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# Government Gazette Staatskoerant

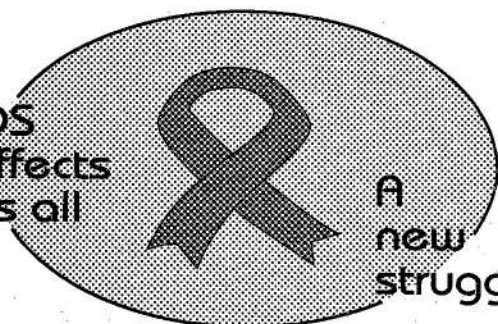
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JULIE 2000

No. 21423

**We all have the power to prevent AIDS**

AIDS  
affects  
us all



A  
new  
struggle

**Prevention is the cure**

**AIDS  
HELPLINE**

**0800 012 322**

DEPARTMENT OF HEALTH

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## GENERAL NOTICES

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NOTICE 2738 OF 2000

### Department of Finance

#### MUNICIPAL FINANCE MANAGEMENT BILL

In accordance with section 154(2) of the Constitution of the Republic of South Africa (Act No. 108 of 1996) the attached Municipal Finance Management Bill, 2000, is published for comment.

Also attached is the Policy Framework for Municipal Borrowing and Intervention informing the draft Bill.

Interested parties are invited to submit comments on the proposed legislation and the underlying policy framework before August 31, 2000 by

- (a) posting comments to –

T.V. Pillay

Director: Local Government Budgets

Department of Finance

P.B. X115

Pretoria, 0001

- (b) fax to – (012) 315-5045

- (c) delivering comments to –

Room 1622

16<sup>th</sup> Floor

Department of Finance

240 Vermeulen Street

Pretoria, 0001

- (d) e-mail to: [pillaytv@finance.pwv.gov.za](mailto:pillaytv@finance.pwv.gov.za)

CHIEF DIRECTOR: INTERGOVERNMENTAL RELATIONS

NATIONAL TREASURY

**Department of Finance**

**MUNICIPAL FINANCE MANAGEMENT  
BILL, 2000**





## **MUNICIPAL FINANCE MANAGEMENT BILL**

**To regulate financial management in the local sphere of government; to require that all revenue, expenditure, assets and liabilities of municipalities and municipal entities are managed efficiently and effectively; to determine the responsibilities of persons entrusted with local sphere financial management; to determine the conditions on which municipalities may borrow money; and to provide for matters connected therewith.**

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## **CHAPTER 1**

### **INTERPRETATION, OBJECT, APPLICATION AND AMENDMENT OF THIS ACT**

#### **Definitions**

**1.** In this Act unless the context indicates otherwise –

**“accounting authority”** means an authority referred to in section 41;

**“accounting officer”** means an officer referred to in section 27 (1);

**“annual Division of Revenue Act”** means the Act of Parliament which must annually be enacted in terms of section 214 (1) of the Constitution;

**“applicable standards of generally recognised accounting practice”** means an accounting practice complying in material respects with standards issued by the Accounting Standards Board for municipalities and municipal entities in terms of the Public Finance Management Act;

**“business plan”**, in relation to a municipal entity, means an annual plan of the entity approved by the Municipal Council that includes –

- (a) the budget for that year;
- (b) key performance objectives; and
- (c) any potential liabilities, including particulars of any proposed borrowing of money during the year;



**“category”**, in relation to municipalities, means a category A, B or C municipality envisaged in section 155 (1) of the Constitution;

**“chief financial officer”**, means an officer of a municipality designated in terms of 35 (2) (a);

**“corporate entity”** means a company, co-operative, trust, fund or any other juristic person established in terms of applicable national or provincial legislation;

**“councillor”** means a member of a municipal council;

**“councillor responsible for financial matters”** means –

- (a) in the case of a municipality with an executive committee referred to in section 42 of the Municipal Structures Act, the member of the committee elected as mayor;
- (b) in the case of a municipality with an executive mayor referred to in section 60 of the Municipal Structures Act, the executive mayor; and
- (c) in the case of a municipality which does not have either an executive committee or an executive mayor, the councillor to whom the responsibility for budgetary matters has been assigned by the council;

**“creditor”**, in relation to a municipality, means any person to whom money is owing by the municipality;

**“debt”** means –

- (a) a monetary liability or obligation created by a financing agreement, note, debenture, bond, overdraft, or the issuance of municipal securities; or
- (b) a contingent liability such as that created by guaranteeing a monetary liability or obligation of another;

