



## Non-Payment of Obligations

### Introduction

*The MFMA requires accounting officers to ensure that all money owing by the municipality be paid within 30 days of receiving the relevant invoice or statement. It has been brought to our attention that municipalities are not making timely settlement of creditors as required by the legal framework. These creditors include the Auditor-General for audit fees, tax liabilities, staff benefits, loan obligations and suppliers of goods and services.*

### Non-payment

#### The scope of the problem

The Office of the Auditor-General and other creditors have raised concerns over the timely payment for services rendered and contractual obligations not met, highlighting a sharp deterioration in payment for services rendered and other contractual obligations.

This matter of the audit fees was first communicated in a letter addressed to all municipalities in June 2007, followed up during 2008 and again raised in letters during March 2009. The letters clearly explained to municipalities the gravity of the situation in which many municipalities appeared unable to meet their financial commitments and is in breach of the MFMA, providing grounds for an investigation of financial misconduct.

#### Accounting Officer to be held accountable

Section 65(2)(f) of the MFMA states that *“the accounting officer of a municipality must... take all reasonable steps to ensure that the municipality complies with its tax, levy, duty, pension, medical aid, audit fees and other statutory commitments”*.

It is imperative, that the accounting officer take steps to ensure that the municipality concerned honour its obligations for payment of audit fees and other financial commitments, when such payments are due. For example, prior to the commencement of an audit, and where it is expected that costs in excess of budget provision may arise, the accounting officer should ensure that appropriate officials scope the requirements with the Auditor-General. If additional resources are required then the accounting officer must ensure that this is taken up during the municipal adjustment budget process. It is incumbent on the accounting officer of the municipality to ensure this happens.

Under section 173(1) of the MFMA the accounting officer is guilty of an offence if that accounting officer “*deliberately or in a grossly negligent way, contravenes or fails to comply with a provision of section 65(2)(f) (above)*”. Penalties for contravention of section 173 are clearly laid out in section 174 (Penalties).

### **Factors indicative of serious financial problems**

Municipalities are reminded that failure to make payments as they become due and default on financial obligations are both factors used to determine whether a municipality is experiencing serious financial problems when conditions for a provincial intervention are considered.

Municipalities are further reminded that if a municipality fails to make payments when due and such failures amount in total to 2% of the municipality’s operating budget for that year may indicate that the municipality is in serious breach of its obligations, which is a factor in considering whether a mandatory intervention is necessary.

## **Measures to be instituted**

### **Withholding of allocations**

The failure of municipalities to meet their commitments to the Auditor-General is a serious or persistent breach of the measures established in terms of section 216(1) of the Constitution. On request from the Auditor-General, the National Treasury in terms of section 38 of the MFMA, will consider instructing departments responsible for the transfer of funds to withhold such transfer for the amount deemed by the Auditor-General to be owed to them by the municipality. The amount will be withheld for as long as the municipality has defaulted or is in arrears and until the matter is addressed by the municipality concerned.

Further, the accounting officer is required to disclose in the annual financial statements of the municipality the amount of funds that have been withheld and the reason for withholding of such amounts.

## **Immediate measures to be instituted by municipalities**

### **Initiating payment and fulfilling current commitments**

Whilst actions are being considered, the enforcement of the MFMA will be implemented progressively, hence it is critical that all municipalities observe the enabling provisions of the MFMA to secure sound and sustainable management of the financial affairs of municipalities and act in the interest of good governance. In order to avoid action, those municipalities who are in contravention of the Act are urged to take steps to clarify unresolved issues and make the necessary payments to the Auditor-General and other creditors for the amounts outstanding.

Those municipalities affected by this Circular are strongly urged to take the appropriate action as an urgent priority. Failure to do so will be considered a direct contravention of the provisions of the MFMA and will necessitate further action, including the withholding of funds equal to the amount outstanding.

## Measures to be initiated by the Auditor-General

### Implementing extensive and thorough credit control measures

The Auditor-General is planning to exercise normal credit control procedures against municipalities that remain long-term debtors who fail to attempt to remedy the situation. This will include those municipalities who fail to institute any of the remedial measures described above and persist in poor payment practices.

### Future considerations for municipalities

Municipalities that find themselves in situations in which actual audit fees have varied considerably from budgeted provisions, are urged to engage with the Auditor-General to develop an audit plan of action and effective scoping of the audit procedures, including costs and timeframes. These exercises should be completed prior to finalisation of the annual budget of the municipality.

