5

Financial management and MFMA implementation

Introduction

Sound financial management practices are essential to the long-term sustainability of municipalities. They underpin the process of democratic accountability. Weak or opaque financial management results in the misdirection of resources and increases the risk of corruption. The key objective of the Municipal Finance Management Act (2003) (MFMA) is to modernise municipal financial management in South Africa so as to lay a sound financial base for the sustainable delivery of services.

Sound financial management practices are essential to the long-term sustainability of municipalities

Municipal financial management involves managing a range of interrelated components: planning and budgeting, revenue, cash and expenditure management, procurement, asset management, reporting and oversight. Each component contributes to ensuring that expenditure is developmental, effective and efficient and that municipalities can be held accountable.

The reforms introduced by the MFMA are the cornerstone of the broader reform package for local government outlined in the 1998 White Paper on Local Government. The MFMA, together with the Municipal Structures Act (1998), the Municipal Systems Act (2000), the Municipal Property Rates Act (2004) and the Municipal Fiscal Powers and Functions Act (2007), sets out frameworks and key requirements for municipal operations, planning, budgeting, governance and accountability.

This chapter gives an overview of:

- reforms in municipal financial management
- strengthening planning and budgeting

- strengthening oversight through improved transparency
- institutional strengthening and capacity building.

Reforms in municipal financial management

The MFMA was introduced in 2003. At that time, the system of local government finance was characterised by practices such as one-year line-item budgeting, which did not support strategic planning and the alignment of budgets with priorities over the medium term. This generally resulted in councils allocating resources based on historical commitments rather than looking at current priorities and the future needs of communities.

Municipal finance practices were also not rooted in a culture of performance and regular reporting. Reports were often irregular or inaccurate, or contained too much data and too little useful information. Often municipalities did not publish annual reports and did not submit their financial statements for audit on time or at all.

Compared to where local government was in 2003, significant strides have been made with implementing the new financial management arrangements spelt out in the MFMA and its regulations. However, progress is uneven and many municipalities are yet to implement both the letter and the spirit of the MFMA, namely 'to enable managers to manage' within a framework of regular and consistent reporting so that they can be held accountable.

Key mechanisms for strengthening accountability

The separation of political and management roles is critical for good governance

The set of legislation governing local government provides for a number of mechanisms for strengthening accountability. The first mechanism involves separating and clarifying roles and responsibilities of mayors, executive councillors, non-executive councillors and officials. This separation of political and management roles is critical for good governance.

The executive mayor and executive committee are expected to provide political leadership, by proposing policies, guiding the development of budgets and performance targets, and overseeing their implementation by monitoring performance through in-year reports. In executing their duties, they may not use their position, privileges or confidential information for private gain or to improperly benefit another person.

The municipal manager holds the primary legal accountability for financial management in terms of the MFMA and, together with other senior managers, is responsible for implementation and outputs. They have a duty to act with fidelity, honesty and integrity, and in the best interests of the municipality at all times.

Non-executive councillors, as elected representatives of the community, debate and approve the proposed policies and budgets and also oversee the performance of the municipality. They hold both the executive mayor or committee and the officials accountable for performance on the basis of quarterly and annual reports.

The second mechanism involves developing a performance orientation. The legal framework introduces requirements and processes for establishing service delivery priorities and plans. The aim is to ensure alignment between the plans, budgets, implementation actions and reporting to ensure proper management accountability for the achievement of service delivery targets.

A performance orientation is crucial for strengthening accountability

The third mechanism involves strengthening reporting and disclosure requirements. High quality and timely management information allows management to be proactive in identifying and solving problems as they arise. It also strengthens the separation of roles and supports a performance orientation in local government.

Reporting and disclosure requirements need to be strengthened

Alignment of planning, budgeting and reporting

Section 153 of the Constitution requires that 'a municipality must structure and manage its administration and budgeting and planning processes to give priority to the basic needs of the community, and to promote the social and economic development of the community'.

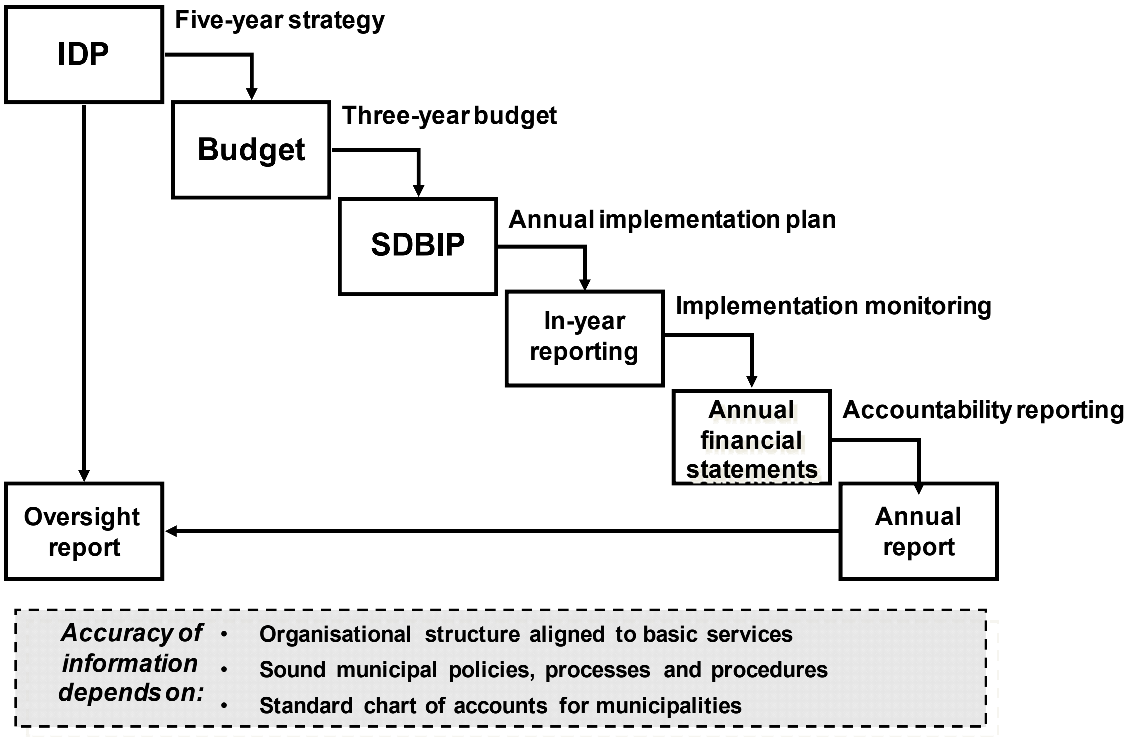
The MFMA, together with the Municipal Systems Act (2000), aims to facilitate compliance with this constitutional duty by ensuring that municipalities' priorities, plans, budgets, implementation actions and reports are properly aligned.

