



Our reference: Circulars to Municipalities
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To: Mayor, Municipal Manager and Chief Financial Officer
KwaZulu Natal Municipalities

PROVINCIAL TREASURY CIRCULAR TC/RM 2 OF 2015/16

FINDINGS ON THE 2015/16 MUNICIPAL BUDGET ASSESSMENT/EVALUATION

Provincial Treasury assessed the 2015/16 Tabled Budgets of all 58 delegated municipalities as required by Section 22 of the Municipal Finance Management Act (MFMA), read in conjunction with Section 23(1) of the MFMA which states that *the municipal council must consider any views of the National Treasury, the relevant Provincial Treasury and any provincial or national organs of state or municipalities which made submissions on the budget.*

1. PURPOSE

The purpose of this circular is to apprise all KwaZulu-Natal Mayors of the findings of the Tabled Budget assessment/evaluation process for the delegated municipalities in KwaZulu-Natal.

2. BACKGROUND AND DISCUSSION

Tabling of the 2015/16 Time schedules outlining key deadlines for the budget process

Section 21(1)(b) of the Municipal Finance Management Act, Act No. 56 of 2003 (MFMA) requires the Mayor to table in council at least 10 months before the start of the budget year, a time schedule, outlining key deadlines for the budget process. One of the objectives of this section is to ensure that the budget preparation process commences timeously and complies with all the legislative requirements.

In this regard, 49 of the 58 delegated municipalities timeously tabled their *Time schedule outlining key deadlines* by the 31 August 2014 as per the requirements of the MFMA. However, 2 of the 49 municipalities namely; Impendle and Umvoti did not provide Provincial Treasury with a Council resolution as documentary proof that the *Time schedule outlining key deadlines* was tabled to Council. The municipalities were sent non-compliance letters from the office of the MEC to the office of the Mayors on 01 October 2014.

Table 1 lists the 9 municipalities which did not table their *Time schedule outlining key deadlines* by 31 August 2014.

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Table 1: Municipalities which did not table their 2015/16 Time schedule outlining key deadlines by the 31 August 2014

No	Name of municipality	No	Name of municipality	No	Name of municipality
1	uMshwathi	4	eMadlangeni	7	Hlabisa
2	Mpofana	5	Amajuba DM	8	uMfolozi
3	Nquthu	6	uPhongolo	9	Maphumulo

Source: KZN Provincial Treasury

Budget preparation

Section 5(4)(a)(ii) of the MFMA states: *to the extent necessary to comply with subsection (3), a Provincial Treasury must monitor the preparation by municipalities in the province of their budgets.* Furthermore, Section 5(4)(b) of MFMA states: *a Provincial Treasury may assist municipalities in the province in the preparation of their budgets.*

The budget preparation process requires all municipalities which provide Electricity to submit their applications for a tariff increase in line with Section 43 of MFMA to the National Energy Regulator of South Africa (NERSA). To ensure an improved quality of submitted applications for tariff increases, NERSA jointly with Provincial Treasury, conducted a provincial workshop where municipalities (including non-delegated municipalities) who are licensed for electricity were informed of the correct process of completing and submitting the relevant application forms. The workshop was held on 02-03 October 2014 in Pietermaritzburg and 61 municipal officials from 25 municipalities licensed to provide electricity attended the workshop.

Technical support

Technical support on the 2015/16 budget preparation process was provided at the request of the following 37 municipalities indicated in Table 2(a) below:

Table 2(a): On site technical support to municipalities on the 2015/16 budget preparation process

No	Name of municipality	No	Name of municipality	No	Name of municipality
1	Vulamehlo	15	Umvoti	25	KwaDukuza
2	uMuziwabantu	16	Umzinyathi DM	26	Ndwedwe
3	Ezinqolweni	17	Dannhauser	27	Maphumulo
4	Ugu DM	18	eDumbe	28	Ilembe DM
5	uMshwathi	19	Umhlabuyalingana	29	Ingwe
6	Richmond	17	Dannhauser	30	Kwa Sani
7	uMgungundlovu DM	18	eDumbe	31	Ubuhlebezwe
8	Emnambithi/Ladysmith	19	Umhlabuyalingana	32	Umzimkhulu
9	Umtshezi	20	Jozini	33	Harry Gwala DM
10	Hibiscus Coast	21	The Big Five False Bay	34	Umlalazi
11	Okhahlamba	22	Mtubatuba	35	Nkandla
12	Imbabazane	23	Umkhanyakude DM	36	Mpofana
13	Uthukela DM	24	Mandeni	37	Hlabisa
14	Endumeni				