**“delegation”**, in relation to a duty, includes an instruction or request to perform the duty, and **“delegate”** has a corresponding meaning;

**“ designated municipal service”** means –

- (a) an electricity reticulation system;
- (b) a gas reticulation system;
- (c) a municipal public transport system;
- (d) a potable water supply system;
- (e) a domestic waste-water and sewerage disposal system; or
- (f) any other municipal service that may be prescribed as a designated municipal service;

**“district municipality”** means a municipality that has municipal executive and legislative authority in an area that includes more than one municipality, and which is described in section 155 (1) of the Constitution as a category C municipality;

**“financial statements”** means statements consisting of at least –

- (a) a balance sheet;
- (b) an income statement;
- (c) a cash-flow statement;

- (d) any other statements that may be prescribed; and
- (e) any notes to these statements;

**“financial year”** means a year ending 30 June;

**“financing agreement”** includes any loan agreement, lease, instalment purchase contract, or hire purchase arrangement under which a municipality undertakes to pay the capital cost of property, plant, or equipment over a period of time;

**“functionary”**, in relation to a municipality, means a person elected, designated or appointed by a municipal council to a post or position regulated by the Municipal Structures Act;

**“irregular expenditure”**, in relation to a municipal entity, means a payment, incurred in contravention of or that is not in accordance with a requirement of this Act or any other legislation applicable to the municipal entity;

**“lender”**, in relation to a municipality, means a person who provides debt finance to a municipality;

**“local municipality”** means a municipality that shares municipal executive and legislative authority in its area with a district municipality within whose area it falls, and which is described in section 155 (1) of the Constitution as a category B municipality;

**“long term debt”** means debt which is repayable over a period exceeding one year;

**“MEC for finance”** means the member of the Executive Council of a province responsible for finance in the province;

**“MEC for local government”** means the member of the Executive Council of a province responsible for local government in the province;

**“metropolitan municipality”** means a municipality that has exclusive executive and legislative authority in its area, and which is described in section 155 (1) of the Constitution as a category A municipality;

**“minimum essential municipal service”** means a service which, if not provided, would pose a threat to public health or safety;

**“Minister”** means the Minister of Finance;

**“municipal council”** or **“council”** means a municipal council referred to in section 157 of the Constitution;

**“municipal entity”** means –

- (a) a corporate entity under the ownership control of one or more municipalities, and includes a subsidiary of such an entity; or
- (b) the governing body of a multi-jurisdictional municipal service district established in terms of section 86 of the Municipal Systems Act;

**“municipal debt instrument”** means any note, bond, debenture, or other evidence of indebtedness issued by a municipality, including dematerialised or electronic evidence of indebtedness intended to be used in trade;

**“municipality” –**

- (a) as a corporate entity, means a municipality as described in section 2 of the Municipal Systems Act; and
- (b) as a geographic area, means a municipal area determined in terms of the Local Government: Municipal Demarcation Act, 1998 (Act 27 of 1998);

**“municipal manager”** means a person appointed in terms of section 82 of the Municipal Structures Act as the head of the municipality’s administration;

**“Municipal Structures Act”** means the Local Government: Municipal Structures Act, 1998 (Act No. 117 of 1998);

**“Municipal Systems Act”** means the Local Government: Municipal Systems Act, 2000 (Act No. of 2000);

**“National Treasury”** means the National Treasury established by section 5 of the Public Finance Management Act, 1999 (Act 1 of 1999);

**“organised labour”** means a trade union registered in terms of section 96 of the Labour Relations Act, 1995 (Act No. 66 of 1995), representing employees of a municipality;

**“overspending” –**

- (a) in relation to the budget of a municipality, means when the operational or capital expenditure incurred by the municipality during a financial year, exceeds the total amount appropriated in that year’s budget for its operational or capital expenditure, as the case may be; and
- (b) in relation to a vote, means when expenditure under a vote exceeds the amount appropriated for that vote, subject to section 31;

**“ownership control”**, in relation to a corporate entity, means the ability to exercise any of the following powers to govern the financial and operating policies of the entity in order to obtain benefits from its activities:

- (a) to appoint or remove all, or the majority of, the members of that entity’s board of directors or equivalent governing body;
- (b) to appoint or remove that entity’s chief executive officer;
- (c) to cast all, or the majority of, the votes at meetings of that board of directors or equivalent governing body; or
- (d) to control all, or the majority of, the voting rights at a general meeting of the entity;

