NATIONAL TREASURY

MFMA Circular No. 70

Municipal Finance Management Act No. 56 of 2003

Municipal Budget Circular for the 2014/15 MTREF

This circular provides further guidance to municipalities and municipal entities for the preparation of their 2014/15 Budgets and Medium Term Revenue and Expenditure Framework (MTREF). It must be read together with all previous MFMA Budget Circulars.

CONTENTS

Key focus areas for the 2014/15 budget process

The Medium Term Budget Policy Statement 2013

The MTBPS notes that over the past four and a half years government has steered the country through the worst global recession in 70 years and that the South African economy is projected to grow by 2.1 per cent in 2013 while the GDP growth is expected to reach 3.5 per cent by 2016.

Specific strategies and interventions required by local government in achieving economic stability and higher levels of growth as outlined in the MTBPS include, among others:

Expanding public sector investment in infrastructure through ensuring the budgets and MTREF's acknowledge that capital programmes needs a balanced funding structure addressing not only backlogs in services but also investment in new infrastructure as well as renewing current infrastructure.

Sustainable job creation remains a national priority and municipalities must ensure that in drafting their 2014/15 budgets and MTREFs, they continue to explore opportunities to promote labour intensive approaches to delivering services, and more particularly to participate fully in the Expanded Public Works Programme. However, municipalities should not carelessly employ more people without any reference and consideration to the level of staffing required delivering effective services. Remuneration increases associated with bargaining council decisions, and affordability must be considered over the medium term. Municipalities should focus on maximizing 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 internship programmes to provide young people with on-the-job training.

Municipalities must act as catalysts for economic growth through creating an enabling environment for investment and other activities that foster job creation. It is important for municipalities to pay particular attention to:

- Joint planning by a municipality, its community and business sectors. This means that all economic forces in the local situation have to be brought on board to identify resources, understand needs and work out plans to find the best ways of making the local economy fully functional, investor friendly and competitively productive;
- Ensuring the timely delivery of their capital programmes 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 to include grants, borrowing and own funding (internally generated funding).

Securing inclusive growth through investing in strategic infrastructure programmes such as electricity generation. An excellent example is the partnership between the public and the private sectors on the Renewable Energy Independent Power Producer Programme.

Implementing the National Development Plan through expanding electricity, transport, communications capacity and promoting industrial competitiveness. Municipalities need to support special economic zones, broadening rural development and strengthening public service delivery while combating waste and corruption.

Building an efficient developmental state through increasing the levels of delivery by ensuring improvements to policy formulation, procurement, management systems, developing mechanisms for sharing skilled personnel in critical delivery areas and minimising waste.

Furthermore the NDP recognises capable municipalities as the core of a capable state. National Treasury will continue to closely monitor and engage – and if need be intervene – in those municipalities that fail to live up to the standards of public service established in the Constitution.

In supporting municipalities over the MTEF period, a strong focus on economic development is proposed by:

- Ensuring that value for money and long term impact / sustainability are key considerations;
- Having an economic development / growth support strategy in place but not just as an end in itself, but rather as an opportunity to understand and respond to the underlying economic dynamics, networks and dynamic systems of interactions of a much wider range of stakeholders that shape the economic fabric of each locality;
- Pursue initiatives that:
  - Stimulate growth required to create jobs and to reduce poverty;
  - Providing a competitive local business environment;
  - Encouraging and supporting networking and collaboration between businesses and public/private and community partnerships;
  - Facilitating workforce development and education;
  - Focusing inward investment to support cluster growth; and
  - Supporting quality of life improvements.

Considering that public expenditure growth has remained well within the limits set by government over the past two years, further efforts to find savings eliminate waste and reprioritise spending toward key social and development objectives must be pursued by all government spheres.

The notion of 'doing more with less' can further be supported by municipal approaches that ensure:

- Spatial strategies align public spending and unlock public and private investment;
- Focus on catalytic interventions that also promote inclusion and desegregation; and
- Provide clear signals to private sector.

Consequently, municipal revenues and cash flows are expected to remain under pressure in 2014/15 and *so* ***municipalities must adopt a conservative approach when projecting their expected revenues and cash receipts***.

Municipalities should 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. ***Municipalities must implement cost containing measures as approved by Cabinet to eliminate non-priority spending***.

Local government conditional grants and additional allocations

The division of available funds to Local Government has increased to R91.9 billion or 8.4 per cent for 2014/15. This is expected to increase to R106.7 billion by 2016/17. The *Medium Term Budget Policy Statement 2013* indicates that over the 2013 MTEF, transfers to local government grow by R7.1 billion, of which R3.9 billion is added to the local government equitable share and R2.6 billion to local government conditional grant framework.

Municipalities MUST ensure that their tabled budgets reflect the conditional grant allocations set out in the 2014 Division of Revenue Bill.

Municipalities are advised to use the indicative numbers for 2014/15 in the 2013 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/2013/Default.aspx

The Medium Term Budget Policy Statement 2013 included several proposed changes to local government allocations for the 2014 MTEF period aimed at shifting funds towards areas that can support economic growth. 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.

The ***Integrated City Development Grant*** which was introduced in 2013/14 provides the eight metropolitan municipalities with incentives to improve spatial development considerations in their planning. An amount of R356 million will be added to this grant over the MTEF to encourage the evolution of more compact and efficient cities.

The availability of water is a prerequisite for the construction of human settlements and for economic activity. The ***Regional Bulk Infrastructure Grant*** (an indirect grant to local government) receives an additional R934 million over the MTEF to accelerate bulk water projects that will support broader economic development.

To fund these priorities, moderate reductions have been proposed on a number of grants, including the Municipal Infrastructure Grant, the Urban Settlements Development Grant, the Expanded Public Works Programme Integrated Grant for Municipalities, the Infrastructure Skills Development Grant and the Energy-Efficiency Demand-Side Management Grant.

Government intends to devolve responsibility for the ***housing function*** from provincial to local government by 2014 in six metropolitan areas namely, Johannesburg, Cape Town, eThekwini Ekurhuleni, Tshwane, and Nelson Mandela Bay. A new conditional grant will be introduced in 2014/15 to fund capacity for human settlements in these cities. The grant of R300 million per year over the MTEF is funded through a reprioritisation from the provincial Human Settlements Development Grant. Once the housing function is assigned to a municipality, section 16 of the Division of Revenue Act provides that the Human Settlements Development Grant infrastructure allocations for their area are transferred directly to cities from the national department resulting in increased allocations to local government over the MTEF.

A ***new local government equitable share formula*** has been phased in from 2013/14. It provides funding for a package of free basic services for the 59 per cent of households with monthly incomes below the value of two state old age grants. Although no additional changes to the equitable share envelope are proposed, the local government equitable share will still grow at an average annual rate of 9.2 per cent over the MTEF.