Source: KZN Provincial Treasury

Subsequent, to the on site technical support. follow up support was provided to the 6 municipalities indicated in Table 2(b) below:

Table 2(b): Follow up support to municipalities on the 2015/16 budget preparation process

No	Name of municipality	No	Name of municipality	No	Name of municipality
1	Umtshezi	3	The Big Five False Bay	5	Ingwe
2	Umvoti	4	Mtshatsha	6	Harry Gwala DM

Source: KZN Provincial Treasury

Furthermore, Provincial Treasury also conducted Budget workshops for the municipalities in the Uthukela District, the Harry Gwala District and the Umvoti Municipality. The Budget workshops covered the Municipal Budget Assessment Framework, completion of the A Schedule Tables as well as MFMA Circulars No. 74 and 75.

To further guide municipalities in the preparation of their 2015/16 budgets and to monitor compliance with the Municipal Budget and Reporting Regulations (MBRR), Provincial Treasury issued Provincial Treasury Circular (TC/RM 7 of 2014/15 dated 25 March 2015) to municipalities. The circular covered the following main reporting areas:

- Format Requirements for the 2015/16 Municipal Budget;
- Matters for consideration in the 2015/16 Municipal Budget process;
- Municipal Demarcation Transition Grant;
- Re – determination of Municipal Boundries;
- Cost containment measures;
- Provincial Transfers to Municipalities;
- Establishment and functionality of Budget Steering Committees (BSCs);
- Service Delivery and Budget Implementation Plans (SDBIPs);
- Preparation of the Municipal Budget Working Paper File;
- Budget Documents Required;
- Submission Process of the Budget Documents and Quality Certification; and
- DCoG back to basics.

Tabling of the 2015/16 Budgets

Section 16(2) of the MFMA states that, *the Mayor of the municipality must table the annual budget at a Council meeting at least 90 days before the start of the budget year.*

With the exception of Jozini Municipality and Umkhanyakude District Municipality, all delegated municipalities tabled their 2015/16 budgets in Council by 31 March 2015.

Letters of non-compliance with Section 16(2) of the MFMA were sent by the MEC for Finance to the Mayors of the municipalities indicated above on 01 April 2015. Jozini Municipality responded by applying for an extension which was granted by the MEC for Finance. Subsequently, Jozini Municipality tabled their 2015/16 budget on 29 April 2015 and Umkhanyakude District Municipality tabled their 2015/16 budget on 10 April 2015.

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Status of the 2015/16 Tabled Budgets Assessments/Evaluations

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 format. Section 23(1) of the MFMA requires that the municipal Council must consider *any views of the National Treasury, the relevant Provincial Treasury and any provincial or national organs of state or municipalities which made submissions on the budget.*

Regarding submission of the tabled budgets indicated above, MFMA Circular No. 75 stipulated a deadline of 01 April 2015 for the submission of the electronic budget documents. The Provincial Treasury received 55 electronic budget documents on 01 April 2015, excluding the two municipalities mentioned above which did not table their budgets on time. A letter of non-compliance for not meeting the deadline was sent to Kwa Sani Municipality on 01 April 2015 by the Head of Department.

Upon receipt of the Tabled 2015/16 Municipal Budgets, Provincial Treasury conducted budget assessments and provided comments to the municipalities as per the requirement of Section 23(1) of the MFMA. The assessment process also included compliance checks on all Tabled Budgets received to establish the level of compliance with the requirements of the MFMA and MBRR in general in order to verify amongst others, whether Tabled budgets submitted were in the correct version (version 2.7) of the prescribed format, whether the information provided in the main budget Tables (A1 to A10) and supporting Tables (SA1-SA37) verify/reconcile to the electronic budget returns submitted to lgdatabase@treasury.gov.za and if it was sufficient to enable the assessments of the Tabled Budgets.

Of the 58 KZN delegated municipalities, Provincial Treasury was unable to conduct an assessment of the 2015/16 Tabled Budget for Hibiscus Coast Municipality, due to the municipality submitting their 2015/16 Tabled Budget in the incorrect format. A non-compliance letter from the Head of Department to the Municipal Manager was issued on 01 April 2015 regarding the contravention of Regulations 9 and 14 of the MBRR.

