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Research Paper Topic**:** Unfunded budgets in local government

KEYWORDS: Unfunded budgets, balanced budgets, credible budgets, local government budgets, valid municipal budgets.

DECLARATION

I, Asiphe Funda, do hereby declare that 'Unfunded Budgets in Local Government' is my original work and I have properly acknowledged all the sources which I have used by means of references. I further testify that it has not been submitted for another degree or to any other institution of higher learning.

Signed……………………………………………..

Date………………………………………………..

Supervisor: Prof Nicolaas Steytler

Signature……………………………………………….

Date…………………………………………………….

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Dedications

This work is dedicated to my late aunt, Noxolo Patricia Gali who passed away a month before I began my Master's degree. Your teachings about the importance of education have kept me going throughout the years, Icamagu livumile Nokwindla.

Abbreviation and Acronyms

DORA	Division of Revenue Act
CFO	Chief Financial Officer
FFC	Financial and Fiscal Commission
IDP	Integrated Development Plan
LGES	Local Government Equitable Share Formula
MEC	Member of the Executive Council
MFMA	Municipal Finance Management Act
PFMA	Public Finance Management Act

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CHAPTER 1: INTRODUCTION

1.1 Problem Statement

The Constitution of the Republic of South Africa entrenches the status of local government as a distinct sphere of government.[1] In terms of section 40(1), the government of the Republic is constituted of three spheres, namely, the national, provincial, and local spheres of government. The local sphere of government has a constitutional mandate of ensuring the provision of services to communities in a sustainable manner.[2] Furthermore, municipalities are required 'to strive to achieve their mandate of the provision of essential services within their financial and administrative capacity.'[2] To achieve this, municipalities compile municipal budgets. The budget is the municipality's financial plan and indicates how much money will go towards each of the activities outlined in the Integrated Development Plan (IDP).[3] The budget should outline where the municipality is getting its money from, how much it will receive and how much will be spent on things like salaries, goods and services, infrastructure and equipment.[4] Due to the nature of its function, the municipal budget is viewed as the most immediate and important mechanism that is used in giving effect to the municipality's service delivery strategies.[5] It is the central policy and governance instrument of a municipality, setting spending priorities and controlling expenditure.[6]

The main challenge facing the local sphere of government is that municipalities are increasingly passing budgets that cannot meet municipal financial obligations, resulting in a failure to deliver basic services to communities. In practice, National Treasury and the Auditor-General have found that municipal budgets are not funded according to legislative prescripts.[8] In a written reply to Parliament in March 2018, former Minister Nhlahla Nene revealed that

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[1] Mathenjwa M 'The constitutional obligations imposed on a provincial government in instances where a municipality cannot provide basic services as a result of a crises in its financial affairs' (2015) *TSAR* 1.
[2] Constitution of the Republic of South Africa, 1996 s 152(1).
[2] Constitution s 152(2).
[3] 'Local Government Action' available at http://localgovernmentaction.org.dedi6.cpt3.hosth.net/xh/content/integrated-development-plan (accessed 02 October 2019).
[4] 'Local Government Action' available at http://localgovernmentaction.org.dedi6.cpt3.hosth.net/xh/content/integrated-development-plan (accessed 02 October 2019).
[5] Mazibuko G & Fourie D J 'Municipal finance: Relevance of clean audit outcomes' (2013) 21 *Administration Publica* 135.
[6] Steytler N & De Visser J *Local Government Law of South Africa* (2014) 11-18. [8] National Treasury Report (2011) 81.

112 of the 257 municipalities had unfunded budgets.[7] National Treasury had assessed the municipal budgets based on the municipal financial information presented in the Municipal Finance Management Act (MFMA) section 71 reports for the second quarter of 2017/2018 financial year. The findings presented by the Minister to Parliament motivated this research on the issue of unfunded budgets in local government.

1.2 Significance of the Problem

The adoption of unfunded budgets impacts negatively on the sustainability of municipalities. According to National Treasury, the adoption of unfunded budgets makes some form of financial distress inevitable.[8] This is particularly relevant for the local sphere of government that is plagued by financial distress. The Department of Co-operative Governance and Traditional Affairs revealed that roughly 31 per cent of the country's municipalities are dysfunctional or distressed, while a further 31 per cent is almost dysfunctional or distressed.[9] The Municipal Financial Stability Index published by Ratings Afrika also found that most South African municipalities are in financial distress.[10] According to Ratings Afrika, the financial dysfunctionality in local government might lead to a total breakdown in service delivery, with catastrophic consequences for residents and businesses.[11] The Agency has further warned that the South African municipal sector is currently facing collapse.[14] This would have a significant impact on communities considering the role of municipalities in delivering services and developing communities.

When municipalities adopt unfunded budgets, they commit more than they can generate in revenue and as a result fail to pay their creditors. This results in municipalities being unable to cover their operational costs. In 2016, municipal debt owed to Eskom[15] stood at R6 billion and

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7 '112/257 municipalities have unfunded budgets - Nhlanhla Nene' available at *www.politicsweb.co.za/.../112257-municipalities-have-unfunded-budgets--nhlan* (accessed 17 November 2018).

8 Van Ransburg D 'Treasury gets tough' available at *https://www.fin24.com/Budget/treasury-gets-tough20180223* (accessed 26 June 2018).

9 Report of the Select Committee on Appropriations on the Division of Revenue Amendment Bill [B24 – 2017] available at *https://pmg.org.za/tabled-committee-report/3205/* (accessed 06 July 2018).

10 Ciaran Ryan 'Municipal sector faces collapse – Ratings Afrika' available at https://www.moneyweb.co.za/news/south-africa/municipal-sector-faces-collapse-ratings-afrika/ (accessed 02 October 2019).

11 Ciaran Ryan (2019). 14 Ciaran Ryan (2019). 15 'Eskom is a South African electricity public utility, established in 1923 as the Electricity Supply Commission' available at *www.eskom.co.za/sites/heritage/.../Eskom%20News%20March%202013%20* (accessed 19 January 2019).

escalated to R17 billion by November 2018.[12] When municipalities fail to pay service providers such as Eskom and the water boards, essential services are discontinued and community members bear the effects of such consequences.[13] Furthermore, the challenge of municipalities adopting unfunded budgets is becoming widespread. As noted above, for the 2017/18 financial year National Treasury revealed that 112 municipalities had adopted unfunded budgets. This means that 40 per cent of municipalities are at risk of not being able to stick to the approved allocations in their budgets.[14] In conclusion, the adoption of unfunded budgets poses an imminent threat to the sustainability of most municipalities in South Africa as well as their ability to deliver services.

1.3 Research Question

The main research question this study seeks to answer is 'How is the problem of unfunded budgets in local government to be addressed?'

The following sub-questions will be answered in the study in order to respond to the main research question.

1. What is the legal framework for funding a budget in local government?
2. What are the causes and manifestations of unfunded budgets?
3. How are unfunded budgets detected and by whom?
4. What can be done to prevent or remedy unfunded budgets?

1.4 Argument

This study argues that municipal budgets must be funded, credible and balanced in order to comply with legislative requirements set out in the MFMA. The paper further argues that the failure to adopt funded budgets by municipalities has dire consequences for municipalities and the communities they serve. The adoption of unfunded budgets results in municipalities being

[12] Municipal debt to Eskom reaches R17 billion' available at *https://www.enca.com/news/municipal-debt-eskomreaches-r17-billion* (accessed 02 January 2019).

[13] 'Municipalities owing Eskom debt: Inter-Ministerial Task Team report' available at *http://pmg.org.za/committee-meeting/26664/* (accessed 06 July 2018).

[14] 'Municipalities with unfunded budgets' available at *www.politicsweb.co.za/.../112257-municipalities-haveunfunded-budgets--nhlan* (accessed 20 June 2018).

unable to meet some of their financial obligations, including the payment of creditors such as Eskom.

This paper argues that the measures put in place for addressing the adoption of unfunded budgets are ineffective and have had only a marginal impact. This is evidenced by the alarming growth in the number of municipalities adopting unfunded budgets every year. This study argues that there is an urgent need for stricter enforcement mechanisms that will serve to guard against the adoption of unfunded budgets by municipalities. There is a need for effective measures to ensure that municipalities do not become dysfunctional as a consequence of adopting unfunded budgets.

This research will further argue that an unfunded budget does not constitute a valid budget as required by relevant sections of the MFMA. Therefore, a municipality that adopts an unfunded budget must be deemed as having failed to adopt a valid budget in terms of section 139(4) of the Constitution of the Republic of South Africa.[15] This study outlines section 139(4) of the Constitution as the appropriate mechanism that can be used to intervene in local government and prevent the adoption of unfunded budgets. The study further argues that if provincial governments fail to intervene using section 139(4) of the Constitution, national government must intervene in accordance with its responsibility in terms of section 139 of the Constitution.

1.5 Literature Review

There is not much literature on the topic of unfunded budgets in international literature. However, there is international literature that focusses on public budgeting in general. The municipal budget process is described as a process of planning, adopting, executing, monitoring and auditing of the fiscal program for government, for one or more future years.[16] This process is at the core of fiscal administration as it is where the broad financial policies and programs of government are developed and the size of the government is established.[17] According to international literature, local government budgets are required to be balanced, meaning that operational deficits are prohibited.[18] A budget is in formal balance when revenues equal

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[15] Constitution of the Republic of South Africa, 1996.

[16] Mikesell JL 'Fiscal administration in local government: An overview' in Shah A(ed) *Local Budgeting* (2007) 27.

[17] Mikesell (2007) 27.