Changes to the 2013 Division of Revenue Amendment Bill

The Minister of Finance also tabled the 2013 Division of Revenue Amendment Bill on 23 October 2013. The details of the changes to municipal allocations and the reasons for these changes are discussed in the explanatory memorandum to the Bill, available on the National Treasury's website at:

http://www.treasury.gov.za/documents/national%20budget/2013/review/Annexure%20W1.pdf

The 2013 Division of Revenue Amendment Bill includes rollovers of funds allocated in 2012/13 but not transferred to municipalities by national departments and funding for recovery from damage caused by widespread flooding in Limpopo, Mpumalanga, KwaZulu-Natal, the Eastern Cape and the Western Cape in late 2012 and early 2013. The R118 million allocated in 2013/14 to repair or replace public infrastructure damaged in the floods is made available through the Municipal Disaster Recovery Grant.

The explanatory memorandum to the 2013 Division of Revenue Amendment Bill also sets out technical corrections to the conditional grant frameworks for the Public Transport Network Operations Grant, Rural Households Infrastructure Grant and the Municipal Water Infrastructure Grant that will be gazetted in December 2013, together with the framework for the new Municipal Disaster Recovery Grant.

Review of infrastructure grants

The 2013 Budget announced that a "thorough review of the local government conditional grant system" would be "coordinated by the National Treasury, using a collaborative process that will include national departments, SALGA and the FFC, and extensive consultation with municipalities." This Review of Local Government Infrastructure Grants is now underway and will continue until recommendations for reform are made in October 2014.

Formal municipal engagements are provisionally scheduled for January/February 2014 (first round) and April/May 2014 (second round). Questionnaires will be distributed electronically. The terms of reference for the review can be viewed on the National Treasury website at:

http://mfma.treasury.gov.za/Media_Releases/ReviewOfLGInfrastructureGrants/Documents/Terms%20of%20Reference%20-%20Review%20of%20LG%20Infrastructure%20Grants.pdf

In addition, any direct inputs can be sent via email to: greg.gardner@treasury.gov.za.

Built environment performance plan (BEPP)

From the 2014/15 financial year the Built Environment Performance Plan (BEPP) will be a requirement of the Integrated City Development Grant (ICDG). Only metropolitan municipalities are required to prepare their 2014/15 BEPP during the 2013/14 financial year and must submit to National Treasury the draft 2014/15 BEPP by the 31 January 2014 and the final Council approved BEPP by the 31 May 2014 as part of the package of plans submitted with the approved Budget.

The objective of the ICDG is to support the development of more inclusive, liveable, productive and sustainable urban built environments in metropolitan municipalities and the BEPP is intended to improve the performance of the built environment over the long term. This will be achieved by adopting a spatial targeting approach at a sub-metropolitan level identifying Integration Zones within which infrastructure grants can be co-ordinated for greater impact and for attracting private sector investment. The information contained in the BEPP will reflect the planning, programmes and outcomes for all major built environment grants allocated to the metropolitan municipality including the ICDG, Urban Settlements Development Grant (USDG), Public Transport Infrastructure Grant (PTIG), Neighbourhood Development Partnership Grant (NDPG) and Integrated National Electrification Programme Grant (INEP).

Strengthening procurement to obtain value for money and fighting against corruption

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

The Office of the Chief Procurement Officer, created in April 2013, will minimise waste and corruption, and ensure that government derives maximum social and economic benefits from every rand spent. Over the next six months, the office will pilot reference pricing. The following steps are being taken as part of developing the pilot programme:

- Fair values of targeted products have been determined;
- Guidelines are being developed; and
- Discussions with key spending departments and agencies are under way to prepare for implementation.

The Office of the Chief Procurement Officer will be working in collaboration with the South African Revenue Service, the Accountant-General and Auditor-General of South Africa to decrease corruption and minimise waste.

Municipalities are again advised that the Supply Chain Compliance Unit will also be focusing on municipal procurement processes. Municipalities are encouraged to introduce greater transparency in their supply chain processes by publishing SCM process outcomes for each bid on their websites. Consequently, municipalities can expect requests for information relating to their tender committees and processes, as well as specific tenders and contracts as specified in detail in MFMA Circular No. 66.

Local government budget and financial management reforms

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

The Minister of Finance published the draft Municipal Regulations on the Standard Chart of Accounts (SCOA) on 3 September 2013 for public comment; the comment period expires on 2 December 2013. As part of the comment process the National Treasury undertook an extensive consultation and awareness campaign; including 44 district engagements incorporating all municipalities.

It is anticipated that the regulatory processes will be finalised in January 2014 and municipalities will be given a two year preparation window prior to full implementation which is 1 July 2016. In this regard, municipalities will be required to be SCOA compliant during the budget and MTREF compilation process leading up to the 2016/17 municipal financial year. Considering the legislated budgeting and planning framework for local government, this implies that municipalities should be in a position to capture their respective detail budgets proposal in the regulated SCOA format by the latest January 2016.

Although it is not compulsory for municipalities to compile their 2014/15 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.

The draft Municipal Regulations on the Standard Chart of Accounts, Project Summary Document and Detailed Classification Framework of the 7 Segments (SCOA Version 4) can be accessed at:

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

A comprehensive change management and capacity building process will be launched with the promulgation of the SCOA Regulation to oversee and assist stakeholders, vendors and municipalities with the transition to the SCOA classification framework. 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 draft SCOA Regulations also propose the specification of minimum business process and system requirements for municipalities and municipal entities as well as the implementation of processes within integrated transaction processing.

In preparation for SCOA implementation, the National Treasury has completed extensive engagements with each of the system vendors as well as the identified pilot municipalities. These engagements have been structured to assess the readiness of the respective system vendors and identified municipalities to pilot the SCOA classification framework. It is envisaged that the outcome of the pilot process will provide clarity as it relates to the specification of minimum business processes and system requirements for municipalities.

Considering the pending Municipal SCOA Regulation the 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

Municipalities are strongly advised not to proceed with any configuration or upgrades to their current core financial systems owing to the pending requirements of the SCOA Regulations. With the promulgation of the Regulation (envisaged for January 2014) a follow-up circular to MFMA Circular No.57 will be issued providing further guidance to municipalities.

Management accounting and tariff setting

National Treasury commissioned a project dealing specifically with management accounting (costing) and its impact on tariff setting.

It has increasingly became apparent that municipalities are not recovering the full 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 its 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 research work has informed the design principles for a costing 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. As a result of the additional reforms undertaken since their introduction, National Treasury envisages consequential amendments to the Municipal Budget and Reporting Regulations going forward.