Key findings on the 2015/16 Tabled Budget Assessment Process

With the exception of the Hibiscus Coast Municipality, the findings on the 2015/16 Tabled Budgets were communicated through feedback letters to all delegated municipalities. Furthermore, the key findings on the Tabled Budgets were also discussed during bilateral meetings held between Provincial Treasury and the municipalities. The municipalities were requested to consider the comments and recommendations provided by Provincial Treasury with the Approved Budgets to be adopted by Council. The following underlying points were key findings in respect of the assessments of the 2015/16 Tabled Budgets:

- **Compliance with Municipal Budget and Reporting Regulations and other legislation**

The most notable improvement when compared to the previous year was the prompt submission of the electronic budget documents by the majority of municipalities, thereby meeting the deadline of 01 April 2015.

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Compliance checks reflected that many municipalities did not provide all budget information and did not submit all the required budget supporting documents such as the Budget Assumptions and the Draft Service Delivery and Budget Implementation Plan (SDBIP), thereby, limiting the extent of the budget assessments.

One of the requirements of the MFMA and MBRR is the submission of the consolidated budgets by all municipalities with established municipal entities. Based on the information submitted by municipalities to Provincial Treasury, with the exception of Zululand, Umzinyathi and Amajuba District Municipalities, the other seven (7) District Municipalities have indicated that they have an entity in the form of an Economic Development Agency. Despite the establishment of entities by the seven (7) district municipalities, only four (4) namely: Ugu, iLembe, Umkhanyakude, and Harry Gwala District Municipalities submitted consolidated budgets. However, due to the fact that Table SA3 was partially completed for the aggregated budget on entities, as well as insufficient information about the entity, Provincial Treasury's analysis for the consolidated budgets submitted was limited. It should be emphasised that the non-submission of budget information relating to the entity by the rest of the District Municipalities compromised some of the important governance principles, namely transparency and accountability.

- **Credibility of budget figures**

The budget tables in the A Schedules for some municipalities were either not fully and/or accurately populated. Discrepancies were noted in the following areas:

- Audited Annual Financial Statement figures did not reconcile to the Audited Outcome figures;
- The full year forecasts figures for 2014/15 were merely replicated as the Adjusted Budget figures and were not in line with the actual performance trends and projections;
- The B schedule figures were not reconciling to the Adjusted Budget figures; and
- In some instances, there were discrepancies between the electronic budgets submitted and the hard copy budgets submitted of the 2015/16 A Schedules.

Challenges were also experienced in some cases where municipalities did not provide the basis for their budget assumptions and/or no budget assumptions were supplied at all.

- **Sustainability of the municipality**

Most municipalities' operating budgets continue to be funded mainly from grants. The Provincial Treasury has noted with concern that some municipalities had tabled a **deficit budget** in the Medium Term Revenue Expenditure Framework cycle. This is despite ongoing advice given to the municipalities through MFMA Circulars that municipalities should budget only for expenditure in with revenue that will be realistically collected as per Section 18 of the MFMA.

- **Funding of budget**

Some municipalities still failed to properly complete Tables A7 and A8 which are critical not only to reflect the cash flow status of the municipality but also assists in determining the funding position of municipal budgets. In Table A7, the most common error was the capturing of incorrect figures in the Adjusted Budget and Audited Outcomes columns. Consequently, incorrect opening balances were being carried over the MTREF. The budgeted revenue projections in some cases were also based on collection rate assumptions which were not realistic.

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Table A8 was commonly characterised by incomplete information, whereby, estimates on *Unspent conditional grants, Statutory requirements and Other provisions* were not reflected and unrealistic working capital requirements which resulted in an incorrect status of *Cash backed reserves/accumulated surplus reconciliation*.

Some municipalities have reflected *negative cash/cash equivalents at the year end and shortfall* positions over the entire MTREF period, thus raising a liquidity concern to pay their debts when they fall due.

Table 3 lists the results of the recalculated Cash Flow Budgets for the 9 selected municipalities.

Table 3: Results of the recalculated Cash Flow Budgets

No	Budget Funded	No	Budget NOT funded	No	Incomplete information submitted
1	Newcastle	1	Hary Gwala DM	1	Jozini
		2	Umzinyathi DM	2	Umkhanyakude DM
				3	Mandeni
				4	Zululand DM
				5	Hibiscus Coast
				6	Mthonjaneni

Source: KZN Provincial Treasury

The results for the selected nine (9) Cash Flow Budgets in Table 3 that was recalculated indicate that the Tabled Budget for Newcastle Municipality was found to be **funded**. Due to incomplete information provided by six (6) municipalities, Provincial Treasury could not determine whether their Tabled Budgets were **funded or not**. The results also show that the Tabled Budgets for two municipalities were found to be **NOT funded**. With the exception of Newcastle Municipality Provincial Treasury, expressed in the budget comments letters to all municipalities indicated above, that their budgets were not supported based on their recalculated Budgeted Cash flow positions. These municipalities were required to revise their budgets and ensure that the budgets were appropriately funded in their Approved Budgets.

