Budgeted Statement of Financial Performance so as to be able to contribute to the funding of the Capital Budget. If the municipality's operating budget shows a deficit it is indicative that there are financial imbalances that need to be addressed (refer to MFMA Circular 55).
8. *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).

Conditional transfers to municipalities

As indicated above, National Treasury will issue a further Budget Circular for the 2013/14 financial year shortly after the tabling of the National Budget on 27 February 2013. This Circular will deal with any new conditional grant issues and processes related to the management of conditional grants.

Municipalities need to take note that National Treasury intends placing increased emphasis on the discrepancies between in-year reporting and the annual financial statements as part of the next conditional grant roll-over application process; in this regard municipalities are requested to improve on the quality of the quarterly sign-off process of Section 71 reports. National Treasury has also observed that municipalities continuously restate historical numbers as part of the compilation of the annual financial statements; especially as it relates to conditional grants. Although an accepted accounting practice, the misuse of this practice is problematic and municipalities are advised to act transparently when compiling annual financial statements. Should municipalities unjustifiably continue with the restatement of historic figures, National Treasury will have to institute additional measures in consultation with the Office of the Accountant General to limit continued reoccurrence.

At this stage in the budget process, municipalities are advised to use the indicative numbers for 2013/14 in the 2012 Division of Revenue Act to compile their budgets. This document is available on National Treasury's website at:

http://www.treasury.gov.za/legislation/acts/2012/Default.aspx

Conditional grant issues dealt with in previous MFMA Circulars

Municipalities are reminded to refer to MFMA Circulars 48, 51, 54 and 55 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 2013 Division of Revenue Bill will contain a provision that allows municipalities to pledge their conditional grants. The end date for the pledges is extended to 2015/16. 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 National Treasury approved and verified primary banking details would be used for effecting transfers.

The Municipal Budget and Reporting Regulations

National Treasury has released Version 2.5 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 2013/14 Budget and MTREF.

Download Version 2.5 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

All municipalities must prepare budgets in accordance with the regulations

Municipalities are reminded that the regulations apply to all municipalities and municipal entities as from 1 July 2009.

All municipalities and municipal entities must prepare annual budgets, adjustments budgets and in-year reports for the 2013/14 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, actions the National Treasury will take includes:

- 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:

Municipalities in…	Responsible NT officials	Tel. No.	Email
Eastern Cape	Nozipho Molikoe Ansie Myburgh	012-315 5662 012-315 5173	Nozipho.Molikoe@treasury.gov.za Ansie.Myburgh@treasury.gov.za
Free State	Vincent Malepa Kgomotso Baloyi	012-315 5539 012-315 5866	Vincent.Malepa@treasury.gov.za Kgomotso.Baloyi@treasury.gov.za
Gauteng	Nozipho Molikoe	012-395 5662	Nozipho.Molikoe@treasury.gov.za
KwaZulu-Natal	Johan Botha	012-315 5171	Johan.Botha@treasury.gov.za
Limpopo	Bernard Mokgabodi Sifiso Mabaso	012-315 5936 012-315 5952	Bernard.Mokgabodi@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	Marli J van Rensburg Mandla Gilimani	012-315 5303 012-315 5807	Marli.Jansenvanrensburg@treasury.gov.za Mandla.Gilimani@treasury.gov.za
North West	Willem Voigt Sadesh Ramjathan	012-315 5830 012-315 5101	Willem.Voigt@treasury.gov.za Sadesh.Ramjathan@treasury.gov.za
Western Cape	Vuyo Mbunge Kevin Bell	012-315 5661 012-315 5725	Vuyo.Mbunge@treasury.gov.za Kevin.Bell@treasury.gov.za
Technical issues with Excel formats	Ilze Baron	012-395 6742	Ilze.Baron@treasury.gov.za

End to the phasing in of formats and tables

This will be the fourth year that all municipalities are required to prepare their annual budgets in accordance with the Municipal Budget and Reporting Regulations. National Treasury therefore expects all municipalities to provide a complete set of information in their annual budget tables, as well as the supporting tables (Schedule A1). All municipalities are once again reminded that the tabled budget including all supporting documents and completed A1 Schedule of the Municipal Budget and Reporting Regulations must be submitted to the National Treasury and respective provincial treasuries prior to the budget and benchmarking exercise.