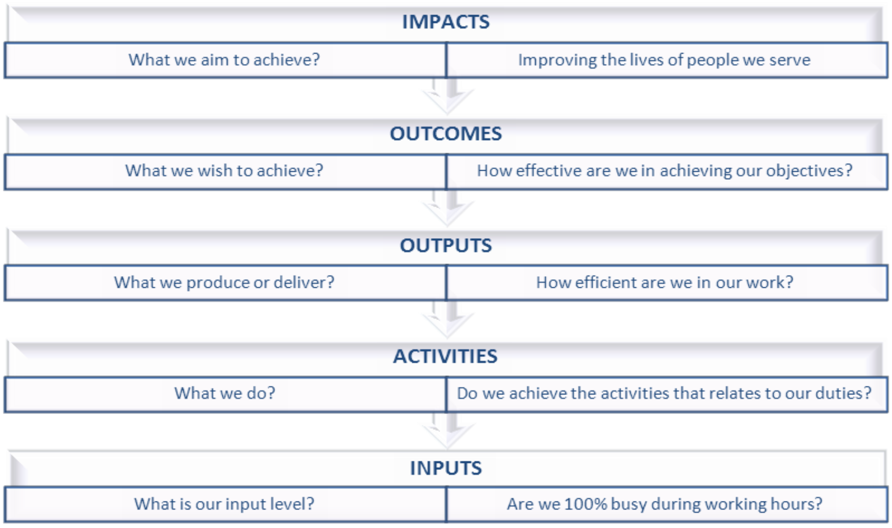
Performance management in local government

Financial performance measurement is undertaken by the National Treasury through the section 71 and 72 in-year reporting framework. Although significant strides have been made with the in-year financial reporting framework for local government, the perfect system of performance measurement, especially as it relates to non-financial performance, is still not in place. The general perception is that local government does not deliver its constitutional obligations to the extent that the public expects. There can be more than one reason for this perception and it is the responsibility of government as a whole to address the core problems and manage them to the benefit of all.

Although various systems of gathering information in government are in place, a number of gaps in information sharing still exist. The following are some examples:

- Weak alignment of strategic and spatial plans, budgeting, implementation and operationalization / maintenance between the IDP/Budget/SDBIP/AFS/Annual Report;
- A coordinated public and private sector investment strategy that ensures that property development is aligned with plans;
- Aligned strategic spatial and sector plans that focus on spatial transformation through the co-ordination and implementation of a catalytic pipeline of projects, i.e. land development, housing, transport and infrastructure investments (and other interventions);
- Service delivery and budget implementation plan is not used as the basis of performance reporting;
- In-year reporting and control is not regularly undertaken, undermining oversight;
- In many cases non-performance has no consequences. This is further exacerbated by a lack of performance monitoring;
- Where performance systems have been established, they rarely ensure accountability of officials and political office bearers; and
- Performance measurement is limited to high level indicators which don't necessary relate back to service delivery imperatives.

The following figure provides a framework for managing programme performance information by National Treasury for national and provincial departments.



The objectives of the framework are to address specific measurable performances; in addition this benchmark can be used against peers in the same industry. It is further recommended that the performance measurement should be classified and divided between the following objectives:

- Strategic issues;
- Governance issues;
- Financial Issues; and
- Non-Financial issues.

The development and implementation of a performance management framework is critical if local government is to achieve its overall objectives. As of the 2012/13 municipal financial year the National Treasury has initiated the incorporation of non-financial performance information as part of the section 71 and 72 in-year reporting framework for metropolitan municipalities. The performance indicators are currently required from the eight metropolitan municipalities and nineteen secondary cities. It will be required from all municipalities from the 2014/15 financial year.

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, 2000 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, escalating 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 to address 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.

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 2014/15 budget process, municipalities are strongly advised to ensure that the necessary policies and processes are institutionalized to proactively curb prohibited expenditure, poor policy implementation and planning. This requires decisive response by all councilors and municipal officials.

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. Most Provincial Treasuries have or are in the process of replicating similar engagements with the delegated municipalities.

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 were historically scheduled in the middle of April and subsequently municipalities found it difficult to incorporate key findings and recommendations into their final budgets in time for consideration and approval by the municipal council.

Municipalities were advised to consider tabling their budgets earlier to enable processing of comments before tabling the final budget for approval. Although some municipalities still wait until the end of March to table their respective budgets before the municipal council, they should consider tabling of the 2014/15 budgets in the ***last week of February or, first week of March 2014***. The request for early tabling will have the following advantages:

- Provide for a lead-time for municipalities to incorporate the findings and recommendations of the engagements with the National Treasury and respective provincial treasuries on the 2014/15 budgets and MTREF's into their final budgets and MTREF's prior to tabling for consideration and approval by the municipal council;
- Provide a longer interval 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 enable municipalities to incorporate any comments and recommendations received by NERSA prior to finalisation of the 2014/15 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 more time for public participation as required by the MFMA; an area where municipalities are generally weak and needs specific attention for improvement.

In order to inform the benchmark exercise performed by the National Treasury and the relevant Provincial Treasuries, municipalities are advised to submit their tabled budget figures on the budget reform returns to lgdatabase@treasury.gov.za in support of the funding tests and other reports available to all users of the Local Government Database and Reporting System.

Headline inflation forecasts

Municipalities must take the following inflation forecasts into consideration when preparing their 2014/15 budgets and MTREF. Again this information will be updated in a further Budget Circular to be issued after the tabling of the National Budget.

Fiscal year	2012 Actual	2013 Estimate	2014	2015 Forecast	2015
CPI Inflation	5.7%	5.9%	5.6%	5.4%	5.4%

Source: Medium Term Budget Policy Statement 2013

Revising rates, tariffs and other charges

Operating Revenue

Section 18 of the Municipal Finance Management Act, 2003 which deals with the funding of expenditure, states as follows:

(1) "An annual budget may only be funded from –

(a) Realistically anticipated revenue to be collected from the approved sources of revenue;
(b) Cash-backed accumulated funds from previous financial years' surpluses not committed for other purposes; and
(c) Borrowed funds, but only for the capital budget referred to in section 17(2).

(2) Revenue projections in the budget must be realistic, taking into account –

(a) projected revenue for the current year based on collection levels to date; and
(b) actual revenue collected in previous years."

Although some improvement was observed with the funding adequacy of the 2013/14 MTREF of the 17 non-delegated municipalities during the Municipal Budget and Benchmark Engagements, municipalities still continue to table unfunded budgets. Various factors contribute to unfunded budgets such as overambitious revenue projections as part of the operating statement of financial performance. In addition, municipalities tend to overstate their collection rates and artificially inflate their cash flow position on the budgeted cash flow statement. This typically leads to cash and liquidity challenges and limited implementation of the budget as planned. At the onset of the budget preparation, if the collection rate is not accurately projected then the consequence is less cash in the bank to support spending priorities.