[18] Lewis CW 'How to read a local budget and assess government performance' in Shah A (ed) A *Local Budgeting* (2007) 188.

expenditure for the fiscal year.[19] Wherefore, local governments are required to ensure that expenditure does not exceed revenue.[20] Local government budgets are also required to be realistic. Realistic annual budgets require revenues be forecasted as accurately as possible.[25] Shah emphasises that realistic and reasonable accurate revenue projections should be a primary objective of forecasts in the annual budget.[21] This is to avoid revenue shortfalls or excessively large revenue surpluses. Budget deficits are common in local government and are mainly encountered in operating budgets.[22] The topic of unfunded budgets has also not been at the forefront in South African literature. Fortunately, there have been a few authors who have written extensively on municipal finance. Steytler and De Visser provide a comprehensive chapter on municipal budget in their book titled 'Local Government Law of South Africa'.[23] This chapter discusses different aspects of local government budgets including credible and balanced budgeting. Steytler and De Visser describe a credible budget as one that contains a comparison between the current and preceding year's budget.[24] Balanced budgeting requires that the estimated expenditure in a municipal budget be backed by realistic estimations of revenues anticipated to be raised by the municipality [30]

Although there is currently no literature on the causes of unfunded budgets, there are views that they are a manifestation of other challenges facing local government.[25] For instance, Ajam and Fourie make interesting observations about government budgets in general. The authors argue that the biggest challenge facing intergovernmental fiscal policy does not lie in the forecasted co-ordination of planned revenues and expenditure during the intergovernmental budget process.[26] But in fact, it lies in budget execution across all three spheres of government. Schoeman makes similar observations in his paper and suggests that government should reevaluate the number of municipalities allowed to manage their own budgets and that more

[19] Lewis (2007) 188.
[20] Schroeder L 'Forecasting local revenues and expenditures' in Shah A (ed) *Local Budgeting* (2007) 53. [25] Schroeder (2007) 53.
[21] Schroeder (2007) 54.
[22] Lewis (2007) 188.
[23] Steytler and De Visser (2014) Chapter 11.
[24] Steytler and De Visser (2014) 11-19.
[30] Steytler and De Visser (2014) 11-19.
[25] Schoeman N J 'Rethinking fiscal decentralization in South Africa' (2006) 41 *Journal of Public Administration* 120.
[26] Ajam T & Fourie D J 'The role of the provincial treasury in driving budget reform in South Africa's decentralised fiscal system' (2014) 22 *Administratio Publica* 45.

stringent financial reporting should be enforced to address challenges to local government finances.[27]

There is no indication of a remedy or intervention in place to address the issue of unfunded budgets. Section 139 of the Constitution sets out a framework in terms of which other spheres intervene in local government. However, there is no evidence of an intervention that has been triggered by the adoption of an unfunded budget. Research conducted by Public Affairs Research Institute (PARI) has shown that very few interventions into local government have had a meaningful and sustained impact on municipal financial health.[28] Instead, municipalities are often left in a worse position after interventions. As a result of this, a notable number of municipalities have been the site of more than one intervention with little to show for it.[29] PARI argues that the main reason for the failure of s 139 interventions is that the legislation has never been implemented as it was intended. Many of its provisions are either ignored or incorrectly applied.[30] This paper will demonstrate how the proper application of s 139(4) will address unfunded budgets.

The reviewed literature above shows a gap in existing literature about how the challenge of unfunded budgets is to be addressed. This study seeks to fill the gap by providing an analysis of what constitutes a funded budget. The research paper will also look at the causes and manifestations of unfunded budgets and consider preventative measures and remedies that can be employed in situations where unfunded budgets are detected.

1.6 Chapter Outline

This study is divided into five Chapters. Chapter 1 is the introductory chapter; it provides the outline of the research study. Chapter 1 further provides the problem statement, research question, argument, literature review and the methodology that will be employed in the study. Chapter 2 provides a discussion on the legal framework for municipal finances, particularly funded budgets. In discussing what constitutes a funded budget, reference will be made to the sources of municipal revenue. Chapter 3 will focus on the causes and consequences of unfunded

[27] Schoeman (2006) 126.
[28] Ledger S & Rampedi M (2019) 1.
[29] Ledger S & Rampedi M (2019) 2.
[30] Ledger S & Rampedi M (2019) 2.

budgets. This chapter will also provide insights on why the current legal framework is failing. Chapter 4 discusses supervision of local government by other spheres of government. Lastly, Chapter 5 contains the main conclusions reached in the study as well as recommendations.

1.7 Methodology

A qualitative research approach was employed in this study. A desktop study was conducted by consulting and analysing different journal articles, chapters in books and books relating to municipal budgets. Research was also conducted by analysing relevant provisions of the MFMA and other key legislations with provisions relevant to the budget process and the implementation of municipal budgets. There will also be an analysis of relevant provisions of the MFMA and other key legislation. National Treasury Reports were also analysed and provided insights on the challenges faced by municipalities in drawing up credible and funded budgets.

CHAPTER 2: LEGAL FRAMEWORK FOR FUNDING A MUNICIPALITY

2.1 Introduction

As described in Chapter 1, the municipal budget process is a process for planning, adopting, executing and monitoring the fiscal programme for government. The MFMA provides a budget preparation process to be followed by municipalities.[31] This is a process followed by municipalities in order to ensure that they have approved budgets by the start of the financial year, on 1 July every year.[32] The objective of this chapter is to provide an overview of the municipal budget formation process and to evaluate the set of rules governing municipal budgeting. The first part of the chapter provides an overview of the legislative framework for municipal budgets, discussing both the constitutional and statutory framework. The chapter then proceeds to provide an outline of the budget formation process laid out in section 21 of the MFMA. The municipal budget structure is discussed, distinguishing between an operational and capital budget. Thereafter, the sources of municipal revenue are evaluated. The chapter proceeds to discuss elements relating to the credibility and funding of local government budgets.

2.2 Legal Framework

This section of the chapter will review the constitutional framework and statutory framework providing for municipal finances.

2.2.1 Constitutional Framework

The Constitution requires that 'national, provincial and municipal budgets and budgetary processes must promote transparency, accountability and the effective management of the economy, debt, and the public sector'.[33] These principles must be given effect in national legislation. Section 215 of the Constitution requires that national legislation must prescribe (a) the form of municipal budgets, and (b) that the budgets 'must show the sources of revenue and

[31] MFMA, s 21.
[32] MFMA, s 16(1).
[33] Constitution, s 215(1)

the way in which proposed expenditure will comply with national legislation.'[34] This national legislation should further implement the following budgetary principles, making provision for:

> (a) estimates of revenue and expenditure, differentiating between capital and current expenditure;
> (b) proposals for financing any anticipated deficit for the period to which they apply; and
> (c) an indication of intentions regarding borrowing and other forms of public liability that will increase the public debt during the ensuing year.[35]

In terms of section 230A of the Constitution, municipal councils may raise loans for capital and current expenditure for the municipality. However, loans for operational expenditure 'may only be raised when it is necessary for bridging purposes during a fiscal year.' Municipalities may only raise loans for operational expenditure for bridging finances within the year when experiencing cash flow problems and not at the beginning of the year when compiling budgets. Therefore, borrowed funds may not be used to supplement operational budgets when the projected income is not equal to projected expenditure.

The MFMA is the national legislation enacted to give effect to these constitutional principles. Municipalities must adhere to the constitutional principles and the legislation by giving effect to them in their budgetary processes. Accordingly, the guaranteed autonomy of local governments in governing the affairs of their communities is subject to national and provincial legislation as provided for in the Constitution.[36]

2.2.2 Statutory Framework

As the principal statutory instrument, the MFMA aims to modernise municipal financial management in South Africa in order to lay a sound financial base for sustainable delivery of services in South Africa.[37] The MFMA applies to all municipalities, municipal entities, and national and provincial organs of state to the extent of their financial dealings with

[34] Constitution, s 215(2).
[35] Constitution, s 215(3).
[36] Constitution, s 151(1).
[37] MFMA, Preamble.

municipalities.[38] Other key statutes include the Local Government: Municipal Systems Act,[39] Local Government: Municipal Rates Act,[40] and the Annual Division of Revenue Act.[47]

2.3 Budget Formation Process

According to the Constitution, the approval of a municipal budget lies within the exclusive competence of the municipal council and is a function that cannot be delegated by the council.[41] Therefore, only the municipal council may approve a budget to be adopted by a municipality. The mayor of a municipality is responsible for 'co-ordinating the processes for preparing the annual budget and for reviewing the municipality's Integrated Development Plan and budget related policies to ensure that the tabled budget and any revision of the integrated development plan and budget-related policies are mutually consistent and credible'.[42]

The planning phase for the preparation of a budget must commence at least 10 months before the start of the budget year.[43] This phase commences with the tabling "in the municipal council of a time schedule outlining key deadlines for:

(i) the preparation, tabling and approval of the annual budget;
(ii) the annual review of-
(aa) the integrated development plan in terms of section 34 of the Municipal Systems Act; and
(bb) the budget-related policies;
(iii) the tabling and adoption of any amendments to the integrated development plan and the budget-related policies; and
(iv) any consultative processes forming part of the processes referred to in subparagraphs (i), (ii) and (iii)".[44]

The planning phase is followed by the preparation phase. The preparation phase involves the analysis of revenue and expenditure projections, revising budget related policies and considering local, provincial and national spending priorities.[45] When preparing the annual budget, the mayor of a municipality must:

(a) take into account the municipality's integrated development plan;

[38] MFMA, s 3(1).
[39] Local Government: Municipal Systems Act 32 of 2000.
[40] Local Government: Municipal Rates Act 6 of 2004.
[47] Constitution, s 214.
[41] Constitution, s 160(2).
[42] MFMA, s 21(1)(a).
[43] MFMA, s 21(1)(b).
[44] MFMA, s 21(1)(b).
[45] MFMA, s 21(2)(a), (b) & (c).

(b) take all reasonable steps to ensure that the municipality revises the integrated development plan in terms of section 34 of the Municipal Systems Act, taking into account realistic revenue and expenditure projections for future years; (c) take into account the national budget, the relevant provincial budget, the national government's fiscal and macro-economic policy, the annual Division of Revenue Act and any agreements reached in the Budget Forum.[46]

In addition, the mayor 'must consult (i) the relevant district municipality and all other local municipalities within the area of the district municipality, if the municipality is a local municipality[47]; (ii) all local municipalities within its area, if the municipality is a district municipality; (iii) the relevant provincial treasury and when requested, the National Treasury must also be consulted.'[48] The mayor must also consult any provincial or national organ of state, as may be prescribed.[49]

Thereafter, the mayor must table the proposed budget in council.[50] Immediately after an annual budget is tabled in a municipal council, 'the accounting officer of the municipality must in accordance with Chapter 4 of the Municipal Systems Act make public the annual budget and the documents referred to in section 17(3).'[51] The accounting officer must also 'invite the local community to submit representations in connection with the budget as part of the public participation process.'[52] The annual budget must be submitted in both printed and electronic formats to the National Treasury and the relevant provincial Treasury, and in either format to any prescribed national or provincial organs of state and to other municipalities affected by the budget.[53]

The municipal council 'must consider the views of the local community, National Treasury, the relevant Provincial Treasury and any national or provincial organ of state of state or municipalities which made submissions on the budget.'[54] After considering all budget submissions, the council must give the mayor an opportunity (a) to respond to the submissions;