Municipalities' priorities, plans, budgets, implementation actions and reports need to be properly aligned

Figure 5.1 shows the main components of the financial management and accountability cycle and how they ought to be aligned:

- *Integrated development plan (IDP):* This sets out the municipality's goals and development plans, which need to be aligned with the municipality's available resources. Council adopts the IDP and undertakes an annual review and assessment of performance based on the annual report.
- *Budget:* The three-year budget sets out the revenue raising and expenditure plan of the municipality for approval by council. The allocation of funds needs to be aligned with the priorities in the IDP.
- *Service delivery and budget implementation plan (SDBIP):* The SDBIP sets out monthly or quarterly service delivery and financial targets aligned with the annual targets set in the IDP and budget. As the municipality's 'implementation plan', it lays the basis for the performance agreements of the municipal manager and senior management.
- *In-year reports:* The administration reports to council on the implementation of the budget and SDBIP through monthly, quarterly and mid-year reports. Council uses these reports to monitor both the financial and service delivery performance of the municipality's implementation actions.
- *Annual financial statements:* These report on the implementation of the budget, and reflect the financial position of the municipality. They are submitted to the Auditor-General, who issues an audit report indicating the reliance council can place on the statements in exercising oversight.

Figure 5.1 Municipal financial management and accountability cycle



Source: National Treasury

- *Annual report:* It is the primary instrument of accountability, in which the mayor and municipal manager report on implementation performance in relation to the budget and the SDBIP, and the progress being made in realising the IDP priorities.

- *Oversight report:* Council produces an oversight report based on outcomes highlighted in the annual report and actual performance.

The figure also highlights how the level of accuracy of the information set out in each of the accountability documents is dependent on a municipality having a properly aligned organisational structure, and sound policies, processes and procedures (including performance management), and implementing a standard chart of accounts (see below for more detail).

Recent and future financial management reforms

Reforming municipal financial management is not an event, but a process

Reforming municipal financial management is not an event, but a process. The introduction of the MFMA in 2003 laid the foundation for this. Since then, regulations dealing with supply chain management, public private partnerships, the minimum competency requirements of municipal finance officials and asset transfers have been put in place. Each reform aims to build on the foundation laid by previous initiatives, taking into account the time needed for municipal systems and practices to change.

Since 2008, National Treasury has been giving specific attention to strengthening municipal budgeting and reporting practices. Key initiatives have been the introduction of the Municipal Budget and Reporting Regulations in 2009, the enforcement of in-year financial reporting processes and firmer management of conditional grants in accordance with the annual Division of Revenue Act. These reforms have been supported by strengthening National Treasury's local government database and by publishing an increasing range of local government financial information on National Treasury's website.

Since 2008, National Treasury has been giving specific attention to strengthening municipal budgeting and reporting practices

Future reform initiatives National Treasury is currently working on include:

- introducing a standard chart of accounts for municipalities to ensure financial transactions are captured consistently by municipalities, and so improve the quality of financial reporting
- strengthening revenue and cash management policies, processes and procedures, with a particular emphasis on tariff setting
- ensuring the better alignment of plans, budgets and reporting by paying attention to the structure and content of SDBIPs and annual reports, and aligning the format of annual financial statements to report against budgets
- strengthening non-financial reporting, to facilitate evaluations of 'value for money'
- finalising of the regulations for financial misconduct to facilitate the enforcement of the provisions dealing with financial conduct in chapter 15 of the MFMA.

Strengthening planning and budgeting

Improved processes for municipal planning and budgeting empower a council to make more informed decisions and are fundamental to sustainable and efficient service provision.

Improved processes for municipal planning and budgeting allow for more informed decisions and are fundamental to sustainable and efficient service provision

The generic municipal budget cycle is set out in the MFMA and described in MFMA circular 19. The cycle involves:

- *a planning phase,* which starts with the mayor tabling in council a budget process schedule by August. This schedule sets key target dates for the budget process. The planning phase involves the strategic review of the IDP, setting service delivery objectives for the next three years, consultation on tariffs, indigent policy, credit control and free basic services, and reviewing the previous year's performance and current economic and demographic trends.
- *a preparation phase,* which involves the analysis of revenue and expenditure projections (based on the mid-year budget and performance assessment), revising budget related policies and considering local, provincial and national priorities.
- *a tabling and public consultation phase,* which requires the mayor to table a proposed budget, IDP revisions and budget policies in council by the end of March. Thereafter, the municipality is required to conduct public budget consultations during April and

May, as well as solicit input from National Treasury (benchmarking exercise), the relevant provincial treasury and other organs of state and municipalities.