## Payment of other statutory and non-statutory financial obligations

As stated, section 65(2)(f) of the MFMA holds the accounting officer responsible for ensuring that the municipality complies with its commitments relating to any tax, levy, duty, pension, medical aid, audit fees and other statutory commitments. Section 65(2)(e) holds the accounting officer responsible to ensure that all monies owing by the municipality are paid within thirty days of receipt of the invoice or statement.

It has been found that in many instances, municipalities have failed to meet their statutory financial commitments and also in the requirement to pay creditors on time, including payments to bulk service providers of electricity and water, payments to contractors under a contract which specifies payment arrangements, repayments of loan installments and payments to other creditors.

Municipalities should be aware that the practice of prolonging payments to creditors beyond the stipulated timeframe contravenes provisions of the MFMA. As a means of boosting available working capital the practice is unsustainable and therefore not recommended, being contrary to sound principles of cash management and investment, which should be examined and put in place to effectively manage liquidity and working capital through a range of other means, including regular reviews of cash flow projections.

The non-payment of statutory obligations in particular, will be regarded as financial misconduct and such serious or persistent breach will result in action being taken in accordance with section 38 of the MFMA, to withhold funds for the amount equivalent to that owed to the creditor. Depending on the nature of the breach of the Act, other action may be considered.

## Summary of actions required by municipalities

### A step-by-step approach

The following step-by-step approach adopted by municipalities will ensure that they consistently fulfill their financial obligations as they arise. This process should be adopted for the prompt payment of all creditors.

#### Table: Suggested – Process for payment of all creditors

##### MATTERS TO BE ATTENDED TO WITHIN THIRTY DAYS OF RECEIPT OF INVOICE

Step 1	<p><b>Confirm scope of project and monitor progress</b> Prior to arrangement of receiving the good / service, where appropriate, confirm the scope of the project with service provider or contractor and monitor progress in terms of contractual obligation</p>
Step 2	<p><b>Receive and check invoice</b> Upon receipt of an invoice for payment, review to ensure it is in line with the quote, contract, contract price, that the good / service have been received in good order and in terms of the contract, and that all calculations in the invoice are accurate</p>
Step 3	<p><b>Compile all supporting documentation for payment</b> If all details are correct on the invoice, attach the requisition, order and other initiating documentation i.e. copy of authorization for the good to be purchased / service to be performed; or copy of contract, or other legal agreement</p>
Step 4	<p><b>Authorise account for payment</b> Once checked and verified, the responsible person should authorise the account for immediate payment by preparing supporting voucher and send for preparation of payment, signing and recording of cheque or authorisation of other payment means</p>
Step 5	<p><b>Make payment</b> Once cheque is signed or other payment means is authorised, pay the creditor within thirty days, and file the documents in a manner that can easily be assessed during the audit</p>

##### IF THERE IS A DISPUTE OVER THE TERMS OR AMOUNT TO BE PAID

Step 6	<p><b>If grounds for dispute over service or costs refer immediately to senior official</b> If there are any grounds to question the amount on the invoice or the service performed, the matter with all accompanying documentation should be provided to a senior official to take up with the creditor</p>
Step 7	<p><b>Initiate formal dispute and communicate matter to creditor</b> The senior official is required to immediately contact by telephone, or other means, the creditor (or other service provider or contractor) to verbally explain the cause for the query or concern, and follow-up that query in writing – if necessary the parties may consider a meeting to discuss the matter</p>
Step 8	<p><b>Withhold only portion subject to dispute</b> If only part of the invoice is queried, arrangements should be made to pay that portion of the amount payable which is not subject to dispute, and then separately take action to remedy the disputed amount</p>
Step 9	<p><b>Decision to seek mediation</b> Once the municipality has attempted to resolve any dispute by a) contacting the creditor, b) following up in writing, c) where necessary meeting the creditor, and those avenues prove unsatisfactory to the municipality, the municipality may seek remedies through the legal system. In the case of fiscal disputes between organs of state, the municipality may approach the National Treasury for mediation, if this falls within the scope of the MFMA, and other approaches have failed (see Circular 21).</p>

## Conclusion

Whilst it is expected that municipalities and organs of state uphold the spirit of co-operative governance contained in the Constitution and the MFMA, there have been a number of instances where this does not appear evident.

To negate the need for us to institute remedial action, municipalities that have amounts owing to creditors which remain unresolved for a period of time are asked to act urgently on the matter.

## Contact



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