Municipalities are therefore required to realistically provide for revenue as part of the operating statement of financial performance and capital programme. In this regard municipalities must ensure that:

- The operating and capital expenditure is in line with the requirements of section 18 of the MFMA; and
- The municipality is required to implement initiatives that would contribute to the sustainability of the municipality during the financial year. This requires the implementation of the budget as planned both on the operating statement of financial performance and cash flow budget.

In assisting municipalities in managing the overall revenue value chain and ensuring budget implementation as planned the National Treasury issued MFMA Circular No. 64: Revenue Management. This Circular provides a guideline for the management of the entire revenue value chain which can be accessed at:

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

It is critical that all components of the revenue value chain work efficiently and in collaboration with each other. The functionality of the different components of the value chain is paramount to the success of the collections and hence cash in the bank.

In terms of section 64 of the MFMA on Revenue Management, the municipal manager with the institutional and technical support of the chief financial officer and senior management is required to create and continuously enhance and strengthen the policy imperatives, procedures and processes to achieve the required minimum rate and standard on revenue collection and debt management.

The mayor and the municipal council must implement and manage its oversight function to demonstrate their direct involvement by studying the monthly revenue management reports and utilize the MFMA System of Delegations to hold the municipal manager/accounting officer directly accountable for the work output, results and performance.

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

In our endeavour to significantly improve revenue management at municipalities, the National Treasury has commenced with its Revenue Management Project. It is essential that all municipalities take advantage of the Project that would provide the support necessary to achieve the right outcomes on revenue collection and its management.

NERSA's process to approve electricity tariffs

Municipalities will submit tariff increase applications from November 2013 aligned with the requirements of section 43 of the MFMA and subsequently NERSA will endeavour to finalise and complete all municipal tariff applications by 15 March 2014.

In this regard municipalities are reminded to submit all outstanding D-forms to NERSA as a matter of urgency as the deadline for submission was 30 October 2013. NERSA will not be in a position to evaluate municipal tariff applications in the absence of complete D-forms. It is important that municipalities and NERSA work together to ensure that the process of approving electricity tariffs 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.

Municipalities applying for an increase that is above the guideline will have to justify their increases to NERSA and the decision will be based on the following requirements:

- a full analysis of additional funds requested needs to be presented to NERSA as part of the motivation for the above-guideline increase (the municipality must give a detailed revenue analysis where it indicates the revenue when using the approved guideline percentage increase and add the revenue and list of items, i.e. repairs and maintenance, where the extra funds will be allocated);
- the approved funds must be ring-fenced to ensure that it is strictly utilised for the identified projects;
- municipalities must report to NERSA on a six-monthly basis on how the additional funds are utilised; and
- funds not utilised for the purpose for which they were approved will be claimed back in the following financial year.

Eskom bulk tariff increases

Municipalities are advised to structure their 2014/15 electricity tariffs based on the approved **7.39 per cent** NERSA guideline tariff increase and provide for an **8.06 per cent** increase in the cost of bulk purchases for the tabled 2014/15 budgets and MTREF. Any changes to the above will be communicated to municipalities in the next budget circular for the 2014/15 financial year, to be issued shortly after the tabling of the National Budget.

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

Where:

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

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

The formula for calculating the guideline:

MG = (B x BPI) + (S x SI) + (R x RI) + (C x CCI) + (OC x OCI)
= (70 x 8.06) + (10 x 6.5) + (6 x 5.5) + (4 x 5.5) + (10 x 5.5)
= 6.48 + 0.64 + 0.32 + 0.22 + 0.54
= 7.39%

Municipalities must familiarize themselves with the Municipal Tariff guideline on electricity price increases for 2014/15 which include inclining block tariffs from NERSA which is available at the following link; www.nersa.org.za.

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 once again 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 – inclusive of 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; this guidance has been supplied in various Budget Circulars. ***As per the guidance in previous Budget Circulars, municipalities are expected to have cost reflective tariffs for the 2014/15 MTREF for both water and sanitation***. Should this not be case, municipalities will be required to clearly articulate the reasons within the budget document including remedial actions in rectifying this position.

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.

As explained in the section dealing with the local government budget and financial management reforms, the project commissioned to formulate an approach to management accounting and tariff setting will assist in achieving cost reflective tariffs especially for the main trading services.

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 need to make some very tough decisions on the expenditure side of the budget. 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;
- Ensure that *public investments, services, regulations and incentives* are focussed in defined spatial areas (spatial targeting) to optimise overall connectivity and access to opportunities;
- Provide clear signals to private sector;
- Transport, human settlements, bulk infrastructure, economic infrastructure, land use management (e.g. zoning), tax and subsidy incentives;
- 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;
- Ensuring that borrowed funds are invested in revenue generating assets as part of the capital programme; and
- To implement cost containment measures.

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 2013 until 31 January 2014, plus 1 per cent for 2014/15 financial year (with effect of 1 July 2014).

Considering that municipalities will be preparing and finalising their respective 2014/15 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 the average CPI for the period November 2012 to October 2013 is 5.8 per cent which compares well to the estimate of 5.9 per cent for 2013 as provided for in the 2013 Medium Term Budget Policy Statement. Municipalities are therefore advised to provide for increases related to salaries and wages as follows:

2014/15 Financial Year – 6.8 per cent (5.8 per cent plus 1 per cent)
2015/16 Financial Year – 6.4 per cent (5.4 per cent plus 1 per cent)
2016/17 Financial Year – 6.4 per cent (5.4 per cent plus 1 per cent)

It is recommended that the projected inflation forecast plus one per cent be applied to the 2015/16 and 2016/2017 financial years in the absence of a collective Salary and Wage agreement.

Once the final average CPI for the period 1 February 2013 until 31 January 2014 is available municipalities will be a position to adjust their 2014/15 budget and MTREF prior to tabling for consideration and approval toward the end of May 2014; 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 10 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 decreased to an average 4 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 such as emergency services.

Remuneration of councillors

Municipalities are reminded to refer to MFMA Circular No. 67 with regard to the following issues:

Benefits to councillors and Mayors' – Municipalities are reminded to adhere strictly to the gazetted limits and provisions.

Cellular telephone (mobile) and data contract policy – Municipalities were required to compile and approve a cellular telephone (mobile) and data (3G) policy with effect from 1 July 2013.

Non-revenue water and electricity

As part of the 2014/15 budget and MTREF municipalities will be required to fully account for non-revenue water and electricity including technical and non-technical losses. In this regard, **Annexure B** provides a synopsis and explanation on how the accounting transactions should be applied.