- *a revision and debate phase,* which gives the mayor the opportunity to revise the tabled budget in response to inputs received, and then to table the budget in council for consideration before 1 June.
- *approval* of the budget by council before 1 July (the start of the municipal financial year).
- *publishing* the budget, the SDBIP and annual performance agreements of the municipal manager and senior managers on the municipal website.

The Municipal Budget and Reporting Regulations

The aim of the Municipal Budget and Reporting Regulations is to promote greater transparency and facilitate the alignment of policy priorities, plans, budgets and reports

The Municipal Budget and Reporting Regulations came into effect on 1 July 2009. The regulations apply to all municipalities and municipal entities. Their primary purpose is to regulate the format and content of annual budgets, adjustment budgets and in-year reports to promote greater transparency and facilitate the alignment of policy priorities, plans, budgets and reports. The prescribed budget tables (tables A1 to A10) are designed to ensure that municipalities disclose key information regarding the funding of their budget, the management of assets and the delivery of basic services. They also facilitate the comparison and consolidation of municipal budget information in accordance with international financial reporting standards.

The regulations also require the establishment of a budget steering committee, regulate the disclosure of budgets for capital projects and specify the purposes and amounts that mayors may approve as ‘unforeseen and unavoidable expenditure’.

Role of the budget steering committee

Section 4 of the Municipal Budget and Reporting Regulations requires that the mayor of a municipality establish a budget steering committee. This committee’s role is to provide technical assistance to the mayor in discharging his or her responsibilities set out in section 53 of the MFMA. These responsibilities include providing political guidance to the IDP and budget processes and the priorities that must guide the preparation of the budget, ensuring the budget gets approved before 1 July, that a SDBIP is produced and that senior managers’ annual performance contracts are signed, submitted to council and made public on time.

The prescribed membership of the committee emphasises the technical nature and role of the committee. It includes all senior managers within the municipality that need to be involved in the IDP and budget processes to ensure that they are aligned and relate directly to the service responsibilities of the municipality. The members of the committee will also ultimately be accountable for the implementation of the IDP and budget, through the SDBIP and their annual performance agreements. The ‘councillor responsible for financial matters’ is a member of the committee to represent the mayor and provide political guidance. The committee should be chaired by the chief financial officer, or alternatively the municipal manager.

The budget steering committee is not a committee of council, or a subcommittee of the mayor’s executive committee. Council may decide to establish a separate council committee to exercise oversight of the IDP and budget, and the mayor may decide to establish a separate subcommittee of the executive committee to provide political guidance to the IDP and budget processes. These committees would need to work closely with the budget steering committee.

National Treasury has issued a range of documents to facilitate the implementation of the regulations. These include Excel schedules of the prescribed budget tables, the Budget Formats Guide, the Funding Compliance Guideline and the annual MFMA budget circulars 48, 51, 54 and 55 (all of which are available on National Treasury's website).

The first time all municipalities were required to produce their annual budgets in accordance with the new regulations was for the 2010/11 financial year. Of the 283 municipalities, 272 municipalities used the prescribed budget schedules (the Excel schedules). This is a major achievement. However, a far lesser number produced annual budget documents in accordance with the format prescribed in schedule A of the regulations. The quality and completeness of the information presented also varied greatly.

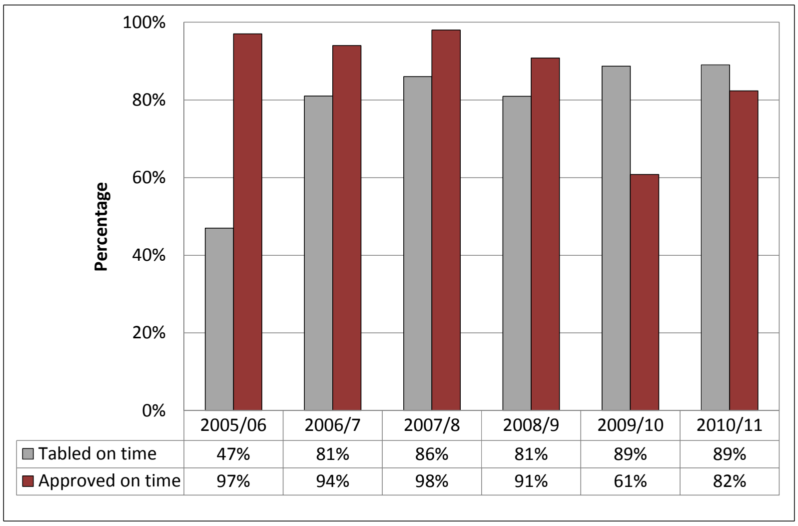
National Treasury's most recent supporting document is the Dummy Budget Guide, which presents the annual budget of a fictitious municipality called Batho Pele City. The aim is to illustrate the kind of information and analysis municipalities are expected to present in their annual budget documents. It is intended that municipal officials will use the guide as a template for producing their own municipality's budget documents in accordance with the requirements of schedule A of the Municipal Budget and Reporting Regulations.