During the high level assessment of the 2015/16 Approved Budgets of the 58 KZN delegated municipalities, where budgets were found to be unfunded, municipalities were afforded an opportunity to rectify such through an adjustments budget, failing which, I will report the errant municipalities to National Treasury to consider the stopping of their Equitable Share transfers of Section 38 of the MFMA.

- **Operating revenue**

The majority of municipalities did not justify in their budget documentation all increases in excess of the 6 percent upper boundary of the South African Reserve Bank's inflation target as recommended in MFMA Circular No. 75.

Most municipalities did not disclose the rateable properties and market values of rateable properties in Tables SA11 and SA12b which limits the analysis of the reasonableness of the *Property rates* revenue budgets in 2015/16.

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Due to non submission of Property Rates policies in some cases, Provincial Treasury could not establish if the municipal rates policies incorporated the amendments resulting from the Municipal Property Rates Amendment Act No. 29 of 2014.

The budgets of some municipalities lacked correlation between the budgeted revenue, the increased rate randages and/or tariffs and the number of households reflected in Table A10.

The majority of municipalities did not submit their tariff schedules, thereby, limiting Provincial Treasury's detailed analysis of whether the inclining block tariffs for electricity services were being correctly applied. It was noted that the *Electricity* service for majority of the applicable municipalities is trading at a budgeted surplus.

Most district municipalities are still providing *Water and Sanitation* services at a budgeted deficit, indicating that their tariffs for *Water and Sanitation* are not fully cost reflective. This is not in line with guideline in terms of MFMA Circular No. 74 as the deadline was 2015 for municipalities to have cost reflective *Water and Sanitation* tariffs in place.

Furthermore, most District Municipalities that are providing *Water and Sanitation* services at a deficit did not articulate the reasons and remedial actions to rectify this position in their budget documents as guided by MFMA Circular No. 74.

To mitigate the need for water tariff increases, municipalities should put measures in place to limit water losses to an acceptable level. Municipalities have indicated during bilateral engagements that they are attending to challenges of water losses in all their areas.

The provision of *Solid Waste* services, for some municipalities are still not cost reflective despite the requirement of MFMA Circular No. 70, which states that, the municipalities should aim to have appropriately structured, cost-reflective solid waste tariffs in place by 2015.

- **Operating expenditure**

Most municipalities did not provide reasons and/or workings for the above inflation increases in the various expenditure items.

Tables SA22, SA23 and SA24 in some cases were not populated and therefore the Provincial Treasury could not assess the reasonableness of the budgeted salary increases.

Most municipalities did not provide the Provincial Treasury with the loan amortisation schedules and as a result, the Provincial Treasury could not determine the reasonableness of their budgeted *Finance charges*.

The 2015/16 Tabled Budget documents did not reflect any detailed expenditure plans to implement the Municipal Regulations on Standard Chart Of Accounts (mSCOA) project which is a notable concern since only one more budgeting year remains before municipalities have to implement all the requirements of mSCOA.

Provincial Treasury was unable to assess whether sufficient provision for *Depreciation* has been made in relation to total asset value by some municipalities as Table A9 was not accurate due to *Property, plant and equipment (PPE)* values being not populated for 2015/16.

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Despite the guidelines from MFMA Circulars No. 58 and 66 and subsequent MFMA Circulars to reduce non-priority spending, it was noted that some municipalities have budgeted for items considered to be non-priority.

Other expenditure in particular raised concerns as the increases in some cases were excessive and undefined projects and non-priority items were noted under *General expenses*.

For most municipalities, *General expenses*, as detailed in Supporting table SA1 contributes more than 10 percent towards *Total Other expenditure* for 2015/16. In terms of the MFMA Budget Format Guide, *General expenses* should not exceed 10 percent of *Total Other expenditure* budget. Municipalities have been advised to review their allocation of expenditure to *General expenses* and reallocate the expenditure to appropriate expenditure items accordingly.