Although the example specifically deals with the accounting transactions for non-revenue water, the same needs to be applied for non-revenue electricity. It must further be noted that the sample does not make any provision for VAT, the payment by debtor/consumers or for any opening or closing stock. It focuses on the purchase, selling transactions and stock control only.

Furthermore, the norm for technical losses for electricity is different to that of the one used for water in Annexure B. It is therefore necessary to use the correct norm and make it part and parcel of the municipalities' budget policies.

Renewal and repairs and maintenance of existing assets

It is observed that budget appropriations for asset renewal as part of the capital programme and operational repairs and maintenance of existing asset infrastructure is still not receiving adequate priority, regardless of guidance supplied in the previous Budget Circular. Asset management is a strategic imperative for any municipality and needs to be prioritised as a spending objective in the budget of municipalities.

For the 2014/15 budgets and MTREF's, municipalities must ensure they prioritise asset management and take into consideration the following:

- Where the municipality allocates less than 40 per cent of its 2014/15 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;
- Table A9 (Asset Management) provides for the breakdown of the capital budget into new assets and asset renewal. Many municipalities don't transparently complete this table and tend to aggregate all capital expenditure against new asset infrastructure. This bad practice needs to be eliminated as it directly impedes the ability of the municipality to proactively manage their infrastructure;
- Where the budgeted amounts for operational repairs and maintenance reflected on Table A9 is 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 2012/13 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. The Ratio measures the level of repairs and maintenance to ensure adequate maintenance to prevent breakdowns and interruptions to services rendered. A minimum level of repairs and maintenance of municipal assets is required to ensure the continued provision of services;
- The average provision made for operational repair and maintenance for the 17 non-delegated municipalities for 2013/14 was 4.2 per cent. Although an improvement from the previous financial year, this is still far from the required norm of 8 per cent as discussed above; and
- In the case of a municipality that received an audit qualification related to its asset register 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 in the budget document.

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 reminded of the importance of supporting tables SA34 a, b, c and d which provides an analysis of capital asset renewal and operational repairs and maintenance. The totals should reconcile with the supporting and main tables.

National Treasury, along with provincial treasuries will assess aspects of asset management as part of the 2014/15 Municipal Budget and Benchmark Engagements. Inadequate asset management appropriations (capital asset renewal and operational repairs and maintenance) will result in the budget been assessed as demonstrating limited credibility.

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 is in the best interest of municipalities to ensure that expenditure against this strategic expenditure imperative is prioritised. If a municipality has failed to appropriately budget for these expenses it will distort reporting outcomes.

Accounting for the rehabilitation of capital assets

It has come to the attention of National Treasury that municipalities account for the rehabilitation of assets as repairs and maintenance as opposed to reporting this as an increase in the value of the capital asset.

Expenditure to rehabilitate, enhance or renew an existing capital asset (including separately depreciable parts) can be recognised as capital if:

- the expenditure enhances the service provision of that capital asset (with the exclusion of operational running maintenance);
- increases the useful life of that capital asset (beyond its original life);
- increases that capital asset capacity (beyond its original capacity);
- increases the performance of the capital asset (beyond the original performance);
- increases the functionality of that capital asset;
- reduces the future ownership costs of that capital asset significantly; or
- increases the size of the asset or changes its shape.

Budgeting for unfunded/underfunded mandates

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

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

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

In terms of Section 21 of the MFMA, the mayor must ensure that the budget tabled in council for consultation is credible. A credible budget must be consistent with the IDP and be achievable in terms of service delivery and performance targets; revenue and expenditure projections must be realistic; and the implementation of the budget must improve the financial viability of the municipality (refer to page 2 of MFMA Circular 28 for a detailed discussion).

Consequently, if the tabled budget is not credible it is a contravention of the MFMA. Municipalities are reminded that the Auditor-General audits compliance with legislation when they conduct their annual audits and that that the non-compliance with the MFMA may be grounds for a qualification.

Municipalities are urged to sign service level agreements and recover costs where unfunded/underfunded mandates are performed on behalf of other spheres of government.

Cost containment measures

Cabinet resolved, on 23 October 2013 that cost containment measures must be implemented to eliminate waste, reprioritise spending and ensure savings on six focus areas namely, consultancy fees, no credit cards, travel and related costs, advertising, catering and events costs as well as costs for accommodation. These measures would be applicable to all national and provincial departments, constitutional institutions and all public entities with effect from 1 December 2013.

While local government is autonomous in its strategy formulation (IDP) and budget appropriations, it remains a sphere of government. In pursuing value for money and curtailing unnecessary costs ***municipalities are strongly urged*** to take cognisance of the cost containment measures as approved by Cabinet and align their budgeting policies to these guidelines to the maximum extent possible.

Eliminating non-priority spending

The *2013 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 cost containing measures and controlling unnecessary spending on nice-to-have items and non-essential activities.

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

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';
xiii. the use of consultants to perform routine management tasks, and the payment of excessive fees to consultants;
xiv. excessive unnecessary spending on personal bodyguards and security to political office bearers; and
xv. Excessive overtime.

General expenditure

The ***Independent Communication Authority of South Africa*** is experiencing challenges with collecting spectrum licence fees from municipalities.

The majority of radio-frequency spectrum licences for South African municipalities have been suspended and/or have been cancelled due to long outstanding radio-frequency spectrum licence fees, this while the majority of municipalities' continue to make use of radio systems e.g. two-way radio systems.

In this regard municipalities are requested to urgently contact ICASA to clarify each municipality's position. Correspondence can be directed to:

chairperson@icasa.org.za or by facsimile to 011 566 3008

Budget management issues dealt with in previous MFMA Circulars

Municipalities are reminded to refer to MFMA Circulars No. 48, 51, 54, 55, 66 and 67 with regards to the following issues:

1. *Mayor's discretionary funds and similar discretionary budget an allocation – National Treasury regards* allocations that are not designated for a specific purpose to be bad practice and discourages them (refer to MFMA Circular No. 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 No. 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 No. 51);
4. *Virement policies of municipalities* – Municipalities are reminded of the principles that must be incorporated into municipal virements policies (refer to MFMA Circular No. 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 No. 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 No. 55 and 66;
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 No. 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 No. 55);
9. *Water and sanitation tariffs must be cost reflective* - refer to Circular No. 66;
10. *Variances between 4th Quarter section 71 results and annual financial statements* – refer to Circular No. 67;
11. *Additional In-Year reporting requirements* – refer to Circular No. 67; and
12. *Appropriation statement (Reconciliation: Budget and in-year performance) - reference is made to Circular No. 67.* It came to the attention of National Treasury that a number of municipalities did not include the appropriation statement as part of the 2012/13 annual financial statement. In terms of the Standards of GRAP 24 on the Presentation of Budget Information in Financial Statements, municipalities are required to present their original and adjusted budgets against actual outcome in the annual financial statements; this is considered an appropriation statement and the comparison between the budget and actual performance should be a mirror image of each other as it relates to the classification and grouping of revenue and expenditure as has been the case in a national and provincial context. This statement is subject to auditing and accordingly supporting documentation would be required to substantiate the compilation of this statement.