The aim of the Dummy Budget Guide is to illustrate the kind of information and analysis municipalities are expected to present in their annual budget documents

Meeting deadlines for tabling and approving budgets

The deadlines set out in the MFMA for tabling and approving budgets are minimum compliance requirements; municipalities may table and approve their budgets earlier. The budget must be tabled for consultation at least 90 days (31 March) before the start of the financial year (1 July). It must be considered for approval at least 30 days (1 June) before the start of that year, and it must be approved before the start of the financial year (1 July).

Figure 5.2 Compliance with municipal budget tabling and approval deadlines, 2005 to 2010



Source: National Treasury local government database

When municipalities fail to meet budget deadlines, it puts the legality of their rates and tariffs at risk

Figure 5.2 shows that since 2005/06, there has been a steady improvement in municipalities' compliance with the tabling deadline of 31 March. However, in 2010/11 there were still 31 municipalities that failed to meet this deadline, resulting in shortened community consultation processes. The number of councils that approved their annual budgets before 1 July has declined. In 2010/11 there were 50 municipalities that failed to meet this deadline. This poses very significant risks to these municipalities in relation to the legality of their rates and tariffs.

Funding compliance and benchmarking municipal budgets

Section 18 of the MFMA requires that a municipality's annual budget must be 'funded', and identifies three possible funding sources: (a) realistically anticipated revenues to be collected, (b) cash-backed accumulated funds from previous years' surpluses not committed for other purposes, and (c) borrowed funds (but only for the capital budget). The regulations require the presentation of all the information needed to evaluate whether a municipality's operating and capital budgets are 'funded' or not. The 'funding compliance' process is described in MFMA circular 42 and the Funding Compliance Guideline.

As municipal officials draft a municipal budget, they are supposed to assess whether the budget is funded or not in accordance with the funding compliance procedure. It is a self-assessment process. To strengthen compliance with this process, in 2010, National Treasury introduced the 'budget benchmark hearings' for the 17 non-delegated municipalities[1]. The aim of the benchmarking is to check whether a municipality's revenue assumptions are realistic, whether its budget is 'funded' and whether the budget allocations are aligned with the IDP. As a consequence of the benchmarking process, National Treasury advised a number of municipalities to either redraft their budgets completely or to align their planned capital budgets with their available resources.

Credibility of municipal budgets

Evaluating whether a municipal budget is credible is a complex exercise

Evaluating whether a municipal budget is credible is a complex exercise. It involves, among other things, checking whether the budget meets the constitutional requirement to prioritise basic services, whether it is aligned to the IDP, whether it is funded, whether the rates, tax and tariff increases are fair and sustainable, whether the cash-flow projections are realistic, and whether the budget provides adequately for the maintenance and renewal of existing infrastructure. The information that municipalities are required to present in the new budget formats allows each of these aspects to be evaluated.

[1] These are the municipalities that National Treasury exercises direct oversight of. They include the metros, the ten largest secondary cities and one district municipality. The Minister of Finance has delegated provincial treasuries to exercise oversight of the remaining municipalities within their provinces.

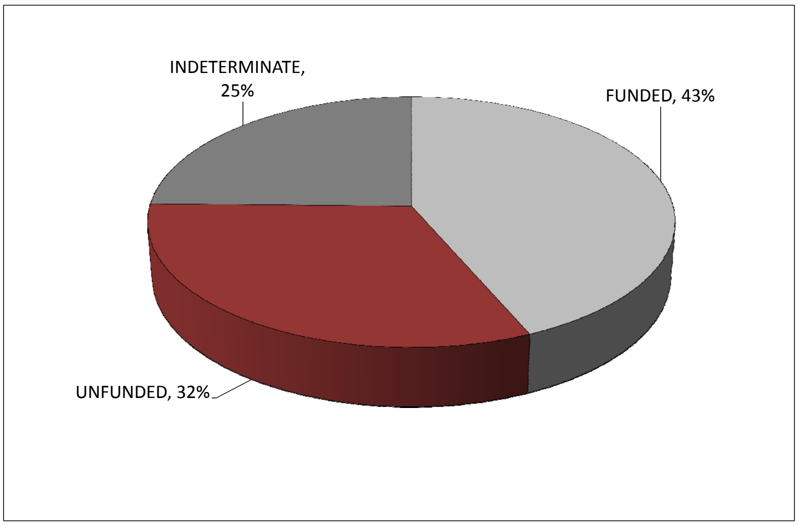
National Treasury analyses each of these aspects in the course of the benchmarking exercise for the 17 non-delegated municipalities. Provincial treasuries are being encouraged to do the same in respect of the delegated municipalities.

Are municipal budgets funded?

Too many municipalities' for 2010/11 did not meet the funding compliance criteria

National Treasury evaluated all 283 municipalities' 2010/11 budgets against the funding compliance criteria. Figure 5.3 shows that based on the information municipalities presented in their approved budgets, only 123 municipal budgets (or 43 per cent) were appropriately 'funded'. Of the remaining budgets, 90 were unfunded, and for 70, there was insufficient information to carry out the evaluation.

Figure 5.3 Funding compliance of municipalities' approved 2010/11 budgets



Source: National Treasury local government database

If a municipal budget is unfunded, it is not a credible budget

If a municipal budget is unfunded, it is not a credible budget – either the revenue projections are unrealistic, the operating expenditures are too high, or the capital budget is too ambitious. In most instances, there are problems in all three areas. Correcting these problems involves going back to basics – and ensuring that the municipality only budgets to spend what it will realistically collect in revenue.

Are there cash-flow problems?