[46] MFMA s 21(2)(a)-(c).
[47] MFMA, s 21(d).
[48] MFMA, s 21(d)(iii).
[49] MFMA, s 21(d)(iv).
[50] MFMA, s 21(3).
[51] MFMA, s 22(a)(i).
[52] MFMA, s 22(a)(ii).
[53] MFMA, s 22(b)(i)-(ii).
[54] MFMA, s 23(1).

and (b) if necessary, to revise the budget and table amendments for consideration by the council.[55] The annual budget 'must be approved by council before the start of the municipal financial year.' [56] The annual budget 'must be approved together with the adoption of resolutions as may be necessary-

(i) imposing any municipal tax for the budget year;
(ii) setting any municipal tariffs for the budget year;

(iii) approving measurable performance objectives for revenue from each source and for each vote in the budget;
(iv) approving any changes to the municipality's integrated development plan; and (v) approving any changes to the municipality's budget-related policies.'[57]

2.4 Municipal Budget Structure

Section 17 of the MFMA prescribes the format and content of the annual budgets. An 'annual budget of a municipality must be a schedule in the prescribed format—

(a) setting out realistically anticipated revenue for the budget year from each revenue source;
(b) appropriating expenditure for the budget year under the different votes of the municipality;
(c) setting out indicative revenue per revenue source and projected expenditure by vote for the two financial years following the budget year;
(d) setting out— (i) estimated revenue and expenditure by vote for the current year; and (ii) actual revenue and expenditure by vote for the financial year preceding the current year.[58]

An annual budget must be divided into a capital and an operating budget in accordance with international best practice, as may be prescribed by the National Treasury.'[59]

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[55] MFMA, s 23(2).
[56] MFMA, s 24(2)(a).
[57] MFMA, s 24(2)(c).
[65] MFMA, s 24(3)
[58] MFMA, s 17(1).
[59] MFMA, s 17(2).

2.5 Distinction between the Operating Budget and Capital Budget

The capital budget 'is an estimate of the capital expenditure which will be incurred over the relevant financial year, and the source of finance from which expenditure will be funded.'[60] A capital budget 'plans for the acquisition or rehabilitation of capital assets.'[61] It is thus used to record the financing sources and expenditures for the acquisition, rehabilitation or replacement of the capital assets of the municipality.[62] According to Mazibuko and Fourie a 'municipality may only spend funds on a capital project if the money has been appropriated in the capital budget.'[63] Furthermore, the capital project and total costs must have been approved by the council and there must be funds available, not committed for other purposes.[64]

The expenditure budget of a municipality sets out projected expenditure by vote and the municipality 'may incur expenditure only …within the limits of the amounts appropriated for the different votes in an approved budget.'[65] A municipality is bound to allocations in the budget in its expenditure decisions, expenditure incurred not in terms of the budget is regarded as unauthorised expenditure and there are consequences for such expenditure.[66] Operating expenditure relates to expenditure incurred in connection with the provision of services, or the provision of benefits which are immediately consumed, such as the salaries, allowances and remunerative benefits of employees, general expenses such as bulk electricity and water.[67]

2.6 Sources of Municipal Revenue

Chapter 13 of the Constitution provides a fiscal framework that enables municipalities to finance their expenditures through own revenue instruments, intergovernmental transfers and debt financing instruments. The fiscal framework for transfers provided for in the Constitution is given effect in the Division of Revenue process.[68]

[60] Mazibuko & Fourie (2013) 136.
[61] Mazibuko & Fourie (2013) 136.
[62] Mazibuko & Fourie (2013) 136.
[63] MFMA, s 19(1)(a).
[64] MFMA, s 19(1)(b).
[65] MFMA, s 15(b).
[66] MFMA, s 15.
[67] Mazibuko & Fourie (2013) 136.
[68] Constitution, s 214.

2.6.1 Revenue Generating Authority

The Constitution grants municipalities limited income generating powers, but subjects these powers to national legislation. Section 229 of the Constitution states that "municipalities may impose rates on property and surcharges on fees for services provided by or on behalf of the municipality."[69] The municipal council is responsible for the exercise of fiscal powers as the imposition of rates, levies and duties falls in its exclusive competence.[78] De Visser argues that the entrenchment of municipalities' revenue generating powers is crucial for the protection of local government's fiscal powers as provincial and national governments are prevented from removing these powers at will.[70] Additionally, municipalities may impose other taxes, levies and duties if authorised by national governments.[71] However, municipalities may not impose income tax, value- added tax, general sales tax or customs duty.[72] Supporting legislation empowers municipalities to identify new tax instruments as long as these do not contradict or fall into the restrictions placed on the sphere by the Constitution.[73]

2.6.2 Borrowing

In giving effect to section 230A of the Constitution, the MFMA governs the ability of local authorities to borrow funds. The Act restricts borrowing to capital expenditure and bridging finances for operating expenditures, which must be repaid by the end of the fiscal year.[74] This means that municipalities may only access loans for operating expenditures to bridge the gap until the municipality is able to access funds from its revenue sources. Therefore, municipalities may only borrow within a financial year for operating expenditures when experiencing cash flow problems. On the other hand, no restrictions are imposed on municipalities borrowing for capital budgets both in terms of the Constitution and the MFMA.[75]

[69] Constitution, s 229. [78]
Constitution, s 160.
[70] De Visser (2005) 135.
[71] Constitution s 229(1)(b).
[72] Constitution, s 229(1)(b).
[73] Municipal Fiscal Powers and Functions Act 12 of 2007.
[74] MFMA, s 18(1).
[75] MFMA, s 18(1)(c).

2.6.3 Intergovernmental Transfers

In practice, more than 70 per cent of local government budgets are derived from local government's own revenue, thereby making own revenue a substantial source of income for local governments.[76] However, the ability to raise own revenue differs considerably across municipalities. For instance, metros, large and small towns in urban areas rely more on own revenue, as they are able to raise substantial amounts from service charges.[77] On the other hand, municipalities that do not have big revenue bases from which to generate own revenue experience budget gaps. This leads to disparities across local government regarding own sources of revenue, and therefore budget gaps. District and rural municipalities rely mostly on government transfers due to limited revenue bases, unemployment and other factors.[78] The Division of Revenue process also recognises the limited taxation powers assigned to provincial and local governments in comparison to national government's substantial revenue raising powers.[79] The horizontal and vertical fiscal gaps necessitate fiscal transfers.[80] Transfers take the form of equitable shares and conditional grants. The discussion below draws a distinction between the two.

2.6.3.1 Equitable Share

Section 214(1) of the Constitution requires that every year a Division of Revenue Act (DORA) determine the equitable division of nationally raised revenue among the national, provincial and local sphere of government. The annual DORA must provide 'for the determination of each province's equitable share of the provincial share of that revenue.'[81] It must further provide for any other allocations to provinces, local government or municipalities from the national government's share of that revenue, and any conditions on which these allocations are made.[82]The Intergovernmental Fiscal Relations Act prescribes the process for determining the equitable sharing and allocation of revenue raised nationally.[83] Sections 9 and 10(4) of the Act set out the consultation process to be followed with the Financial and Fiscal Commission

[76] De Visser (2005) 135.
[77] Monkam & Mabugu (2013) 7.
[78] Monkam & Mabugu (2013) 7.
[79] Khumalo, Dawood & Mahabir (2015) 211.
[80] Monkam & Mabugu (2013) 7.
[81] Constitution, s 214(1)(b).
[82] Constitution, s 214(1)(c).
[83] Constitution, s 214(1).

(FFC), including considering recommendations made regarding the equitable division of nationally raised revenue.

In terms of section 227(1) of the Constitution, local government is entitled to an equitable share of revenue raised nationally to enable it to provide services and perform functions allocated to it. As the equitable share is an entitlement and not a largesse, additional revenue raised by municipalities may not be deducted from their share of revenue raised nationally.[84] The equitable share that accrues to a municipality is not regarded as 'own revenue' and it is spent primarily on operating expenditures.[85] Other spheres cannot prescribe how these funds should be spent, however, municipalities are accountable to communities for how these funds are spent in the provision of services.[86]

The vertical division of revenue refers to the allocation of the equitable share to the different levels government. The size of local government's equitable share is decided through the national budget process. Thereafter, local government's share is divided among the country's 278 municipalities in a process of 'horizontal division'. The equitable share allocation is distributed horizontally through the Local Government Equitable Share (LGES) Formula provided below.

$$LGES = BS + (I + CS) RA \pm C$$

In the Formula

- LGES is the local government equitable share;
- BS is the basic service component;
- I is the institutional component;
- CS is the community service component;
- RA is the revenue adjustment factor; and
- C is the correction and stabiliser factor.[87]

[84] Steytler and De Visser (2014) 5-6.
[85] Khumalo, Dawood, & Mahabir (2015) 214.
[86] Khumalo, Dawood, & Mahabir (2015) 214.
[87] Khumalo, Dawood & Mahabir (2015) 214.

A revenue adjustment factor is applied to the institutional and community services components of the formula to ensure that these funds assist municipalities that are least likely to be able to fund these functions from their own revenues.[88]

2.6.3.2 Conditional Allocations

Section 227(1)(b) of the Constitution provides that local government may receive other allocations from national and provincial government revenue, either conditionally or unconditionally.[98] Conditional allocations are used by national government to incorporate national priorities in municipal budgets.[89] These include promoting national norms and standards, addressing service delivery backlogs and regional disparities in municipal infrastructure.[90] Municipalities receiving conditional grants must comply with any conditions attached to them, therefore limiting their fiscal autonomy.[91] Conditional grants in local government mainly focus on infrastructural expenditure and capacity building.[92]

2.7 Features of the Budget

This section of the chapter analyses the different elements of municipal budgets. The section includes brief discussions of each of the elements of the budget and the consequences for municipalities that fail to adhere to the rules contained in each of the elements of the budget.

2.7.1 Balanced Budget

A municipal budget must be balanced. In other words, both sides of the budget must be equal. The projected expenditure must be the same as the projected funds to be received by the municipality. For capital budgets, the total budgeted capital funding by source must equal the budgeted capital expenditure.[93] The sources of funding the capital budget include borrowed

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[88] 'Local Government Equitable Share Formula Review' available at https://ffc.co.za/docman-menuitem/reports/613-lges-discussion-paper-2-analysis-of-the-current-formula-2 (accessed 05 October 2019) [98] Constitution, s 227.
[89] Steytler & De Visser (2014) 5-10.
[90] Steytler & De Visser (2014) 5-10.
[91] Khumalo, Dawood, Mahabir (2015) 215.
[92] Monkam & Mabugu (2013) 5.
[93] Municipal Finance Management Act 56 of 2003: Municipal Budget and Reporting Regulations GN 393, GG 32141, 17 April 2009.

funds, meaning that municipalities may supplement their capital budgets with borrowed funds if there is a deficit.[94] For operational budgets, as discussed in paragraph 2.6.2, section 230A of the Constitution imposes the fiscal rule that municipal operational budgets must be balanced. Municipalities may only raise loans for operational expenditure for bridging finances within the year when experiencing cash flow problems and not at the beginning of the year when compiling budgets. Therefore, borrowed funds may not be used to supplement operational budgets when the projected income is not equal to projected expenditure. The budget must be balanced from the other sources of funding available.