Treasury control

Section 216(2) of the Constitution of the Republic of South Africa (Act No. 108 of 1996) stipulates the following:

“The National Treasury must enforce compliance with the measures established in terms of subsection (1), and may stop the transfer of funds to an organ of state if that organ of state commits a serious or persistent material breach of those measures.”

National Treasury has increasingly observed persistent material breaches of the legislative framework governing local government. Municipalities need to take note that the National Treasury has institutionalized the right to invoke Section 216(2) of the Constitution which directly implies the immediate and indefinite stopping of all grant transfers to municipalities, including the equitable share for those municipalities that are in breach of the municipal legal framework. In this regard the following aspects need to be carefully noted and proactively dealt with by affected municipalities.

Forensic audit reports

It has come to the attention of National Treasury that forensic audit reports are not submitted to council for action. Councils are again reminded of their responsibility to discuss the report in council and to implement a fair procedure in dealing with the findings of the report; this would in all probability require action against councilors and/or officials.

If it is found that a municipality commissioned a forensic audit and that the subsequent report did not serve before the municipal council, National Treasury will invoke Section 216(2) of the Constitution against that municipality and stop all grant transfers. In addition, the Auditor General will be informed of the incurred fruitless and wasteful expenditure.

Settlement of outstanding creditors

In terms of Section 65(2)(e) of the MFMA, all invoices must be paid within 30 days of receipt thereof. Section 5(2)(e) further states that the National and Provincial Treasuries must monitor compliance with the Act and take appropriate steps if a municipality commits a breach of the MFMA.

It has come to the attention of National Treasury that many municipalities neglect to settle outstanding creditors within the prescripts of the MFMA. This includes water boards, Eskom and the Auditor General. Any municipality that neglects to settle these creditors within 30 days of invoice will be subject to the invoking of Section 216(2) of the Constitution.

Conditional transfers to municipalities

Section 28(1)(a) of the Division of Revenue Bill originates from the role played by the districts with regard to co-ordinating intergovernmental relations with municipalities in their jurisdiction as per section 38 of the IGR Framework Act, 2005. This necessitates enhanced co-operation between municipalities in order to achieve a common vision in planning, integration, alignment and harmonisation of strategies, in areas such as economic development and development planning, infrastructure investment, and building partnerships with a broad range of stakeholders. With regard to the division of powers and functions between district and local municipalities, section 84(1)(o) of the Municipal Structures Act stipulates that the district municipality is obliged (where applicable) to budget and distribute grants allocated in a particular financial year. Therefore section 28(1)(a) aims to facilitate the above scenario in a more structured manner.

Linked to the above, section 16 of MFMA should be read in conjunction with Section 22(b) of the MFMA stating that immediately after an annual budget is tabled in a municipal Council, it must be submitted to the National and provincial treasuries, other national or provincial organs of state and to other municipalities. In the absence of the specific timelines, the Municipal Budget and Reporting Regulations (MBRR) provide guidance and specify that annual budgets should be submitted to the prior-mentioned stakeholders by the 10th working day post tabling at the municipal Council. However, it should be noted that DoRB – Division of Revenue Bill has equal weight against the MFMA and we will therefore amend the 2014 DoRB to ensure consistency as it relates to the 10th and 14th day disjuncture.

Various concerns have been raised relating to the possibility that district municipalities might end up submitting annual budgets twice to the relevant stakeholders prior to final adoption. This is premised on the event that the DoRB is enacted with major changes on 01 April each year. This is a highly unlikely scenario as the National Treasury has effectively managed this over the years.

National Treasury draws municipalities' attention to section 29 of the 2013 Division of Revenue Act, regarding the responsibilities of provincial treasuries. National Treasury has noticed through the municipalities' Pre-audit Annual Financial Statements of 2012 that municipalities are receiving significant funding from provinces. This funding is however not supported by legislation in terms of the requirements of section 29 of DoRA by ensuring grants received are supported by an appropriation. Without the necessary gazette the municipality would not have a basis for spending the received funds.

Second to the gazetting, the province must publish a payment schedule which will guide the flow of money to municipalities for purposes of proper planning and cash flow management. To this cause, the Treasury encourages provinces and municipalities to adhere to the legal prescripts as stated in the Division of Revenue Act.

Reporting in terms of section 71

Section 71 of MFMA provides for a parallel reporting to be done by the receiving officer to both the national department responsible for transferring the allocations and to the National Treasury. The purpose for the reporting is amongst others to ensure a consistent reporting by the receiving officers on a monthly basis.

We continue to observe municipalities reporting varying numbers between National Treasury and the National departments. Municipalities must establish a standard operating procedure by which there is only one version of the truth; this can only be achieved if municipalities use one reporting tool through the Office of the CFO.

Refer to the Reporting Requirements document for a full explanation of the requirements.

Reporting against grant performance

Municipalities must ensure that grant funding is not spent against goods and services not delivered or against work not done. Treasury discourages procurement of such related transactions as they may be deemed to undermine the SCM processes and directly result in irregular expenditure. Payments for services rendered can only be made upon receipt of invoices. Furthermore, National Treasury has observed that many municipalities report underperformance against grant spending during the financial year only to have this corrected at the end of June; among others, weak internal control processes as it relates to payment certificates significantly contributes to this challenge. Municipalities are therefore requested to ensure that all capital payment certificates are sourced by the respective engineering and service delivery departments and accounted for by the last working day of the month. Any capital payment certificates that are not received and accounted for by the last working day will be included in the next reporting period.

Reporting on VAT on grant in the financial statements

MFMA Budget Circular No. 58 provided guidance on the treatment of VAT on conditional grants. Further municipalities were also advised on how to classify grants in the control accounts. Municipalities were advised to report grant spending VAT inclusive through the DoRA and section 71 reports. With regards to grant disclosures in the Annual Financial

Statements, municipalities are advised to ensure that there is a clear disclosure on the type of grant (per grant name) on the amounts received, spent and unspent during the year. Further, in instances where VAT input was received from SARS, a clear disclosure in the statements be made through the VAT control accounts reconciling with the grant disclosure note or annexures.