The Municipal Budget and Reporting Regulations therefore require municipalities to budget for both revenue and cash, and also to allow for the timing differences between billing and collection

In the past, municipalities tended to focus on budgeting first for expenditure and then for revenue. Apart from this being the wrong way round, revenue does not equal cash until it is collected, and if there are significant timing differences between the issuing of municipal bills and the customers paying their accounts, or if there are simply low collection rates, this can lead to severe cash-flow problems. The Municipal Budget and Reporting Regulations therefore require municipalities to budget for both revenue and cash, and also to allow for the timing differences between billing and collection. For many municipalities budgeting for cash, and cash-flow management is new, and many of them already find themselves in vulnerable cash positions (see the textbox in *Chapter 4 Revenue and expenditure trends in local government*). Consequently, having exhausted their historical cash reserves, many municipalities are learning cash management the hard way: first getting into difficulty, facing the reality of not being able to pay staff salaries and creditors, and then putting in place a plan to manage cash carefully and proactively. This means cutting unnecessary expenditures and prioritising revenue management.

What is the extent of over and under-spending of budgets?

When municipalities do not stick to the approved allocations, they often overspend on the operating budget and under-spend on the capital budget

If a municipality's budget is not credible, then the municipality will not be able to implement it – i.e. stick to the approved allocations. This most often results in overspending on the operating budget and underspending on the capital budget.

Table 5.1 shows municipalities' percentage over- and underspending of their 2009/10 operating budgets. If the variance on the operating budget is greater than 5 per cent it is very likely that the original budget was not credible.

Table 5.1 Over and under spending of operating budget for the 4th quarter ended 30 June 2010

	Over			On target		Under		
Number	More than 15% over	10% to 15% over	5% to 10% over	0% to 5% over	0% to 5% under	5% to 10% under	10% to 15% under	More than 15% under
Province								
Eastern Cape	5	–	1	17	1	3	4	14
Free State	3	–	–	–	2	4	1	15
Gauteng	–	1	–	–	3	6	1	4
Kwazulu-Natal	5	–	3	3	9	10	8	23
Limpopo	6	1	–	8	3	2	5	5
Mpumalanga	3	1	–	5	2	1	–	9
Northern Cape	2	–	–	7	3	1	4	15
North West	2	–	3	3	1	2	1	12
Western Cape	3	–	–	1	2	7	5	12
Total	**29**	**3**	**7**	**44**	**26**	**36**	**29**	**109**

Source: National Treasury Local Government Database

Given the service delivery pressures at municipal level, the fact that 174 municipalities underspent their operating budget by more than 5 per cent is somewhat surprising. It indicates that: (a) the budgets were over ambitious; (b) there were management problems in implementing the budget; or (c) the municipality did not collect the revenue required to fund the expenditure. All of these explanations point to problems with the credibility of the municipalities' approved budgets.

Overspending on the operating budget can be due to inadequate expenditure controls in place or non-credible allocations in the approved budget

On the other side, 39 municipalities overspent their operating budgets by more than 5 per cent. Usually this is due to the municipality having inadequate expenditure controls in place, but may also be due to the allocations in the approved budget not being credible, i.e. too low.

Table 5.2 shows municipalities' percentage over- and underspending of their 2009/10 capital budgets. If the variance on the capital budget is greater than 10 per cent it is very likely that the original budget was not credible. The table shows that 28 municipalities overspent their capital budgets by more than 10 per cent, while 183 underspent by more than 10 per cent. 9 municipalities (or 3 per cent) underspent their capital budgets by between 5 and 10 per cent.

Table 5.2 Over and under spending of capital budget for the 4th quarter ended 30 June 2010

	Over		On target				Under	
Number	More than 15% over	10% to 15% over	5% to 10% over	0% to 5% over	0% to 5% under	5% to 10% under	10% to 15% under	More than 15% under
Province								
Eastern Cape	5	–	1	21	1	–	3	14
Free State	1	–	1	1	–	1	–	21
Gauteng	2	–	–	2	–	–	1	10
Kw azulu-Natal	7	3	2	5	2	2	3	37
Limpopo	3	1	–	6	1	1	1	17
Mpumalanga	1	–	1	5	–	–	–	14
Northern Cape	4	–	–	10	–	2	1	15
North West	–	–	–	3	–	–	–	21
Western Cape	1	–	–	1	–	3	5	20
Total	**24**	**4**	**5**	**54**	**4**	**9**	**14**	**169**

Source: National Treasury Local Government Database

In total, municipalities underspent their 2009/10 capital budgets by R15 billion. Of this amount, R3.3 billion was under spending of conditional grants for infrastructure. The reasons for capital under spending differ between municipalities, but usually it is either because budgets are unfunded (i.e. the cash for implementation is not available), or because the municipalities do not have the technical management capacity to implement.

In total, municipalities underspent their 2009/10 capital budgets by R15 billion

The funding compliance procedure and the emphasis on cash management in the new budget formats seeks to address certain of these problems. However, issues of appropriate prioritisation, costing of services and projects, and technical capacity need to be addressed at an organisational level.

Strengthening oversight through improved transparency

The system of reporting in the MFMA aims to ensure that municipalities produce financial and performance information that is timely and reliable. This enables managers to act proactively to identify and resolve problems and provide councils with the information they need to fulfil their oversight responsibilities.

The reports on the implementation of the budget and the SDBIP required by the MFMA include monthly and quarterly budget statements, a half-yearly performance assessment, annual financial statements and annual reports.