2.7.2 Credible Budget

With balanced budgeting, the focus is on whether the two sides of the budget are equal. On the other hand, credibility focusses on whether the projected income by source and projected expenditure are reliable. Section 18(1) of the MFMA identifies three funding sources for an annual budget. An annual budget 'may only be funded from realistically anticipated revenues to be collected, cash-backed accumulated funds from previous years' not committed for other purposes and borrowed funds for the capital expenditure.'[95] The annual budgets are required to set out realistically anticipated revenue for the budget year from each revenue source and to appropriate expenditure for the year under the different votes of the municipality.[96] Furthermore, the budget must be consistent with past and current collection trends of actual funding collected and received.[97] For the budget to show credibility, it must contain a comparison between the current and preceding year's budget.[98] This comparison allows for the assessment of the municipality's "past behaviour" in terms of collection of own revenue, spending of conditional grants and whether roll-overs budgeted for have been approved in the past. Thus, a credible budget is a budget that contains revenue and expenditure projections that are consistent with current and past performance.[99] Paramount to credible budgeting is the careful estimation of realistic revenues to be collected, required by section 18(1) and (2) of the

[94] Constitution, s 230A.
[95] MFMA, s 18(1).
[96] MFMA, s 17(1).
[97] Regulation 10(1) Budget and Reporting Regulations (2009).
[98] Steytler and De Visser (2014) 11-19.
[99] MFMA Circular 42 (2007) 2.

MFMA. Overall, the determination of whether a budget is funded requires a thorough analysis of the different aspects of a budget at the same time.

2.8 Valid Budget

For a budget to be regarded as having been approved in the context of the MFMA, it must meet certain substantive requirements.[100] The MFMA sets both substantive and procedural requirements. Non-compliance with procedural requirements does not affect the validity of a budget.[101] However, a budget that does not comply with the substantive requirements which are mandatory is not a valid budget for purposes of the MFMA.[102] As discussed above, Section 18 of the MFMA stipulates that a budget "must be funded from realistically anticipated revenues to be collected" and from "cash backed accumulated funds from previous' years surplus not committed for other purposed and borrowed funds". The wording of section 18 of the MFMA indicates that municipalities do not have discretion to deviate from funding a budget with the identified sources. Therefore, an unfunded budget does not constitute a valid budget for purposes of the MFMA and section 139(4) of the Constitution.

2.9 Conclusion

This chapter concludes that there is a legal framework in existence that guides municipalities in preparing funded budgets. This legal framework is located in Chapter 4 of the MFMA. The chapter demonstrated that municipal budgets are not only required to be funded but must also contain credible revenue and expenditure assumptions. Furthermore, municipalities must comply with the constitutional requirement for balanced budgets. All these elements serve to ensure that municipalities can meet their expenditure needs in order to be able to fulfil their mandate.

[100] MFMA, s 17.
[101] MFMA, s 21-24.
[102] Steytler & De Visser (2014) 15-40.

CHAPTER 3: MANIFESTATIONS AND CAUSES OF UNFUNDED BUDGETS

3.1 Introduction

As highlighted in chapter one, over 40 per cent of municipalities adopted unfunded budgets in 2018.[103] This was a significant increase in comparison to previous years, as the number of municipalities that had adopted unfunded budgets grew from 83 in the 2017/18 financial year to 112 municipalities in the 2018/19 financial year.[104] Chapter two established that municipal budgets are required to be funded and laid out the existing framework. This chapter analyses why the existing framework has failed. The objective of this chapter is to investigate the underlying causes of municipalities adopting unfunded budgets. It will further analyse the consequences of the adoption of such budgets for municipalities. The first part of this chapter will discuss the manifestations of unfunded budgets, including the consequences of the adoption of such budgets for communities. The next section identifies and discusses the main causes of unfunded budgets.

3.2 Manifestations

The discussion below focusses on the consequences of unfunded budgets and demonstrates how municipalities that adopt unfunded budgets fail to stick to approved allocations in their budgets. The section discusses in detail the practice of overspending and underspending of budgets by municipalities. The discussion further demonstrates how municipalities that fail to adopt funded budgets incur mounting debt as a result of a failure to pay creditors.

3.2.1 Overspending on Operational Budgets

Operational expenditure relates to expenditure incurred in connection with the provision of services.[114] Municipalities are bound to allocations made in their budgets when making these

[103] '112/257 municipalities have unfunded budgets 0- Nhlanhla Nene' available at www.politicsweb.co.za/.../112257-municipalities-have-unfunded-budgets--nhlan (accessed 17 November 2018).
[114] Mazibuko G & Fourie D 'Municipal Finance: Relevance of clean audit outcomes' (2013) *Administratio Publica* 134.
[104] 'Serious concerns over municipalities passing unfunded budgets' available at https://www.iol.co.za/business-report/economy/serious-concerns-over-municipalities-passing-unfunded-budgets-18159119 (accessed on 10 March 2020)

expenditure decisions.[105] The binding nature of the budget entails that expenditure not incurred in terms of the budget is referred to as unauthorised expenditure.[106] The MFMA defines unauthorised expenditure as any expenditure incurred by the municipality not in accordance with the budget and the votes within a budget.[117] This includes overspending on the total amount of the budget, overspending on a vote, expenditure unrelated to a vote, and expenditure for a purpose other than an approved purpose.[107]

The adoption of budgets that are not credible by municipalities results in municipalities incurring unauthorised expenditure. This occurs because the estimated expenditure is below what it would realistically cost. When a municipality's budget is not credible as explained above,[108] the municipality will not be able to stick to the approved expenditure allocations, this often results in overspending on the operating budget. The Auditor General reported that unauthorised expenditure of R12 603 million was incurred at 161 municipalities for the 2016/17 financial year.[109] Of this amount, R12 540 million, which is 99 percent of the total unauthorised expenditure, was classified as overspending.[110] Meaning that municipalities understated their expenses by R12 540 million. When budgeted expenditure is underestimated, anticipated revenue may not be sufficient to fund the planned level of service delivery.[122] In addition to this, overspending on operational expenditure by municipalities may have other unintended consequences such as the diversion of conditional grants for purposes of funding operational expenses.[111]

3.2.2 Underspending of the Budget

Conversely, the adoption of overambitious expenditure budgets by municipalities results in underspending of the budgets. The result is that municipalities cannot perform their functions and deliver services, as the cash for implementation is not available. This mainly occurs when

[105] MFMA, s 15.
[106] Steytler & De Visser (2014) 11-6.
[117] MFMA, s 1.
[107] MFMA, s 1.
[108] Chapter 2 para 2.7.2.
[109] Auditor-General's Report (2018) 17.
[110] Auditor-General's Report (2018) 17.
[122] MFMA Circular 42 (2007) 5.
[111] "Mkhize: 87 municipalities 'dysfunctional', require urgent intervention" available at https://www.news24.com/SouthAfrica/News/mkhize-87-municipalities-dysfunctional-require-urgentintervention-20180515 (accessed 05 November 2018).

municipalities budget for a specific amount in anticipation of revenue to be collected by the municipality but perform poorly in collecting revenue. Resulting in a shortfall in cash for implementation.

3.2.3 Municipal Debt

There are two sides to debt concerning municipalities: first, municipal consumer debt owed by consumers of municipal services to the municipalities and, secondly, municipal debt owed by the municipality itself to its own service providers. According to the MFMA, when a municipality owes money for goods and services purchased, the municipality must settle such outstanding amounts within 30 days of the date of the invoice or statement, unless it is prescribed otherwise.[112] The payment of creditors or accounts payable must be reconciled monthly, according to the statements received from the service providers.[113] The adoption of unfunded budgets manifests itself through the inability of municipalities to pay their service providers (also referred to as creditors), timeously. The biggest creditors owed by municipalities are Eskom and the Water Boards for the bulk supply of electricity and water.[114] Debt owed by municipalities to Eskom grew from R9.5 billion in 2017 to R17 billion at the end of 2018.[115] By November 2018, the water boards were owed R13.1 billion by municipalities.[116]

National Treasury has also noted that the tabling of unfunded budgets is a fundamental problem whereby municipalities commit to spending more than they can generate revenue.[117] The link between the adoption of unfunded budgets and huge municipal debts is demonstrated by five of the top ten defaulting municipalities that had adopted unfunded budgets.[118] By May 2018, the municipality of Ngwathe in the Free State owed Eskom R936-million.[131] This municipality

[112] MFMA, s 65(1)(e).
[113] MFMA, s 65(1)(e).
[114] Auditor-General's Report (2018) 20.
[115] 'Municipal debt to Eskom reaches R17 billion' available at https://www.enca.com/news/municipal-debteskom-reaches-r17-billion (accessed 02 January 2019).
[116] Auditor-General's Report (2018) 20.
[117] 'Outstanding Eskom debt by municipalities: COGTA, SALGA, National Treasury & Eskom briefing Cooperative Governance and Traditional Affairs 10 October 2017' available at https://pmg.org.za/tabledcommittee-report/3205/ (accessed 30 October 2018).
[118] Omarjee L 'The top ten municipal culprits not paying Eskom debt' Mail & Guardian 17 May 2018 available at https://mg.co.za/.../2018-05-17-00-the-top-ten-municipal-culprits-not-paying-eskom (accessed 01 December 2018). [131] Omarjee L 'The top ten municipal culprits not paying Eskom debt' Mail & Guardian 17 May 2018 available at https://mg.co.za/.../2018-05-17-00-the-top-ten-municipal-culprits-not-paying-eskom (accessed 01 December 2018).

has not adopted a funded budget in the past five years. Likewise, the municipality of Lekwa in Mpumalanga has only been able to adopt one funded budget in the past five years, which only became "funded" after the tabling stage.[119] The fact that all ten municipalities failed to table funded budgets reflects severe weaknesses in their capabilities to appropriately manage their expenditure and compile their budget properly.