Conditional grant issues dealt with in previous MFMA Circulars

Municipalities are reminded to refer to MFMA Circulars No. 48, 51, 54, 55 and 67 with regards to the following issues:

1. *Accounting treatment of conditional grants* – Municipalities are reminded that in accordance with accrual accounting principles, conditional grants should only be treated as 'transfers recognized' revenue when the grant revenue has been 'earned' by incurring expenditure in accordance with the conditions of the grant;
2. *VAT on conditional grants:* SARS has issued a specific guide to assist municipalities meeting their VAT obligations – ***VAT 419 Guide for Municipalities***. To assist municipalities accessing this guide it has been placed on the National Treasury website at: http://mfma.treasury.gov.za/Guidelines/Pages/default.aspx;
3. *Interest received and reclaimed VAT in respect of conditional grants:* Municipalities are reminded that in MFMA Circular 48, National Treasury determined that:
   - Interest received on conditional grant funds must be treated as 'own revenue' and its use by the municipality is not subject to any special conditions; and
   - 'Reclaimed VAT' in respect of conditional grant expenditures must be treated as 'own revenue' and its use by the municipality is not subject to any special conditions;
4. *Appropriation of conditional grants that are rolled over* – As soon as a municipality receives written approval from National Treasury that its unspent conditional grants have been rolled-over it may proceed to spend such funds (refer to MFMA Circular No. 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; and
8. *Conditional grant transfers/payments and the responsibilities of transferring and receiving authorities and the criteria for the rollover of conditional grants –* It is important that the transfers applicable to municipalities' are made transparent, and properly captured in the municipalities'' budget. MFMA Circular No. 67 in this regard refers. The criteria for the rollover of conditional grants are referred to MFMA Circular No. 51 for more information.

The Municipal Budget and Reporting Regulations

National Treasury has released Version 2.6 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 2014/15 Budget and MTREF.

Download Version 2.6 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 2014/15 financial year in accordance with the Municipal Budget and Reporting Regulations. In this regard, municipalities must comply with both:

- The formats set out in the Schedules to the Municipal Budget and Reporting Regulations; 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 include:

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

Assistance with the compilation of budgets

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

	Responsible NT officials	Tel. No.	Email
Eastern Cape	Templeton Phogole Matjatji Mashoeshoe Kgothatso Matlala	012-315 5044 012-315 6567 012-315 5005	Templeton.Phogole@treasury.gov.za Matjatji.Mashoeshoe@treasury.gov.za Kgothatso.Matlala@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 Thabang Manaka	012-395 5662 012-395 6557	Nozipho.Molikoe@treasury.gov.za Thabang.Manaka@treasury.gov.za
KwaZulu-Natal	Bernard Mokgabodi Johan Botha	012-315 5936 012-315 5171	Bernard.Mokgabodi@treasury.gov.za Johan.Botha@treasury.gov.za
Limpopo	Una Rautenbach Sifiso Mabaso	012-315 5700 012-315 5952	Una.Rautenbach@treasury.gov.za Sifiso.Mabaso@treasury.gov.za
Mpumalanga	Jordan Maja Anthony Moseki	012-315 5663 012-315 5174	Jordan.Maja@treasury.gov.za Anthony.Moseki@treasury.gov.za
Northern Cape	Willem Voigt Mandla Gilimani	012-315 5830 012-315 5807	Willem.Voigt@treasury.gov.za Mandla.Gilimani@treasury.gov.za
North West	Sadesh Ramjathan Lindiwe Ngcongwane	012-315 5101 012-315 5357	Sadesh.Ramjathan@treasury.gov.za Lindiwe.Ngcongwane@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 fifth 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 31 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.

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 2013/14 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.

It is therefore important for each municipality to ensure its information is up-to-date and accurate. In addition, during the assessment of the 2014/15 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 to the unit of measure i.e. kilolitres, kilowatt-hour etc.

2014/15 MTREF budget verification process – Asset management return (AM)

The budget verification exercise involves the reconciliation between the hard copy of the budget adopted by Council with the electronic Schedule A budget document (tables) and return forms submitted to the National Treasury which must contain the same information/numbers. The following figure graphically represents this process.

In addition to the verification of the MTREF budget, all previous year's figures should also be correctly aligned with the audited financial statements of the municipality and any restatement of figures.

In addition most municipalities struggled with the completion of the Asset Management (AM) return. The AM return is an extension of the information on Appendix B – Analysis of property, plant and equipment and the relevant notes to the AFS. Municipalities' difficulty in completing this return is likely due to lack of proper asset registers and incorrect reporting in the AFS.

The reconciliation of the AM return starts with an opening value which is the carrying value of assets for the previous financial year. The carrying value is the difference between the cost/revaluation minus accumulated depreciation. Information that should be added is new and replaced capital for the financial year. The information included in these columns must be exactly the same per line item as the information disclosed on the Table A9 (Asset

Management) with the same information duplicated on the Capital acquisition form (CA); these need to reconcile. It will only be the CA form and information on new and replaced assets that will be transferred to the AM form for reconciliation purposes and not the information on the AM return. The reconciliation of all the above is therefore imperative.

The accumulated depreciation should be correctly calculated. The accumulated depreciation will be the accumulated depreciation for the previous financial year plus the depreciation for the current year. The closing total or carrying value is a reconciliation of the opening value (carrying value) plus the purchase of new and renewal of assets minus disposals and accumulated depreciation.

Municipalities must test the above reconciliation before completion of the asset register summary on Table A9 (Asset management). Finally the closing balance in any financial year should be the opening balance for the next financial year.

MBRR issues dealt with in previous MFMA Circulars

Municipalities are reminded to refer to MFMA Circulars No. 48, 51, 54, 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' are discussed in MFMA Circular No. 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 No. 54); and
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 No. 55).

Budget process and submissions for the 2014/15 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 2014/15 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, **15 April 2014**; and

- Section 24(3) of the MFMA, read together with regulation 20(1), requires that the approved annual budget must be submitted ***within ten working days*** after the council has approved the annual budget. So if the council only approves the annual budget on 30 June 2014, the final date for such a submission is Monday, **14 July 2014**, 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.

In addition, the National Treasury and provincial treasuries will be conducting benchmark budget hearings on the municipalities' tabled budgets during April and early May 2014 to assess whether the budgets are realistic, sustainable and relevant, and the extent to which they are funded in accordance with the requirements of the MFMA. In this regard, National Treasury will communicate further with the non-delegated municipalities, while the provincial treasuries will communicate with their respective delegated municipalities.