Publication of municipal information

Over the past three years, National Treasury has significantly expanded the range of municipal information published on the MFMA section of its website: www.treasury.gov.za

Over the past three years, National Treasury has significantly expanded the range of municipal information published

The information now includes annual budget information, quarterly section 71 finance reports and annual financial statements, as well as municipal IDPs, approved budget documents and annual reports. By publishing all this information, National Treasury aims to:

- *increase transparency:* There is a well-known public management maxim that says ‘when performance information gets reported, performance improves; when it gets published, performance improves still further’. This is because the increased transparency places pressure on managers to deliver. It is also well-known that greater transparency forces improvements in the accuracy of information – as no manager wants to explain why the numbers he or she signed off on are wrong.

- *support monitoring:* In the absence of credible information, it is not possible to monitor where there may be problems and to develop appropriate support strategies. By publishing the information, National Treasury aims to support other national departments and provincial treasuries in their monitoring of municipalities.
- *support analysis and research:* By publishing municipal information, National Treasury aims to encourage a broader pool of researchers to engage with the challenges facing local government, and facilitate the development of evidence based policy proposals to overcome the challenges.
- *reduce the reporting burden:* In 2007, National Treasury reviewed the range of information requests that national departments made to municipalities. The findings revealed enormous duplication, particularly in relation to financial information. National Treasury has therefore put in place processes to ensure that municipalities only have to report financial information once. National Treasury checks the quality of the information and publishes it. So there is now, one authoritative, readily accessible national source of municipal financial information, and no need for any other entity to approach municipalities for this information.

The MFMA requires municipalities to publish key documents and information on their website

Municipalities are also required by section 75 of the MFMA to publish key documents and information on their website, including the IDP, the annual budget, adjustments budgets and budget related documents and policies. A municipal website should be an integral part of a municipality's communication strategy. If managed effectively, it allows easy access to relevant information, can serve as a tool for community participation and improve stakeholder involvement in monitoring and evaluation of municipal performance.

In-year monitoring

Monitoring the implementation of the budget is a key responsibility of the mayor and should ensure that financial problems are identified early

Section 71 of the MFMA requires the accounting officer to submit monthly budget statements to the mayor, who must table these in council on a monthly basis. Monitoring the implementation of the budget is a key responsibility of the mayor and should ensure that financial problems are identified early.

Municipalities are also required to submit the section 71 reports to National Treasury on a quarterly basis. This information is captured on National Treasury's local government database, checked and then published on National Treasury's website as soon after the end of the quarter as possible. Improving the coverage and timeliness of the section 71 reporting process has been a key priority. In 2007/08 the number of municipalities that reported in the fourth quarter was 271, in both 2008/09 and 2009/10 there were quarters in which all municipalities reported.

While the quality of the information is still uneven, it does improve with each quarter. National Treasury is also working at developing a range of diagnostic and process checks to improve the quality of the information. However, as noted above, if managers have to account for the information, they will take more care when signing off on it.

If managers have to account for the information, they will take more care when signing off on it

Annual financial statements

The annual financial statements are the most important record of the financial status of a municipality and municipal entity. Every municipality and municipal entity must prepare annual financial statements and submit them to the auditor-general for auditing no later than 31 August of each year. In the case of a municipality with municipal entities, the municipality is also required to submit consolidated annual financial statements to the auditor-general no later than 30 September of each year.

The annual financial statements are the most important record of the financial status of a municipality and municipal entity

Annual reports

The MFMA requires that every municipality and municipal entity must prepare an annual report for each financial year.

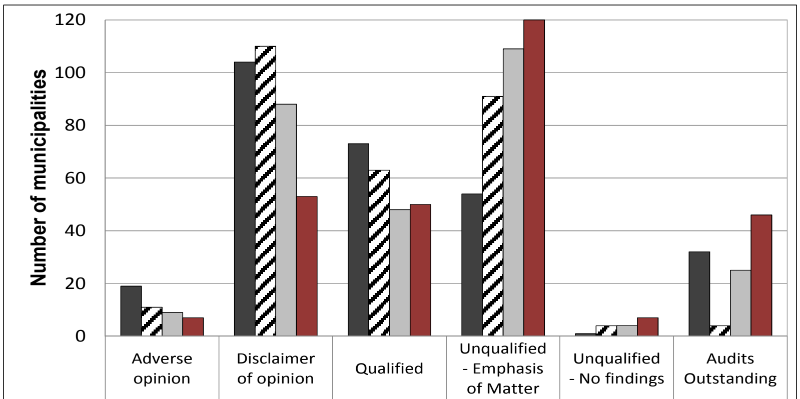
The annual report is the key instrument of transparent governance and accountability and must be used to report on performance for the year. The early completion and submission of annual reports, together with the annual financial statements, will facilitate timely oversight. Oversight of the annual report represents the final stage in the accountability cycle.

Once approved by the council, the annual report must be placed on the municipal website, made available to the wider community and copies must be sent to various stakeholders.

Audit opinions issued by the Auditor-General

The Auditor-General's opinion is the most important part of the auditor's report provided to the municipality. The audit findings are based on an independent and often extensive verification process of the annual financial statements and the performance information in the annual report.