While approval was granted by Political Change Management Committees (PCMCs) and Technical Change Management Committees (TCMCs) in certain instances, for utilisation of municipalities' reserves, it was noted with concern that the reserves budgeted were significant and have a possibility to leave the new municipalities cash strapped and not viable. Municipalities might not even be able to fund costs relating to demarcation process.

- **Asset Management**

Some municipalities still did not fully complete all Tables relating to their capital budget, including Table SA36 – Consolidated detailed capital budget. Most municipalities did not sufficiently budget for *Renewal of existing assets* as per Table A9 in line with the National Treasury Guideline. Once again they were encouraged to revise their budgets, as municipalities should budget at least 40 percent of their *Capital expenditure* budget on *Renewal of asset* as per the National Treasury guideline.

Furthermore, the budgets for *Repairs and maintenance* were sometimes unrealistic or questionable. *PPE* net book value for 2015/16 were sometimes omitted and *Asset register summary – PPE* values were also not linked to Asset Registers.

In cases where Blue Drop reports were negative, budgets were reviewed to confirm the existence for adequacy of budget to address related concerns.

Notwithstanding the importance of supplementing the capital programme from own funding, the narration reports of some municipalities could not adequately demonstrate that they have cash backed accumulated funds from previous years which remain uncommitted for other purposes. With the poorly populated Tables A7 and A8, the ability to finance capital programmes from own funding in some cases could not be established.

- **Service delivery**

As part of budget related supporting documents, some municipalities did not submit their draft Service Delivery Budget and Implementation Plan (draft SDBIP) and Draft Integrated Development Plan (draft IDP) together with the Tabled Budget, therefore it could not be assessed whether the information contained in the draft SDBIP and draft IDP align to the information contained in the Tabled Budget.

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The strategic objectives as outlined in Tables SA4, SA5 and SA6 were at times not aligned with local government key priorities, however it should be noted that discrepancies were sometimes observed between Tables A4 and A5, and Tables SA4, SA5 and SA6.

Some municipalities did not comply with MFMA Circular No. 58 as they did not report on the delivery status of all services offered within their municipal area, irrespective of whether the service is provided by a municipal entity, another municipality or an external mechanism.

Table A10 is an important source of information on actual service delivery and the backlogs thereof, despite this, some municipalities still poorly populate this table and/or do not provide reliable information regarding the status of service delivery in their municipal area.

Summary of 2015/16 Tabled Budget Process

A summary of the status on the 2015/16 tabled municipal budget assessment process is shown in Table 4:

Table 4: Summary of the Status on the 2015/16 Tabled Budget Assessment Process

Budget	No of Budgets	Name of municipality
2015/16 Tabled Budgets		
Budget tabled late (after 31 March)	2	Jozini, Umkhanyakude DM
Budgets not tabled in required format	1	Hibiscus Coast
Budgets received	58	
Budgets evaluated	57	
Budgets not evaluated	1	Hibiscus Coast

Source: KZN Provincial Treasury

3. RECOMMENDATIONS

- Municipalities must commence with their budget process timeously, by tabling their *Time schedule outlining key deadlines* for the following financial year's Budget and IDP processes by 31 August, as per the requirements of the MFMA;
- Municipalities must strive to align their budget and IDP processes as set-out in the *Time schedule outlining key deadlines*;
- Municipalities must commence the process of population of the A Schedules early in the required format to ensure timeous resolution of any problems that might be experienced by municipalities with the preparation of their budgets;
- Municipalities should prepare and provide Provincial Treasury with their Municipal Budget Working Paper files as this will enable the Provincial Treasury to determine the reasonableness of the budgeted figures;
- All municipalities should provide progress reports in terms of reporting responsibilities by municipal entities;
- Municipalities should strive to improve on the narration of information relating to explanations, assumptions and projections in their budgets. This can be achieved by using the Dummy Budget Guide issued by National Treasury;
- Municipalities are encouraged to invite Provincial Treasury to attend their Finance and/or Budget Steering Committee meetings during the budget preparation process;

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- Municipalities must ensure the early completion and submission of their draft SDBIP together with their Tabled Budgets;
- Municipalities must improve on budgeting for the *Renewal of assets* and *Repairs and maintenance* in line with the National Guidelines;
- Municipalities are advised to reduce the excessive non-priority spending, in line with the recommendations of MFMA Circulars.
- Municipalities must timeously and fully populate all budget schedules including Table SA36 – *Consolidated detailed capital budget* as required by MFMA Circular No. 72 to provide for the GPS coordinates of individual projects to reflect the GPS.

Yours sincerely



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