**“prescribe”** means prescribe by regulation, instruction or guideline in terms of section 78 or 85;

**“provincial department”** has the meaning assigned to it in section 1 of the Public Finance Management Act;

**“provincial treasury”** has the meaning assigned to it in section 1 of the Public Finance Management Act;



**“Public Finance Management Act”** means the Public Finance Management Act, 1999 (Act 1 of 1999);

**“Revenue Fund”**, in relation to a municipality, means the revenue fund of a municipality established in terms of section 7 and for the purposes of which the municipality must open one or more bank accounts in terms of section 8 (3);

**“security”** means a lien, pledge, mortgage, cession or other form of collateral intended to secure the interest of a creditor;

**“short term debt”** means a debt which is repayable over a period not exceeding one year;

**“structure”**, in relation to a municipality, means the council of the municipality or any committee or other collective structure of a municipality elected, designated or appointed in terms of the Municipal Structures Act;

**“this Act”** includes regulations made and instructions issued in terms of section 78 or 85;

**“unauthorised expenditure”**, in relation to a municipality, means –

- (a) overspending a budget of the municipality;
- (b) overspending a vote, subject to section 31;
- (c) expenditure from a vote which is unconnected with the purpose of that vote; or

- (d) expenditure incurred in contravention of or which is not in accordance with a requirement of this Act or any other legislation applicable to a municipality;

**“vote” means –**

- (a) one of the main segments into which a budget of a municipality is divided for the appropriation of money for the different departments or functional areas of the municipality; and
- (b) which specifies the total amount which is appropriated for the purposes of the department or functional area concerned.

### **Object of this Act**

2. The object of this Act is to secure transparency, accountability, and sound management of the revenue, expenditure, assets and liabilities of the local government institutions to which this Act applies.

### **Local government institutions to which this Act applies**

3. (1) This Act applies to –
- (a) municipalities; and
  - (b) municipal entities.

(2) In the event of any inconsistency between this Act and any other legislation, excluding the Public Finance Management Act, this Act prevails.

**Amendments to this Act**

**4.** Draft national legislation directly or indirectly amending this Act, or providing for the enactment of subordinate legislation that may conflict with this Act, may be introduced in Parliament –

(a) by the Minister only; or

(b) only after the Minister has been consulted on the contents of the draft legislation.

## **CHAPTER 2**

### **NATIONAL AND PROVINCIAL SUPERVISION**

#### **Functions and powers of National Treasury**

- 5. (1) The National Treasury must –**
- (a) promote the object of this Act as set out in section 2; and**
  - (b) perform the other functions assigned to the National Treasury in terms of this Act.**
- (2) To the extent necessary to perform the functions mentioned in subsection (1), the National Treasury may –**
- (a) monitor the budgets of municipalities to establish whether they –**
    - (i) are consistent with the national government's fiscal policy framework and macro-economic policy; and**
    - (ii) comply with sections 14 and 18;**
  - (b) monitor expenditure and revenue of municipalities to establish whether expenditure and revenue remain within budget;**
  - (c) prescribe uniform treasury norms and standards for municipalities and municipal entities;**
  - (d) establish annually a growth factor for the budgets of municipalities as envisaged in section 14 (1) (c);**
  - (e) monitor and assess compliance by municipalities and municipal entities with –**
    - (i) this Act; and**
    - (ii) any standards of generally recognised accounting practice and uniform classification systems prescribed in terms of Chapter 11 of the Public Finance Management Act; and**

- (f) assist municipalities and municipal entities in building their capacity for efficient, effective and transparent financial management;
- (g) review any system of financial management and internal control in any municipality;
- (h) intervene by taking appropriate steps, including the withholding of funds in terms of section 216 (2) of the Constitution, to address a serious or persistent material breach of this Act by a municipality or municipal entity; and
- (i) do anything further that is necessary to fulfil its responsibilities effectively.

#### **Delegations by National Treasury**

**6.** (1) The Minister may in writing delegate any of the powers or duties entrusted to the National Treasury in terms of this Act –

- (a) to the head of a department forming part of the National Treasury;
- (b) to the head of a national department charged with responsibility for local government;
- (c) to a provincial treasury, or to the head of a provincial department, as the Minister and the MEC for finance in the province concerned may agree; or
- (d) to a structure or functionary of a district municipality subject to subsection (4), as the Minister and the council of the district municipality may agree.