Furthermore, the failure to pay creditors by municipalities has negative consequences for community residents and businesses that cannot operate effectively without electricity. For instance, in the beginning of 2018 Eskom decided to roll out power cuts to municipalities that failed to honour their payment agreements.[120][121] The scheduled power cuts for defaulting municipalities have a negative impact on the daily lives of residents and the efficient running of businesses, and thereby negatively impacting the country's economy. Protracted non-payment also undermines the financial sustainability of state-owned entities such as Eskom.[134] This is supported by a statement in a report by the Inter-Ministerial Task Team set up in 2017 to resolve the debt crisis in local government. The task team warns that non-payment by municipalities poses a serious going concern threat for water boards.[122] Two water boards have already been disestablished because of non-payment by municipalities.[123]

3.3 Causes of Unfunded Budgets

The adoption of unfunded budgets by a municipality is a consequence of several situations including lack of credible budgeting by municipalities. Municipalities are also faced with human resource challenges that lead to financial losses and mismanagement for municipalities. The section below provides an analysis of each of the factors mentioned above.

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119 See National Treasury's Master table of tabled and adopted unfunded budgets.
120 Lepodise O 'Eskom Debt: Power cuts scheduled for municipalities that don't pay' Daily Maveric 26 February 2018 available at https://www.dailymaverick.co.za/.../2018-02-26-eskom-debt-power-cuts-scheduled-fo.. (accessed 23 October 2018).
121 Budget Review Division of Revenue and Spending by Provinces (2018) 77.
122 'Municipalities owe water boards, water and sanitation debt R13.1BN'available at *https://ewn.co.za/.../municipalities-owe-water-boards-water-and-sanitation-dept-r13* (accessed 20 December 2018).
123 'Municipalities owe water boards, water and sanitation debt R13.1BN'available at *https://ewn.co.za/.../municipalities-owe-water-boards-water-and-sanitation-dept-r13* (accessed 20 December 2018).

3.3.1 Lack of Credible Budgeting

Municipalities are failing to create credible budgets that contain revenue and expenditure projections that are consistent with current and past performance. For a municipal budget to show credibility, it must contain a comparison between the current and preceding year's budget. This has not been the case in practice as municipalities have a tendency of overestimating revenue projections without taking into consideration past collection performance. For example, municipalities with a track record of low collection rates adopt budgets with high revenue projections for collection. These kinds of budgets are near impossible to implement unless there are drastic policy and implementation changes taken by the municipality for billing services. A less severe example of this would be Amahlathi local municipality which had budgeted for a collection rate of 98 percent but only managed to collect 80 percent of the anticipated revenue.[124]

Another reason for the adoption of budgets that are not credible is a lack of political will. Councils tend to prepare over-optimistic budgets in order to get community support during the public participation process.[125] Examples of overly optimistic revenue forecasts include excessive increases in property rates and service charges and donor grants with no guarantee of being received by a municipality.[126] This renders it difficult for municipalities to realise their revenue projections and directly impacts negatively on the ability of municipalities to pay their debtors as and when they fall due.

Another challenge relating to credibility is that revenue assumptions prepared by municipalities are often not supported by documented evidence that guarantees that funding will be secured. An example is how municipalities include unspent conditional grants they expect to be rolled over for the next financial year, however roll-over funds are not guaranteed and this places municipalities in vulnerable financial positions.[127] This practice disregards MFMA requirements for funding sources accumulated from previous years to be cash-backed. Municipalities also budget with funds committed for other purposes so that they reflect a

[124] 'Report of the Select Committee on Cooperative Governance and Traditional Affairs, Water and Sanitation and Human Settlements Inspection in Loco on Notice of Intervention issued in terms of section 139(1)(b) and (5) of the Constitution (1996), in Amahlathi Local Municipality, dated 20 August 2019'available at https://pmg.org.za/tabled-committee-report/3907/ (12 March 2020).
[125] National Treasury Report (2017)15.
[126] MFMA Circular 42 (2007) 4.
[127] National Treasury Report (2017) 17.

'surplus' at the end of the financial year.[128] Some municipalities do not consider debt owed to creditors when compiling their budgets, resulting in these debts being carried forward to the next financial year with no funding allocated for the payment of those debts.[129] Municipalities such as Naledi and Ratlou local municipalities have had unfunded budgets for consecutive years and have carried over debt to service providers such as Eskom over those years without making any payment.[130] Ratlou local municipality had an outstanding debt of R29 million to Eskom by 2019.

3.3.2 Poor Performance on Revenue Management

Municipalities fail to meet their revenue projections due to under-collection of billed revenues.[131] Municipalities have poor collection systems, with billing systems and debtor registers that are not credible.[132] The credibility of creditors and debtors information submitted in terms of section 71 of the MFMA has been found to not be reliable, resulting in failures to collect revenue owed to the municipality by consumers.[133] Poor collection performances may also be attributed to the lack the political will from municipalities to collect revenues from residents, as they do not want to alienate voters.[134] Naledi Local Municipality has passed unfunded budgets for consecutive three years due to a failure to implement credit controls to recover outstanding debts from customers amongst other challenges.[135] Another example is Lekwa municipality which had adopted an unfunded budget for the 2018/19 financial year and had a total outstanding debt of R651 million owed to the municipality at February 2019. Household debt constituted most of the debt at R589 million, followed by debt owed by business and government. This means that a substantial amount of money which had been billed

128 MFMA Circular 42 (2007) 5.
129 MFMA Circular 42 (2007) 5.
130 'Report of the Select Committee on Co-operative Governance and Traditional Affairs, Water, Sanitation and Human Settlements Inspection in Loco on Notice of Intervention, issued in terms of section 139(1)(b) of the Constitution, 1996 in Ratlou Local Municipality, dated 29 October 2019' available at https://pmg.org.za/tabled-committee-report/3982/ (accessed 12 March 2020).
131 National Treasury Report (2017) 17.
132 National Treasury Report (2017) 17.
133 National Treasury Report (2017) 17.
134 Buks Viljoen 'Mpumalanga municipalities forced to write off R6.4bn of its R8.4bn debt' available at *https://www.fin24.com/Economy/South-Africa/mpumalanga-municipalities-forced-to-write-offr64bn-of-its-r84bn-debt-20190208* (accessed 13 June 2019).
135 'Report of the Select Committee on Cooperative Governance and Traditional Affairs, Water, Sanitation and Human Settlements Inspection in Loco on Notice of Intervention, issued in terms of section 139(1)(b) of the Constitution, 1996 in Naledi Local Municipality, dated 29 October 2019' available at https://pmg.org.za/tabled-committee-report/3981/ (accessed 10 March 2020).

had not been collected which raises serious concerns about the credit controls in the municipality.[136]

3.3.3 High Operating Expenditures

To ensure a budget is appropriately funded, there is a requirement for expenditure estimations to be realistic.[137] If budgeted expenditure is underestimated, the budgeted revenue may not be sufficient to fund the planned level of service delivery. Consequently, a municipality will be faced with an unfunded budget as the actual operating expenditures will be much higher than anticipated.[138] According to the South African Municipal Workers Association (SAMWU), there are currently 30 municipalities unable to pay workers' salaries.[139] Factors that contribute to high operating expenditures in municipalities include bloated organisational structures and appointments to positions that do not exist in the approved organisational structures.[140] This puts municipalities in a position where they have to divert funds committed for other purposes in order to pay staff salaries to the people occupying positions that do not exist in the approved organisational structures.

3.3.4 Deficiencies in Administrative Capacity

The problems listed above often result from a lack of knowledge and skills pertaining to compiling credible budgets. One of the main capacity challenges in local government relates to a lack of skills and appropriate qualifications in the administrative personnel of municipalities.

Municipal councils must appoint a municipal manager to serve as the head of administration and the accounting officer. The municipal manager plays a critical role in the budget preparation and implementation process, thus it is imperative that the person appointed in this position must have the relevant skills and expertise required to perform the duties associated

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137 MFMA Circular 42(2007) 5.

138 MFMA Circular 42 *(*2007) 5.

139 The Sowetan 'Municipalities in dire financial state, can't pay workers' available at https://www.sowetanlive.co.za/news/south-africa/2019-06-27-municipalities-in-dire-financial-state-cant-payworkers/ (accessed 15 October 2019).

140 National Treasury Report (2011) 113.

with this post as prescribed by legislation.[141] As the accounting officer of a municipality, the municipal manager must assist the mayor in performing budgetary functions assigned to the mayor, including ensuring that the budget is funded according to the requirements set out in the MFMA.[142] Furthermore, the municipal manager is responsible for revenue and expenditure management, including taking all reasonable steps to ensure that municipal debtors are paid timeously. As the accounting officer of a municipality, the municipal manager is also responsible for 'implementing the municipality's approved budget', including taking all reasonable steps to ensure that the spending of funds is in accordance with the budget.[143] Furthermore, the municipal manager must take all reasonable steps to ensure that spending of funds is reduced as necessary when revenue is anticipated to be less than projected in the annual budget.[144] The accounting officer performs these duties with the assistance of the Chief Financial Officer (CFO).

The MFMA requires every municipality to have a Budget and Treasury Office consisting of a CFO and other persons contracted by the municipality for the work of that office.[145] The CFO is administratively in charge of the Budget and Treasury Office and has to advise the accounting officer on the exercise of powers and duties assigned to the accounting officer in terms of financial matters.[146] Thus, it is important that a CFO of a municipality has the appropriate skills and qualifications required for the position as they hold a crucial position as an expert and adviser on financial matters in the municipality.[147] At the end of the 2016/17 financial year, 28 per cent of the CFO positions were vacant while municipal manager positions were vacant at 27 per cent of municipalities. This is an indication of the challenges the local government sphere faces with filling vacancies. Open vacancies in the Budget and Treasury Office was a common challenge faced by the municipalities that had adopted unfunded budgets in the 2018/19 financial year. For example, Makhado local Municipality had a number of open vacancies in its Budget and Treasury Office while Mogalekwana Municipality had operated for years without Section 57 managers.[148]

[141] Thornhill (2008) 504.
[142] MFMA, s 68.
[143] MFMA, s 69(1)(a).
[144] MFMA, s69(1)(a).
[145] MFMA, s 80.
[146] MFMA, s 81.
[147] Thornhill C (2008) 504.
[148] 'Report of the Select Committee on Co-operative Governance and Traditional Affairs, Water, Sanitation and Human Settlements on Proactive Oversight Visit to Makhado Local Municipality in Monitoring and Assessing

The growing utilization of consultants in local government is an indication of incapacity. Municipalities are increasingly utilising the services of consultants to prepare financial statements even when there are people in the employ of the municipality designated for such a role.[149] Municipalities brought in consultants in 2017/18 at a cost of R757 million to prepare financial statements and underlying records.[150] First, this is expenditure that was most likely not budgeted for in the annual budget. Secondly, it is not value for money for municipalities as the financial statements submitted for auditing also have material misstatements in the areas in which consultants did work. For example, Makhado local municipality has been relying on consultants to compile financial statements, however there were still material misstatements identified on the financial statements.[151] Furthermore, there is no skills transfer to workers in the employ of the municipality when services of consultants are utilised.[159]

The lack of competence in municipal officials may be attributed partially to the practice of cadre deployment.[152] Through this practice, municipalities employ candidates based on political affiliation. This practice has been exacerbated by the involvement of municipal councils in the appointment of section 56 managers.[153] These managers serve a crucial role as they are directly accountable to the municipal manager. In most cases, such candidates do not possess the required skills and qualifications associated with the duties to be performed in the post.[162]The MFMA mandates the National Treasury 'to make regulations or issue guidelines that prescribe financial management competency levels for senior management among others.'[154] The regulations envisaged in the MFMA were promulgated in 2007.[155] The competency regulations provide for general and minimum competencies required of senior and middle managers.'[156] These competencies relate to higher education qualifications, work

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the Implementation of 2017/18 Post Audit Action Plan, dated 26 November 2019' available at https://pmg.org.za/tabled-committee-report/4027/ (accessed 12 March 2020).