Figure 5.4 Municipal audit opinions, 2006/07 – 2009/10



	Adverse opinion	Disclaimer of opinion	Qualified	Unqualified - Emphasis of Matter	Unqualified - No findings	Audits Outstanding
2006/07	19	104	73	54	1	32
2007/08	11	110	63	91	4	4
2008/09	9	88	48	109	4	25
2009/10	7	53	50	120	7	46

Source: Auditor General, Audit opinions 2009/10

Since 2006/07, the number of municipalities that received an adverse or disclaimed audit opinion has more than halved

Figure 5.4 shows that there has been a significant improvement in municipalities' audit outcomes since 2006/07. The number of municipalities that received an adverse or disclaimed audit opinion has more than halved, while the number of unqualified opinions with emphasis of matter has more than doubled. Most of these improvements pre-date the launching of the Department of Cooperative Governance's Operation Clean Audit – so further improvements in audit outcomes are likely as the initiative moves to achieve its objective of clean audits for all municipalities by 2014.

It is important to note that a compliance audit is not an assessment of financial health

Where audit outcomes are adverse, disclaimed or qualified it indicates that fundamental principles of good governance, transparency and financial management are not being adhered to. Even an unqualified audit with an emphasis of matter can indicate serious financial management shortcomings – depending on the issues raised by the Auditor-General. It also needs to be noted that an unqualified audit opinion does not mean that the municipality is financially sound. These issues need to be separated from each other – a compliance audit is not an assessment of financial health.

Common weaknesses identified in the Auditor-General's audit reports are in management and accounting skills, operational financial management, internal controls, and revenue and supply chain management

The most common weaknesses identified through the Auditor-General's audit reports are in management and accounting skills, shortcomings in operational financial management, lack of internal controls and weaknesses in revenue management, supply chain management and asset management. These weaknesses result in high levels of material losses/impairments, unauthorised expenditure, fruitless and wasteful and irregular expenditure.

Processes to authorise unauthorised expenditures

In terms of section 32 of the MFMA, 'unauthorised expenditure' may only be authorised (condoned) by the municipal council in an adjustments budget. In this regard, regulation 23(6) of the Municipal Budget and Reporting Regulations provides that:

> (6) An adjustments budget contemplated in section 28(2)(g) of the Act may only authorise unauthorised expenditure as anticipated in section 32(2)(a)(i) of the Act, and must be –
> (a) dealt with as part of the adjustments budget contemplated in sub-regulation (1); and
> (b) a special adjustments budget tabled in the municipal council when the mayor tables the annual report in terms of section 127(2) of the Act, which may only deal with unauthorised expenditure from the previous financial year which the council is being requested to authorise in terms of section 32(2)(a)(i) of the Act.

In practice this means:

- Unauthorised expenditure that occurs in the first half of a municipal financial year may be authorised by the council in the main adjustments budget that must be tabled in council before 28 February (see regulation 23(1) of the Municipal Budget and Reporting Regulations).
- Unauthorised expenditure that occurs in the second half of the financial year, or that occurred in the first half of the year but was not authorised in the main adjustment budget (above), has to be reported in the annual financial statements, audited and then only when the mayor tables the annual report in council can an adjustment budget be tabled in council to authorise this expenditure.
- If the council decides not to authorise an unauthorised expenditure, then it must be recovered from the person liable for that expenditure unless the council certifies that the amount is irrecoverable and it is written off by the council.

This power to authorise unauthorised expenditure and certify unauthorised, irregular or fruitless and wasteful expenditure as irrecoverable may not be delegated to a council committee or to any administrative committee or official. It is a core competency and function of the council.

In this regard, regulation 74 of the Municipal Budget and Reporting Regulations provides that:

> (1) A council committee contemplated in section 32(2)(a)(ii) of the Act to investigate the recoverability of any unauthorised, irregular or fruitless and wasteful expenditure must consider –
> (a) the measures already taken to recover such expenditure;
> (b) the cost of the measures already taken to recover such expenditure;
> (c) the estimated cost and likely benefit of further measures that can be taken to recover such expenditure; and
> (d) submit a motivation explaining its recommendation to the municipal council for final decision.

Section 32 of the MFMA (nor any other section) does not permit a council to authorise or condone irregular or fruitless and wasteful expenditure under any circumstances. Irregular or fruitless and wasteful expenditure' may only be (1) recovered from the person liable for that expenditure or (2) certified by the council as irrecoverable and written off. Under exceptional circumstances the National Treasury may be approached to condone such expenditure in terms of section 170 of the MFMA.

Institutional strengthening and capacity building

In most municipalities there is a general lack of the technical skills and knowledge necessary for performing key duties in financial management from an operational perspective. This is a major constraint and one of the biggest challenges facing municipalities. These technical skills include planning, engineering, project management and plant operating. Inadequate capacity at the senior management level and a lack of appropriate financial management skills in municipalities results in poor service delivery. Furthermore, a high turnover of senior management in municipalities, particularly of chief financial officers, is a major issue affecting municipalities' capacity to manage their finances properly and thus lay a sound foundation to expand and improve service delivery.

The budget and treasury office

The budget and treasury office is responsible for managing the municipality's finances and overseeing that all branches of the municipality comply with all finance related legislation and council policies

Section 80 of the MFMA requires that each municipality have a budget and treasury office, headed by the chief financial officer and consisting of the officials that report to him or her. The budget and treasury office is responsible for managing the municipality's finances and overseeing that all units of the municipality comply with all finance related legislation and council policies.

National and provincial programmes to strengthen the financial management capacity of municipalities have invariably focused on strengthening the budget and treasury offices, and building the capacity of staff within the office. While there is progress, and municipal financial management is improving, the effectiveness of these capacity-building initiatives is hampered by low levels of staff experience, staff with inappropriate qualifications, high vacancy rates and high staff turnover. Of concern is that even when a municipality has an opportunity to appoint new staff to the budget and treasury office, very often people with inappropriate experience and qualifications get appointed. This is despite the fact that the Municipal Regulations on Minimum Competency Levels came into effect on 1 July 2007.