(2) A delegation in terms of subsection (1) –

- (a) is subject to any limitations or conditions that the Minister may impose; and

- (b) does not divest the Minister of the responsibility concerning the exercise of the delegated power or the performance of the delegated duty.

(3) A delegation in terms of subsection (1) (a), (b) or (c) to the head of a department, or to a provincial treasury -

- (a) may authorise that head of department, in the case of a delegation in terms of subsection (1) (a) or (b), to sub-delegate, in writing, the delegated power or duty to –
  - (i) another National Treasury official or an official in that department;
  - (ii) the holder of a specific post in the National Treasury or that department; or
  - (iii) the accounting officer of a municipality; or
  - (iv) the accounting authority of a municipal entity; and
- (b) may authorise a provincial treasury or head of a provincial department, in the case of a delegation in terms of subsection (1) (c), to sub-delegate, in writing, the delegated power or duty to –
  - (i) an official in that provincial treasury or department;
  - (ii) the holder of a specific post in that provincial treasury or department;
  - (iii) the accounting officer of a municipality or municipal entity; or
  - (iv) the accounting authority of a municipal entity.

(4) A structure or functionary of a district municipality to whom a



power or duty has been delegated in terms of subsection (1) (d), may perform the delegated function only in relation to local municipalities in the area of the district municipality.

(5) The Minister may confirm, vary or revoke any decision taken in consequence of a delegation or sub-delegation in terms of this section, provided that no such variation or revocation of a decision may detract from any rights that may have accrued as a result of the decision.

## CHAPTER 3

### MUNICIPAL REVENUE

#### *Part 1: Municipal Revenue Funds*

##### **Establishment**

7. (1) Every municipality must establish a Revenue Fund into which all money received by the municipality must promptly be paid, including any grants made to it –

- (a) in terms of the annual Division of Revenue Act; and
- (b) by the province.

(2) Subsection (1) does not apply to –

- (a) money received by a municipality on behalf of a municipal entity or other person providing a municipal service to communities in the municipality; or
- (b) any other money of a prescribed category excluded from payment into a municipality's Revenue Fund.

(3) Money may be withdrawn from a municipality's Revenue Fund only in terms of section 9 (1).

##### **Control of Municipal Revenue Funds**

8. (1) The municipal manager of a municipality is accountable for the municipality's Revenue Fund and must enforce compliance with the provisions of section 9.

(2) A municipal manager may not delegate the duties mentioned in subsection (1) to another person except to the municipality's municipal finance officer.

(3) Money that must be paid into a municipality's Revenue Fund is paid into the Fund by depositing it into a bank account of the Fund in accordance with any requirements that may be prescribed.

#### **Withdrawals from municipal Revenue Funds**

9. (1) Only the municipal manager of a municipality, or an official of the municipality acting on the written authority of the municipal manager, may withdraw money or authorise the withdrawal of money from the municipality's Revenue Fund, and may do so only –

- (a) to provide funds that have been authorised in terms of an appropriation contained in a budget approved by the municipal council;
- (b) to refund money incorrectly paid into the Fund; or
- (c) to refund deposits paid by users and consumers of municipal services.

(2) A payment in terms of subsection (1) (b) may be made without appropriation by the municipal council, provided that particulars of such payment are tabled in the council no later than two months after the payment has been made.

(3) Any payment from a municipality's Revenue Fund must be dealt with as unauthorised expenditure if the municipality is unable to produce written proof that –

- (a) the payment was made in accordance with subsection (1); or
- (b) the proviso to subsection (2) has been complied with.

## ***Part 2: Banking, cash management and investments***

### **Cash management and investment framework**

10. The National Treasury may prescribe a framework within which municipalities must conduct their cash management and make investments of money not immediately required.

### **Banking and cash management**

11. (1) A municipality must establish appropriate and effective cash management and banking arrangements in accordance with the framework prescribed in terms of section 10.

(2) Municipalities may not open a bank account abroad or with a bank not registered in terms the Banks Act, 1990 (Act no. 94 of 1990).

(3) A bank that has opened an account for a municipality, or any other institution that holds money for a municipality, must promptly disclose information regarding the account when so requested by the National Treasury, the relevant provincial treasury or the Auditor-General.

### **Investments**

12. (1) A municipality must establish appropriate arrangements in accordance with the framework prescribed in terms of section 10 for the investment of money not immediately required.

(2) An investment in terms of subsection (1) must be of a kind permitted by the investment framework.