[149] Auditor-General's Report (2018) 17.

[150] Auditor-General's Report (2018) 16.

[159] Auditor-General's Report (2018) 16.

[151] 'Report of the Select Committee on Co-operative Governance and Traditional Affairs, Water, Sanitation and Human Settlements on Proactive Oversight Visit to Makhado Local Municipality in Monitoring and Assessing the Implementation of 2017/18 Post Audit Action Plan, dated 26 November 2019' available at https://pmg.org.za/tabled-committee-report/4027/ (accessed 12 March 2020).

[152] Muller K & Ndevu Z 'A Conceptual Framework for Improving Service Delivery at Local Government in South Africa' (2017) 7*African Journal of Public Affairs* 18.

[153] Ntliziwana P *The transformation of local government service delivery in South Africa: the failures and limits of legislating new public management* (Unpublished LLD thesis, University of the Western Cape, 2017) 232. [162] Muller & Ndevu (2017) 18.

[154] MFMA s 168.

[155] Competency Regulations.

[156] Competency Regs 2-12.

related experience, and core managerial and occupational competencies.[157] However, the staggered implementation of these regulations has deemed them ineffective. The competency regulations took effect on 1 July 2007 but gave a five-year grace period within which all senior managers throughout the country were required to attain the minimum competency levels.[167] The grace period started on 1 January 2008 and was supposed to end 31 December 2012.[158] However, the National Treasury later extended this deadline three times.[169] The Competency Regulations took effect in 2007, yet in 2018 there were less than 50 per cent municipal accounting officers and CFO's with required competency levels for the performance of their functions.[159]

3.3.5 Unfunded Mandates

The issue of unfunded mandates arises when municipalities are compelled to perform functions not allocated to them in terms of the Constitution and legislation.[160] These functions have financial implications but come without the necessary funding for implementation. This results in municipalities diverting funds allocated for other purposes to funding unfunded mandates. As a result, municipalities perform unfunded mandates that are not allocated as votes in their budgets, and thus incur unauthorised expenditure. A report compiled by the Financial and Fiscal Commission, reported on the financial implications of unfunded mandates on the 6 metropolitan municipalities. The study reflected that municipalities spent an additional amount of more than R4 billion on unfunded mandates in 2009/10.[161]

[157] Competency Regs 3, 5, 7, 9 & 12.
[167] Ntliziwana (2019) 344.
[158] Ntliziwana (2019) 344.
[169] Ntliziwana (2019) 344.
[159] 'Less than 50% of municipal accounting officers and CFOs have required competency levels' available at https://www.businesslive.co.za/.../national/2018-09-18-less-than-50-of-municipal-acco... (accessed 02 December 2018).
[160] Financial & Fiscal Commission 'Chapter 15: the impact of unfunded mandates in South African Intergovernmental Relations' available at *http://www.ffc.co.za/docman-menuitem/commission-submissions/266-chapter-15-the-impact-of-unfunded-mandates-in-southafrican-intergovernmental-relations* (accessed on 19 December 2018).
[161] Financial & Fiscal Commission 'Chapter 15: the impact of unfunded mandates in South African Intergovernmental Relations' available at *http://www.ffc.co.za/docman-menuitem/commission-submissions/266-chapter-15-the-impact-of-unfunded-mandates-in-southafrican-intergovernmental-relations* (accessed on 19 December 2018).

3.4 Conclusion

As discussed above, municipalities are still grappling with weaknesses in financial management and a significant number of municipalities continue to adopt budgets that are not funded. The adoption of unfunded budgets not only affects municipalities but also communities, businesses and state-owned entities that offer services to municipalities are also impacted negatively. This chapter concludes that the causes of unfunded budgets are complex and interrelated with other challenges facing the local sphere of government. Most notably, the weaknesses in municipal capacity result in a combination of challenges. Municipalities fail to prepare credible budgets due to a lack of expertise and knowledge in financial management.

CHAPTER 4: SUPERVISION AND DETECTION OF UNFUNDED BUDGETS IN LOCAL GOVERNMENT

4.1 Introduction

The Constitution of the Republic of South Africa requires national and provincial government to supervise local government. Section 155(6) requires each provincial government to provide for the monitoring of local government in their province and section 155(7) instructs the national and provincial governments to oversee the effective performance by municipalities of their duties. This chapter aims to analyse the supervision of local governments by national and provincial governments. The objective of this chapter is to determine the sphere of government responsible for the supervision of the formation and implementation budgets by municipalities. Most importantly, the chapter provides a recommendation for the appropriate intervention that ought to be implemented in resolving/ preventing the adoption of unfunded budgets.

The first section identifies national and provincial treasuries as the key role players in the supervision of local government finances and discusses the obligations to be carried out by the supervisors. The chapter proceeds to discuss the role of national and provincial treasuries in a narrow context, by looking at the supervision of the local government budget preparation process and implementation. The support and monitoring required from national and provincial governments is discussed and placed in the context of what support is required by municipalities in the process of preparing and executing their budgets. Thereafter, the legal framework provided in section 139 of the Constitution is discussed. Lastly, the study outlines section 139(4) as a remedy to address the adoption of unfunded budgets by municipalities and discusses the possible consequences of the failure to implement this proposal.

4.2 Supervision

Supervision includes four distinct but interrelated activities, namely: regulation, monitoring, support and intervention.[162] The focus of this discussion will be on selected elements of supervision, namely, monitoring, support and intervention. Provincial governments must provide for the monitoring and support of local governments established in their respective

[162] Steytler & De Visser (2014) 15-5.

provinces.[163] Furthermore, provinces, together with national government have the executive and legislative authority to see to the effective performance by municipalities of their functions.[164]

4.2.1 Key Role Players in the Supervision of Local Governments

The MFMA distinguishes between monitoring, support and intervention relating to general matters, and those pertaining to financial management.[176] Provinces play a dominant role in the supervision of general matters, while national and provincial treasuries play a central role in the supervision of financial management matters.[165] Steytler argues that the basis of the MFMA and the allocation of specific responsibilities to the Provincial Treasuries and National Treasury is that these institutions are better equipped to handle financial matters.[166]

4.2.1.1 National Treasury

The Constitution requires national legislation to establish a national treasury, to introduce uniform treasury norms and standards, to prescribe measures to ensure transparency and expenditure control in all spheres of government.[179] The Public Finance Management Act No.1 of 1999 (hereafter PFMA) was enacted to give effect to section 216(1) of the Constitution, amongst other provisions, and established a national treasury.[167] Section 216(2) goes further and provides that 'the National Treasury must enforce compliance with the measures established in terms of subsection (1).' Accordingly, Steytler and De Visser argue that the wording of section 216(2) indicates that the National Treasury's role is to formulate and enforce the measures established in terms of section 216(1) of the Constitution.[181]

National Treasury is also empowered by section 216(2) to intervene in municipalities by stopping the transfer of funds to any organ of state that commits a serious or persistent breach of the measures prescribed to promote transparency, accountability and the effective

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[163] Constitution s 155(6)(a).
[164] Constitution s 155(7)
[176] MFMA.
[165] Steytler & De Visser (2014) 15-5.
[166] Steytler N 'A new role for Provincial Treasuries' (2004) 6 *Local Government Bulletin* 2.
[179] Constitution s 216(1).
[167] The Act promotes the objective of good financial management in order to maximise service delivery through the effective and efficient use of the limited resources, section 5 [181] Steytler & De Visser (2014) 15-5.

management of the economy, debt, and the public sector. This constitutional obligation is further provided for in section 38 of the MFMA and section 18 of the Division of Revenue of 2012. The power to stop transfers to municipalities accorded to the National Treasury must be read in conjunction with the amended provisions of section 139 of the Constitution, which allows interventions in the case of financial problems or financial crisis.[168]

The National Treasury is also central to the supervisory scheme of the MFMA.[169] In terms of section 5 of this Act, national treasury must fulfil its responsibilities in terms of Chapter 13 of the Constitution, and the MFMA and must enforce compliance with the measures established in terms of section 216(1) of the Constitution. In fulfilling this obligation, the National Treasury may monitor the budgets of municipalities to establish that they 'are consistent with the national government's fiscal and macro-economic policy and comply with budget preparation requirements of the MFMA.'[170] National Treasury may also promote good budget and fiscal management by municipalities by monitoring the implementation of municipal budgets, including their expenditure, revenue collection and borrowing.[171] The MFMA also confers general enforcement mechanisms on the National Treasury by providing that it may take 'appropriate steps' if a municipality commits a breach of the Act.[172] Overall, the MFMA empowers the National Treasury to 'take any other appropriate steps necessary to perform its functions effectively'.[173]

4.2.1.2 Provincial Treasuries

The PFMA establishes a Provincial Treasury for each province.[174] Every Provincial Treasury must fulfil its responsibilities in terms of the MFMA, including assisting the National Treasury in enforcing compliance with measures established in terms of section 216(1) of the Constitution and those established in terms of the MFMA.[189] In executing this mandate, a Provincial treasury must monitor:

(i) compliance with this Act by municipalities and municipal entities in the province;

[168] Steytler & De Visser (2014) 15-7.
[169] Steytler & De Visser (2014) 15-7.
[170] MFMA, s 5(2)(i)-(ii).
[171] MFMA, s 5(2)(b).
[172] MFMA, s 5(2)(e).
[173] MFMA, s 5(2)(f).
[174] Public Finance Management Act 1 of 1999 s 17.
[189] MFMA s 5(3)(c).