Preparing for the effective date of the competency regulations

According to regulation 18 of the Municipal Regulations on Minimum Competency Levels the continued employment of financial officials and supply chain management officials appointed after 1 July 2007 is subject to them obtaining the required higher education qualification and the required minimum competency level on or before 1 January 2013. If they fail do so their employment will automatically be terminated. There is no problem if the official is working towards obtaining the necessary qualifications and competencies. But it would seem that many are not doing so. This poses an enormous risk both to the officials who stand to lose their jobs, and to the municipalities who may find that few of their officials actually make the grade to work in the budget and treasury office and supply chain management function, and who will then be faced with a forced exodus of staff.

Municipalities must ensure that their job descriptions, competency requirements, advertisements, selection criteria and appointments are aligned with the requirements set out in the regulations

National Treasury is working with the South African Local Government Association (SALGA) to raise awareness of the regulations and to ensure that they are institutionalised in municipalities' human resource management processes. This means that municipalities must ensure that their job descriptions, competency requirements, advertisements, selection criteria and appointments are aligned with the requirements set out in the regulations.

Municipal finance management programme

This is a formal training programme designed to support the implementation of the competency regulations. It is structured to enable officials to attain the required competency levels by participating in accredited training sessions over time. Officials occupying senior financial management positions need to obtain formal qualifications at NQF levels 5 and 6. Entry level positions require competencies at NQF levels 3 and 4.

The municipal finance management programme is structured to enable officials to attain the required competency levels

National Treasury, working with the LGSETA, has trained and accredited 41 regionally based training providers, including PALAMA and the DBSA's Vulindlela Academy. These service providers are required to use a uniform set of training and assessment instruments on their courses. Training on the lower level competencies is being done through LGSETA funded learnerships delivered in partnership with the South African Institute of Chartered Accountants. By mid-2010, over 600 learners had graduated from this programme.

Table 5.3 presents a high level summary of the number of municipal officials that have participated in this programme since its inception.

Table 5.3 Participation in the formal programme - MFMP

Learning Programmes	EC	FS	GP	KZN	LP	MP	NW	NC	WC	Total
Strategic Management; Budgeting Implementation and Performance Management	584	446	125	282	378	461	400	402	300	3 378
Municipal Accounting and Risk	330	265	75	154	180	253	211	212	142	1 822
Governance and Legislation	219	186	51	111	141	163	153	166	112	1 302
Cost and Capital Planning	2	–	–	–	2	4	–	–	4	12
Muncipal IT support and Project	1	–	–	–	3	7	–	–	2	13
SCM and PPP	205	111	27	85	81	136	103	132	114	994
Total	**1 341**	**1 008**	**278**	**632**	**785**	**1 024**	**867**	**912**	**674**	**7 521**

Source: National Treasury local government database

Municipal finance management internship programme

The programme started in 2004 to help municipalities build up their in-house financial management capacity by providing internships to graduates in accounting, economics, finance and risk management. The internship is for two years, and includes mandatory formal training in the competencies required by the Municipal Regulations on Minimum Competency Levels. Municipalities are encouraged to provide permanent employment to interns once they have completed the programme.

The municipal finance management internship programme provides internships to graduates in accounting, economics, finance and risk management

In 2004, the first intake was 114 interns. Table 5.4 shows that there were 1 241 interns on the programme as at 30 September 2010. Past interns are those who are currently in their second year, while current interns are those who are in their first year.

Table 5.4 MFMIP as at 30 September 2010

Province	No. of munici-palities	Captured on Intern Database		
		Past Interns	Current Interns	Cumulative Total
Eastern Cape	45	73	105	178
Free State	25	25	117	142
Gauteng	14	9	46	55
Kwazulu Natal	61	78	184	262
Limpopo	30	51	110	161
Mpumalanga	21	20	67	87
North West	25	14	61	75
Northern Cape	32	38	118	156
Western Cape	30	43	82	125
Total	**283**	**351**	**890**	**1 241**

Source: National Treasury local government database

Reform of the Siyenza Manje programme

The Siyenza Manje programme now includes financial and engineering components

The Siyenza Manje programme was initiated by National Treasury in partnership with the DBSA in 2006. The programme was designed to run for three years, but was extended for a fourth year to end March 2011. Initially the programme focused on developing municipalities' capacity to manage the implementation of infrastructure projects. So, much of the hands-on support was provided by engineering deployees. Later the programme was expanded to include financial management deployees.

In 2010, government decided to restructure the programme in order to ensure the departments responsible for financial management and infrastructure matters respectively were placed in a position to direct the deployment of support and to monitor the effectiveness of the programme.

Conclusion

A firm foundation of financial management systems and capacity is key to the successful implementation of infrastructure programmes, service delivery expansion efforts, improvements in the level, reliability and frequency of services. It is therefore absolutely critical that the correct skills, mindset and expertise are located at the right places within the municipality.

Further measures will need to be considered as to how best to enforce compliance with the legal framework for financial management. A combination of measures, such as withholding transfers, firmer implementation of the code of conduct for municipal councillors and officials and withholding performance bonuses when service delivery fails will need to be reinforced. It is now seven years since the Act was introduced. The phasing that was afforded to so-called low, medium and high capacity municipalities lapsed completely in 2007/08, therefore all municipalities are expected to comply fully.

However, the aim is ultimately that municipal officials will do the right thing because they agree with and seek to act in accordance with the principles of good governance, transparency and stewardship of public resources.