National Treasury, working with the provincial treasuries, will carry out a compliance check and where municipalities have not provided complete information, 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.

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.

Municipalities are reminded, that 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 A Schedule 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.

Completion of service delivery information on Table A10

Similar to the previous budget compilation process, municipalities are reminded that Table A10 is becoming an increasingly important source of information on actual service delivery and service delivery backlogs; during the assessment of the 2012/13 budgets and MTREF's it was observed that the information provided in this Table A10 lacks credibility and compromises transparency and accountability of the entire budget process.

National Treasury plans to prepare a special report on this service delivery information for Parliament in the second half of 2013. It is therefore important for each municipality to ensure its information is up-to-date and accurate. In addition, during the assessment of the 2013/14 budgets and MTREF's specific attention will be given to Table A10 by National Treasury and all respective provincial treasuries. Municipalities are advised to give particular attention with the completion of Table A10 in ensuring the information accurately depicts the actual position of the municipality. In completing Table A10 care must be given the unit of measure i.e. kilolitres, kilowatt-hour etc.

MBRR issues dealt with in previous MFMA Circulars

Municipalities are reminded to refer to MFMA Circulars 48, 51, 54 and 55 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 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 discussed in MFMA Circular 51.
2. *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).
3. *2013/14 MTREF Funding Compliance Assessment* – All municipalities are 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 2012/13 budgets (refer to MFMA Circular 55).

Budget process and submissions for the 2013/14 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 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 2013/14 MTREF

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 Tuesday, **10 April 2013**.
- 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 29 June 2013, the final date for such a submission is Thursday, **12 July 2013**, 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
- Signed Budget Locking Certificate as found on the website.

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; any problems experienced in this regard can 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. Please review the municipality's performance last year, and ensure that the gaps are addressed.

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. *The old formats may not be used to submit 2013/14 budget information*. All municipalities must have already migrated to using the aligned version of the electronic returns. All returns are to be sent to lgdatabase@treasury.gov.za.

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.

Dealing with reporting inconsistencies

In achieving reporting consistency across all municipalities' the following needs to be give specific attention:

- *Reporting on property rates and revenue foregone*
  When reporting Property Rates on the electronic returns submitted to lgdatabase@treasury.gov.za, municipalities are required to do so in the GFS function **Budget and Treasury Office** to promote consistent reporting by all municipalities. Revenue forgone must be divided into the 4 GFS functions (Water, Electricity, Waste

Management and Waste Water Management as well as Property rates (in the BTO function) and accounted for on supporting Table A1 of the MBRR.

- *Tariffs*
  Municipalities are required to complete supporting Tables SA13a and SA13b and Table SA14. Table SA13a has been locked as part of the release of the updated Version 2.5 A1 Schedule. It is the intention of National Treasury to assess and analyse this information across all municipalities going forward. In addition, this information will be incorporated into the next Local Government Budget and Expenditure Review.

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
11 December 2012

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

As noted above, National Treasury has released Version 2.5 of Schedule A1 (the Excel Formats). It incorporates the following changes:

No.	Sheet	Amendment	Reason
1	SA8	Insertion of quantum of water and electricity losses.	Simplification of data gathering for mid-year assessment purposes.
2	SA22, SA23, SA24	Insertion of new footnote.	To clearly state that the personnel figures captured in the budget are only valid at the adoption date of the budget.
3	SA24	Insertion of new footnote.	To clarify that headcount figures must include budgeted vacancies and current staff in order to improve alignment of figures with the municipal organogram.
4	SA13	SA 13 has been split into two separate sheets – SA13a – Service Tariffs by Category SA13b – Service Tariffs by Category (explanatory).	To facilitate the collection of consistent information on municipal tariff structures.