(ii) the preparation by municipalities in the province of their budgets;

(iii) the monthly outcome of those budgets; and

(iv) the submission of reports by municipalities in the province as required in terms of this Act;[175]

It is clear that the MFMA envisions provincial treasuries playing a crucial role in the supervision of municipalities.

4.2.2 Supervision of the Local Government Budget Preparation Process and Implementation

In order to give effect to its supervisory role, the National Treasury may monitor and assess compliance with the MFMA and 'any applicable standards of generally recognised accounting practices and uniform expenditure and revenue classification systems'.[176] Furthermore, it 'may monitor the budgets of municipalities with the aim of establishing whether they are consistent with the national government fiscal and macro-economic policy and the prescribed requirements for municipal budgets provided for in Chapter 4 of the MFMA.'[177]

Provincial Treasuries are also accorded monitoring power over municipal finances.[178] In order to fulfil their obligations, provincial treasuries must monitor the preparation of municipal budgets by municipalities and the monthly outcomes of those budgets.[179] Accordingly, the provincial treasuries must share with a municipality results of its monitoring 'to the extent that those results may assist the municipality in improving its financial management.'[180] Furthermore, in situations where a provincial treasury detects an emerging or impending financial problem, it must alert the municipality and assist in averting or resolving the problem. Provincial treasuries may offer support to municipalities by assisting them in the preparation of the budgets.[181]

A municipality's annual draft budget must be submitted to the National Treasury and Provincial

[175] MFMA, s 5(4)(a)(i)-(iv).
[176] MFMA, s 5(2)(c).
[177] MFMA, s (5)(2)(a).
[178] Steytler & De Visser (2014) 15-7.
[179] MFMA, s 5(4)(a).
[180] MFMA, s 34(3)(a).
[181] MFMA, s 34(3)(b) & (c).
[197] MFMA, s 22(b)(i).

Treasury, as must the approved budget.[197] Through the submission of draft budgets, National Treasury and Provincial Treasuries are able to monitor compliance with the MFMA by municipalities when preparing budgets. In 2010, National Treasury introduced the budget benchmark hearings for the 17 'non-delegated' municipalities.[182] The 17 'non-delegated' municipalities are municipalities that National Treasury exercises direct oversight over.[199] They include the eight metros, eight largest secondary cities and one district municipality.[183] The Minister of Finance has delegated provincial treasuries to exercise oversight of the remaining municipalities within their respective provinces.[184]

The aim of the benchmark is to check whether a municipality's revenue assumptions are realistic, whether its budget is 'funded' and whether the allocations are aligned with the IDP. Provincial treasuries have adopted similar processes that assist them in determining whether budgets are funded or not.[185] This process takes place after municipalities table their proposed budgets. Provincial Treasuries and National Treasury scrutinise the budgets and consult with the respective municipalities to share results of the monitoring process.[186] Through the benchmarking process, 'National Treasury and the provincial treasuries have advised municipalities either to redraft their budgets completely or to align their planned budgets with available resources.'[187]

The detection of unfunded budgets by municipalities has been effective, both National and provincial treasuries have successfully detected unfunded budgets during the benchmark process. However, the question is, what happens once these budgets are detected?

4.3 Interventions

Steytler and De Visser describe interventions in local government as 'the competence and on certain occasions, a duty of the national and provincial government to direct activities and

[182] National Treasury Report 'Financial Management and MFMA Implementation' (2011) 80. [199] National Treasury Report (2011) 80.
[183] National Treasury Report (2011) 80.
[184] National Treasury Report (2011) 80.
[185] National Treasury Report (2011) 80.
[186] National Treasury Report (2011) 80.
[187] National Treasury Report (2011) 80.

outcomes in municipalities.'[188] Steytler and De Visser state that interventions 'comprise the most powerful form of supervision over local government.'[189] This is the case because 'intervention is by its very nature an intrusion into the autonomy of another sphere'.[207] The principal instrument for intervening in local government is section 139 of the Constitution.[190] De Visser also describes section 139 as an 'instrument used to correct serious failures in local government.'[191] Intervention is an instrument resorted to when monitoring and support of local governments has not yielded results and instead the situation of a municipality has deteriorated to the extent where the provision of basic services is affected negatively.

4.3.1 The Legal Framework for Interventions in Local Government

Section 139 of the Constitution provides a framework within which interventions in local government must take place.[192] The original version of section 139 only included one type of discretionary intervention.[193] An intervention that could be triggered by 'a failure to fulfil an executive obligation'.[194] This excluded the possibility of an intervention when a municipality failed to pass a budget and revenue raising measures.[195] Additionally, an intervention was confined to an assumption of responsibility for the execution of the responsibility by a province.[196] Overall, the original version did not include any specific remedies for financial problems in a municipality.[197] This led to the National Treasury pushing for the amendment of section 139.[198] The result was the amendment of section 139 to include paragraphs (4) to (7) in 2003.[199]

The amendments provided the constitutional basis for the measures provided for in the MFMA with regard to municipalities in financial trouble. Four types of interventions are now provided for in the Constitution and in the MFMA. The first type of intervention is referred to as 'regular'

[188] Steytler & De Visser (2014) 15-5.
[189] Steytler & De Visser (2014) 15-18(2). [207]
Mathenjwa (2015) 64.
[190] Steytler & De Visser (2014) 15-18(2).
[191] De Visser & November (2017) 109.
[192] Ledger & Rampedi (2019) 3.
[193] Ledger & Rampedi (2019) 3.
[194] Steytler & De Visser (2014) 15-18.
[195] Steytler & De Visser (2014) 15-18.
[196] Steytler & De Visser (2014) 15-18.
[197] Ledger & Rampedi (2019) 3.
[198] Ledger & Rampedi (2019) 4.
[199] Ledger & Rampedi (2019) 4.

intervention in terms of section 139(1) and deals with what is termed as "failure to fulfil an executive obligation".[200] The second intervention is invoked in response to a 'municipality that cannot or does not fulfil an obligation in terms of the Constitution or legislation to approve a budget or any revenue-raising measures necessary to give effect to the budget.'[219] The third type of intervention is used in response to a municipality that is in serious or persistent breach of its obligations to provide basic services or to meet its financial commitments as a result of a financial crisis.[201] It can also be invoked when a municipality admits that it is unable to meet its obligations or financial commitments.[202] The last type of intervention provided for in the MFMA is invoked when a municipality experiences serious financial problems.

The focus of the discussion below will be on the last two types of interventions, namely the interventions in response to a municipality that has budgetary problems and those in response to a municipality experiencing a crisis in its financial affairs.

4.3.1.1 Regular intervention

The first type of intervention referred to as 'regular' intervention in terms of section 139(1) is invoked when a municipality cannot or does not fulfil an executive obligation in terms of the Constitution or legislation.[203] The relevant provincial executive may intervene by taking any appropriate steps to ensure the fulfilment of that obligation, including issuing a directive to the municipal council, describing the extent of the failure to fulfil its obligations and stating any steps required to meet its obligations.[223] The provincial executive can also intervene by assuming responsibility for the relevant obligation in that municipality or dissolving the Municipal Council and appointing an administrator until a newly elected municipal council has been declared elected, if exceptional circumstances warrant such a step.[224] The steps available to a provincial executive in terms of this section are aimed at addressing problems in a municipality and restoring service delivery.[204]The section 139(1) intervention is a response to problems that result from a municipality's failure to comply with an executive obligation and

[200] Steytler & De Visser (2014) 15-18. [219]
Constitution, s 139(4).
[201] Constitution, s 139(5).
[202] Constitution, s 139(5).
[203] Steytler & De Visser (2014) 15-19.
[223] Constitution, s 139(1). [224]
Constitution, s 139(1)
[204] Ledger & Rampedi (2019) 5.

the adoption of a budget is a legislative act.[205] Therefore, these interventions cannot be invoked in the situation where a municipality adopts an unfunded budget.

4.3.1.2 Interventions due to budgetary problems

The section 139(4) intervention applies when a municipality cannot or does not fulfil its obligation in terms of the Constitution or legislation to approve a budget or revenue raising measures necessary to give effect to the budget.[206] Section 160 of the Constitution provides that the council may not delegate its duty to approve a budget and impose revenue- raising measures.[207] Accordingly, it is the primary task of the municipal council to approve an annual budget and revenue raising measures to fund the budget.[208] The entire functioning of the budget is premised on the annual approval of the budget and revenue raising measures, because expenditure should only be incurred if there is an income in terms of an approved budget.[209]

As discussed in Chapter 2, municipalities must approve an annual budget before the start of the budget year, which commences on 1 July.[210] The budget must be approved, together with resolutions imposing any municipal tax or setting any municipal tariffs.[211] A council must consider the approval of the budget at least 30 days before the start of the budget year.[212] The MEC for local government may not give time extensions for the approval of the budget.[213] If a municipality fails to adopt the budget before the thirty-day period expires, it must reconvene within seven days and consider the budget again.[214] This process must be continued until a budget is approved before the commencement of the budget year.[215] If no budget, including revenue-raising measures, has been adopted by the first day of the budget year, the council has failed to comply with its obligations to adopt a budget in terms of the MFMA.[216] The Mayor

[205] *Fedsure Life Assurance Ltd and Others v Greater Johannesburg Transitional Metropolitan Council and Others* 1998 (12) BCLR para 42.
[206] Constitution s 139(4).
[207] Constitution s 160.
[208] Steytler & De Visser (2014) 15-38.
[209] MFMA, s 15(a).
[210] MFMA, s 16(1).
[211] MFMA, s 24(2)(c).
[212] MFMA, s 24(1).
[213] MFMA, s 27(2) read with s 16(1).
[214] MFMA, s 25(1).
[215] MFMA, s 25(2).
[216] Steytler & De Visser (2014) 15-39.

must then immediately notify the MEC for local government. The MEC for local government may recommend an appropriate intervention in terms of section 139 of the Constitution.[217]

Section 139(4) of the Constitution has only been invoked on two occasions in the Western Cape Province only.[218] The purpose of section 139(4) has always been to prevent the financial collapse of municipalities which is why it is the appropriate remedy to address the issue of municipalities adopting unfunded budgets. As explained in Chapter 2, the main issue with the adoption of unfunded budgets is that these budgets are fundamentally flawed because they do not comply with the mandatory requirements for valid budgets in terms of section 18 of the MFMA. The adoption of an unfunded budget by a municipality constitutes a failure to fulfil the obligation to approve a valid budget in terms of the legislation. Therefore, an unfunded budget is not a budget for the purposes of section 139(4).