Budget reform returns to the Local Government Database for publication

For publication purposes, municipalities are still required to use the Budget Reform Returns to upload budget and monthly expenditure to the National Treasury Local Government Database. All 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. 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
4 December 2013

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

As noted above, National Treasury has released Version 2.6 of Schedule A1 (the Excel Formats). It incorporates the following changes:

No.	Sheet	Amendment	Reason
1	SA8	Amended formula in line 18	Accurate reflection of the current or budget collection rate
2	SA8	Allowance for water and electricity losses in percentage terms	Assist data gathering for mid-year assessment purposes
3	SA9	Column heading replaced to reflect Census 2011 results	Census 2011 data was made available to municipalities in March 2013.
4	SA16	Allowance for withdrawals out of and sinking funds into existing investments.	Alignment to the IM return form
5	SA13a	Amended to reflect rate in the Rand to four decimal places	Municipalities were unable to capture figures less than zero accurately
6	SA29	'Sources of Finance' added	Alignment of monthly capital expenditure budget to total capital expenditure as reported on sheet A5

Annexure B – Accounting treatment for non-revenue water and electricity

1. Purchase of water:

Water Inventory (B/S)

Dt			R				Cr R
Date	Description	Ref	Amount	Date	Description	Ref	Amount
	Purchase of Water (100000kl @ R2kl)	1	R 200 000.00		Cost of water billed (80000kl @ R2kl)	4	R 160 000.00
					Water - Technical Losses (2% of Purchases @ R2kl)	5	R 4 000.00
					Cost of Free basic Water (10000kl @ R2kl)	6	R 20 000.00
					Water: Non-Technical Losses (8000kl @ R2kl)	7	R 16 000.00
			R 200 000.00				R 200 000.00
			R -				R -
			R 200 000.00				R 200 000.00
	Balance				Balance		

Water is purchased from a supplier at R2 per kl (Cost Price) and the amount of water purchased was 100 000kl. The account transaction is accounted for directly to inventory for water by debiting the “Water Inventory” and crediting the “Supplier” with the actual cost as per invoice. The debit to the “water inventory account” may also include water purification costs (the total cost of inventory may include costs in addition to the actual bulk purchase).

2. Payment of Supplier:

Supplier (B/S)

Dt							Cr
Date	Description	Ref	Amount	Date	Description	Ref	Amount
	Payment of Supplier	2	R 200 000.00		Purchase of Water (100000kl @ R2kl)	1	R 200 000.00
			R 200 000.00				R 200 000.00
			R -				R -
			R 200 000.00				R 200 000.00
	Balance				Balance		

Dt			Bank Account (B/S)				Cr
Date	*Description*	*Ref*	*Amount*	*Date*	*Description*	*Ref*	*Amount*
					Payment of Supplier	2	R 200 000.00
			R -				R 200 000.00
	Balance		R 200 000.00				R -
			R 200 000.00				R 200 000.00
					Balance		R 200 000.00

The payment of the "Supplier" is a normal payment by crediting the "Bank" and debiting the "Supplier" with the full amount as per invoice/account.

3. Billing of water:

Dt			Water Sales Revenue (Income Statement)				Cr
Date	*Description*	*Ref*	*Amount*	*Date*	*Description*	*Ref*	*Amount*
					Bill water Sales (80000kl @ R3kl)	3	R 240 000.00
			R -				R 240 000.00
	Balance		R 240 000.00				R -
			R 240 000.00				R 240 000.00
					Balance		R 240 000.00

Dt			Customers (B/S)				Cr
Date	*Description*	*Ref*	*Amount*	*Date*	*Description*	*Ref*	*Amount*
	Bill Water Sales (80000kl @ R3 kl)	3	R 240 000.00				
			R 240 000.00				R -
			R -		Balance		R 240 000.00
			R 240 000.00				R 240 000.00
	Balance		R 240 000.00				

Billing is taken place and 80 000kl are billed against debtor accounts at an escalated price of R3 per kl. The amount of R240 000 is debited against the consumer debtor accounts and the revenue for "water Sales" are credited.

4. Cost of the billed water:

Cost of Sales - Water Billed (Expensed)

Dt							Cr
Date	*Description*	*Ref*	*Amount*	*Date*	*Description*	*Ref*	*Amount*
	COS water billed (80000kl @ R2kl)	4	R 160 000.00				
			R 160 000.00				R -
			R -		Balance		R 160 000.00
			R 160 000.00				R 160 000.00
	Balance		R 160 000.00				

The amount of water taken from stock to be sold by way of the billing must now be taken from stock and be expensed at the cost price. The next step is to debit the expense account “Cost of Sales – Water Billed” at the cost price of R2 for 80 000kl. The amount of R160 000 is then credited against the “Water Inventory” account.

5. Water non-revenue technical losses:

Water Non-Revenue - Technical Losses (Expenditure)

Dt							Cr
Date	*Description*	*Ref*	*Amount*	*Date*	*Description*	*Ref*	*Amount*
	Water - Technical Losses (2% of Purchases @ R2kl)	5	R 4 000.00				
			R 4 000.00				R -
			R -		Balance		R 4 000.00
			R 4 000.00				R 4 000.00
	Balance		R 4 000.00				

The next step is to journalise the water non-revenue technical losses in terms of national norms and standards. The norm for water technical loss is between 2% and 3%. The example uses 2% calculated on the amount of water purchased from the Supplier. It calculated 2 000kl @ R2 per kl, which amounts to R4 000. The amount is debited against the expenditure line item “Water non-revenue – Technical losses” and credited against the “Water Inventory”.

6. Cost of free basic water (If a tariff is not linked to it):

			Cost of free Water Services (Expenditure)				
Dt							*Cr*
Date	*Description*	*Ref*	*Amount*	*Date*	*Description*	*Ref*	*Amount*
	Cost of Free basic Water (10000kl @ R2kl)	6	R 20 000.00				
			R 20 000.00				R -
			R -		Balance		R 20 000.00
			R 20 000.00				R 20 000.00
	Balance		R 20 000.00				

The next step is to calculate the cost of free basic water at the cost price. This is only applicable in cases where the free basic services for water are not charged in terms of the water consumption tariff. The cost of the water is calculated by multiplying the amount of water (kl) that was provided as free basic water times the cost price. The amount of R20 000 is debited against the expense line item "Water – Cost of free basic services" and credited against the "Water Inventory".

7. Accounting for the non-technical losses (unaccounted for water):

			Water non-revenue - Non-Technical Losses (Expenditure)				
Dt							*Cr*
Date	*Description*	*Ref*	*Amount*	*Date*	*Description*	*Ref*	*Amount*
	Water: Non-Technical Losses (8000kl @ R2kl)	7	R 16 000.00				
			R 16 000.00				R -
			R -		Balance		R 16 000.00
			R 16 000.00				R 16 000.00
	Balance		R 16 000.00				

The only transaction that is left is the writing off of the non-technical losses. The authorisation for this is an actual council resolution and it should be accounted for at cost price. The R16 000 (which is the 8 000kl @ R2) is debited against the expense "Water non-revenue: Non-Technical Losses" and is credited against the "Water Inventory".