4.3.1.3 Implementation of section 134(4) of the Constitution

The Constitution provides that a provincial executive must intervene by taking any appropriate steps to ensure that the budget or revenue measures are approved, including dissolving the council.[219] In *Premier of the Western Cape and others v Overberg District Municipality and others*, the court had to consider what other 'appropriate steps' are available, apart from dissolution.[220] This was the first case where section 139(4) was used to dissolve a council for failing to adopt a budget on time. In interpreting section 139(4), the court held that although it was imperative for the provincial executive to intervene, there was no necessity to dissolve the council.[221] The court explained that 'the steps to be taken are left to the discretion of the executive with the limitation that it must be appropriate and suitable for the purpose of the annual budget.'[222] The provincial executive may thus take any lesser measures to ensure that the council adopts the budget, including instructing it to meet and adopt the budget even after 30 June.[223] In the case of unfunded budgets, the provincial executive has the discretion to take

[217] MFMA, s 25(3) & s 55.
[218] De Visser & November (2017) 117.
[219] Constitution, s 139(4).
[220] *Premier of the Western Cape and others v Overberg District Municipality and others* [2011] 3 All SA 385 (SCA) (Overberg).
[221] *Overberg*, para 19.
[222] *Overberg*, para *19*
[223] Steytler & De Visser (2014) 15-41.

lesser measures such as instructing municipalities to budget within available resources, instructing them to cut expenditures, and advising them on revenue raising measures.

4.3.1.4 Financial collapse

When municipalities proceed to adopt budgets that are not adequately funded, they cannot meet some of their expenditure and this results in municipalities failing to pay staff salaries and creditors. The debt often escalates to a point where municipalities find themselves in financial crises and provinces are required to intervene in terms of section 139(5). An intervention in terms of section 139(5) of the Constitution is mandatory if a crisis in the financial affairs of the municipality has resulted in one or two situations. First, the municipality is in a serious or persistent breach of its obligations to provide basic services or to meet its financial commitments.[224] Secondly, when a municipality by its own admission reveals that it is unable to comply with its obligations or to meet its financial commitments.[225] If one of the situations occurs, the provincial executive must request the Municipal Financial Recovery Service (MFRS) to determine the reasons for the crisis.[226] MFRS was established in 2007 as a Directorate in the National Treasury within the Office of the Accountant-General.[227] It must 'assess the financial position of the municipality, prepare a recovery plan with recommended changes to the budget and revenue-raising measures that will give effect to the recovery plan and submit this to the MEC for finance.'[228] All relevant factors should be considered to determine whether the breach of financial commitments is serious, persistent or material.[229] The MFRS is intended to play a key role in the implementation and management of section 139(5) interventions, but the unit appears unable to fulfil that mandate effectively.[230] In the few examples given by PARI where the MFRS has actually been involved in an intervention, there have been multiple and serious concerns raised about the quality and efficacy of its work.[231]

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[224] Constitution, s 139(5).
[225] Constitution, s 139(5).
[226] MFMA, s139(1).
[227] National Treasury Presentation available at http://www.treasury.gov.za/publications/other/MinAnsw/2017/Reply%20to%20PQ%2088%20[NW92E].pdf (accessed 25 November 2019).
[228] MFMA, s139(1)(a) & s139(1)(a)(v)(aa).
[229] MFMA, s140(1).
[230] Ledger & Rampedi (2019) 21.
[231] Ledger & Rampedi (2019) 3.

The purpose of outlining section 139(4) of the Constitution as the appropriate intervention mechanism in the case of unfunded budgets is to guard against the consequences of unfunded budgets. Chapter 3 explained how the adoption of unfunded budgets leads municipalities to financial difficulties. Research by PARI shows that almost irreparable harm is done to a municipality that is permitted to remain in a state of operational and financial failure for any meaningful length of time.[232] It is crucial that intervention measures are introduced from the onset in order to prevent the manifestations of unfunded budgets. According to PARI, the longer the period of time during which a municipality operates in a dire state before an intervention is initiated, the less likely it is that the intervention will have a meaningful impact.[233]

4.5 Conclusion

This chapter concludes that the National Treasury and the provincial treasuries are responsible for monitoring and guarding against the adoption of unfunded budgets by municipalities. The National Treasury together with Provincial Treasuries play a central role in the supervision of financial management by municipalities by virtue of empowering provisions in the MFMA. The MFMA clearly states that the National Treasury may monitor municipal budgets to establish whether they comply with chapter 4 of the MFMA. Chapter 4 of the MFMA includes section 18 provisions relating to the funding of a budget. Likewise, Provincial Treasuries are obligated to monitor compliance with the MFMA by municipalities. The study concludes that the monitoring and support offered by the National Treasury and Provincial Treasuries has failed to guard against the adoption of unfunded budgets, therefore intervention measures should be utilised to remedy the situation.

This chapter further concludes that there is an existing remedy for the issue of unfunded budgets in local government. Provinces must intervene in terms of section 139(4) when municipalities adopt unfunded budgets. In the event of a failure to intervene on the part of a province, national government must intervene.

Section 139(5) of the Constitution is not an appropriate intervention mechanism to guard against unfunded budgets, as it is often a measure of last resort that is implemented when the

[232] Ledger & Rampedi (2019) 1.
[233] Ledger & Rampedi (2019) 1.

municipality is in a serious or persistent breach of its obligations to provide basic services or to meet its financial commitments, and in most faces already facing financial collapse.

CHAPTER 5: CONCLUSION

5.1 Introduction

The primary research objective of this paper was to assess how the problem of unfunded budgets in local government can be addressed. In chapter 2 the study assessed the existing legal framework for funding municipal budgets. The chapter also assessed how the current legal framework for local government financial management enables municipalities to fund their budgets. Chapter 2 also focussed on the constitutional rules relating to borrowing and the elements relating to credibility and funding of budgets stipulated in the MFMA. Chapter 3 identified and discussed the causes and manifestations of unfunded budgets. This chapter sought to bring to the fore the impact of the adoption of unfunded budgets on the ability of municipalities to deliver services and the impact it has on communities in general. The third chapter of this paper also evaluated the existing processes for detecting unfunded budgets and determined the authority responsible for monitoring whether budgets are funded or not. This chapter further assessed the existing mechanisms used to detect and supervise the funding of valid budgets for municipalities. Chapter 4 outlined the powers that can be utilised to prevent or remedy unfunded budgets. The purpose of this chapter is to provide the conclusions of the study and to offer recommendations that will assist in ensuring municipalities adopt funded budgets.

5.2 Findings

The Constitution and legislation, particularly the MFMA provide an elaborate legal framework that guides municipalities in the preparation of municipal budgets. Municipalities have an obligation to adhere to the constitutional principles and legislation by giving effect to the relevant provisions in their budgetary processes. The key point is that there is a clear legislative framework in place that requires municipalities to prepare and approve budgets that are balanced and funded with credible sources of funding as prescribed by section 230A of the Constitution and in section 18 of the MFMA respectively. However, the challenge lies in the failure by municipalities to comply with legal rules dictating how budgets must be prepared.

The failure to comply with relevant legislative provisions for funding a budget has serious consequences for municipalities and the communities they serve. The adoption of unfunded budgets has dire consequences for communities who depend on essential services provided by

Eskom and the Water boards. It was demonstrated in this paper that there is a clear link between municipalities who adopt unfunded budgets and the failure to pay creditors. This study also noted that deficiencies in administrative capacity in the form of incompetent officials without the required experience and qualifications also results in weaknesses in the preparation of funded budgets and financial management in general. The study concludes that the causes of unfunded budgets are complex and interrelated with other challenges facing local government, therefore requiring an all-encompassing solution that will address the root causes of unfunded budgets, rather than isolating the different challenges in local government.

The research paper found that the MFMA places treasuries at the centre of supervision of financial management in local government, including monitoring the adoption of funded budgets. The study concludes that the monitoring processes offered by the National and provincial treasuries are sufficient. However, there seems to be a lack of capacity in providing support to the municipalities once unfunded budgets are detected. Research by PARI has also indicated that quality of advice provided by MFRS is poor.

The benchmarking process used by National Treasury to monitor municipal budgets' compliance with funding requirements has been met with some success, as both the National and provincial treasuries have been able to detect unfunded budgets at tabling stage. Thus, this has given them an opportunity to advise municipalities to redraft tabled budgets that were not adequately funded. However, another challenge lies with the implementation of the recommendations from the treasuries by the municipalities. There is an overwhelming number of municipalities that still proceed to adopt unfunded budgets even after being advised to revise their budgets. There is clearly a need for an intervention in such cases.

The paper contended that an unfunded budget does not constitute a valid budget for purposes of the MFMA and section 139(4) of the Constitution. Therefore, a municipality that adopts an unfunded budget must be deemed to have failed to adopt a valid budget and section 139(4) intervention measures must be invoked under such circumstances. The study concludes that there is a need for the implementation of section 139(4), which is a mandatory intervention mechanism rather than the current process of treasuries "advising" municipalities. The current process offers municipalities the discretion to disregard advice and often to their detriment. If this problem is not resolved, municipalities will continue to experience financial problems that inevitably lead to some form of financial crisis, which negatively affects the ability of municipalities to deliver services.

5.3 Recommendations

The findings of these thesis demonstrate that there is an urgent need to address the adoption of unfunded budgets by municipalities. A solution is already in existence in the form of a constitutional intervention contained in section 139(4) of the Constitution. Below are the recommendations on how the powers contained in section 139(4) must be used in implementing effective interventions to prevent and stop the growing trend of municipalities adopting budgets that are not funded.

First, clarity is required on what constitutes a valid budget for purposes of section 139(4) of the Constitution and sections 25 and 26 of the MFMA. This paper recommends the reading in/inclusion of the word ‘valid’ in the provisions contained in the MFMA giving effect to section 139(9) of the Constitution. It is likely that municipalities pass unfunded budgets to ensure that there is a budget in place by the 1st of July regardless of how flawed that budget is. This is a way to circumvent the application of the above sections and their consequences.

Section 16(1) of the MFMA must read as: “The council of a municipality must for each financial year approve a ‘valid’ annual budget for the municipality before the start of that financial year.”

Secondly, national and provincial government must intervene in terms of section 139(4) when municipalities adopt unfunded budgets. National Treasury must present the results from the National Benchmarking tests to provinces so that provinces can identify municipalities that are adopting unfunded budgets.

Thirdly, National Treasury must issue guidelines on how interventions into municipalities that have adopted unfunded budgets will be regulated.

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