## **CHAPTER 4**

### **MUNICIPAL BUDGETS**

#### **Annual appropriations**

13. A municipal council must for each financial year by way of an annual budget appropriate money from its Revenue Fund for the requirements of the municipality.

#### **Municipal annual budgets**

14. (1) The annual budget -
- (a) must be in accordance with a format as may be prescribed;
  - (b) must be balanced to ensure that the total amount appropriated in terms of the budget does not exceed the realistically anticipated revenue; and
  - (c) may not exceed a growth factor as determined by the National Treasury.
- (2) The annual budget must at least contain -
- (a) estimates of all revenue expected to be received during the financial year to which the budget relates;
  - (b) estimates of current expenditure for that financial year, broken down per vote as may be appropriate for the municipality concerned;
  - (c) estimates of interest and debt servicing charges, and any repayments on loans;
  - (d) estimates of capital expenditure for that financial year and the projected financial implications of that expenditure for future financial years;
  - (e) proposals for financing any anticipated deficit for that financial year in terms of the provisions of Chapter 5 relating to short term borrowing;

- (f) an indication of intentions regarding borrowing and other forms of public liability that will increase the municipality's debt during that financial year and future financial years;
- (g) the projected –
  - (i) revenue for the previous financial year;
  - (ii) expenditure for the previous financial year, broken down per vote;
  - (iii) borrowing for the previous financial year; and
  - (iv) funding flows from the municipality to municipal entities under its ownership control and from such municipal entities to the municipality, during the previous financial year;
- (h) the actual –
  - (i) revenue for the year preceding the previous financial year;
  - (ii) expenditure for that financial year, broken down per vote;
  - (iii) borrowing for that financial year; and
  - (iv) funding flow from the municipality to municipal entities under its ownership control and from such municipal entities to the municipality, during that financial year; and
- (i) any other information as may be prescribed, including any multi-year budget information.

(3) When an annual budget is tabled in the municipal council, the municipal manager must submit measurable objectives for each vote in the budget.

(4) The National Treasury, after consulting the relevant provincial treasury, may withhold funds due to a municipality from the National Revenue



Fund if the municipality fails to comply with a provision of this section or any other applicable treasury norms and standards established in terms of section 216 (1) of the Constitution.

### **Budget process**

15. (1) The councillor responsible for financial matters must at least four months before the start of each financial year, prepare a draft annual budget for that financial year.

(2) The councillor responsible for financial matters must –

(a) allow the public –

(i) access to the draft budget by making it available at the main administrative office of the municipality; and

(ii) to submit written comments and representations to the municipality; and

(b) table the draft budget in the municipal council for discussions and public hearings.

(3) The councillor responsible for financial matters must submit a copy of the municipality's draft budget to –

(a) the National Treasury, in the case of a municipality whose name appears on a list published by the Minister by notice in the *Government Gazette*;

(b) the relevant provincial treasury, in the case of a district municipality whose name does not appear on the list referred to in paragraph (a);

(c) the district municipality in whose area it falls, in the case of a local municipality; and

(d) the local municipalities in its area, in the case of a district municipality.

(4) The councillor responsible for financial matters must as soon as the council discussions and the public hearings referred to in subsection (2) have been completed –

- (a) prepare the budget for the financial year, taking into account –
  - (i) the considerations of and public hearings conducted by the council on the draft budget;
  - (ii) any public comment and representations received by the municipality in terms of subsection (2) (a); and
  - (iii) any recommendations of the National Treasury and the relevant provincial treasury on the draft budget and any guidelines and policy statements issued by the National Treasury; and
- (b) table the budget in the council for approval.

(5) The councillor responsible for financial matters must manage the budget process in such a way that the budget is tabled in the council in terms of subsection (4) (b) at least 30 days before the start of the financial year to which that budget relates.

(6) A municipality must pass its annual budget before the start of the financial year to which it relates.

#### **Approval of annual budgets**

16. (1) The annual budget of a municipality is approved by a decision taken by the council of the municipality with a supporting vote of a majority of the members of the council.

(2) If a municipal council fails to pass an annual budget by the majority required in terms of subsection (1), the council must reconsider the budget and again vote on the budget or an amended version thereof within 14 days of the meeting that failed to approve the budget.

(3) If a municipal council again fails to pass an annual budget by the requisite majority and, as a consequence of which, there is no approved annual budget at the start of the financial year to which it relates, funds may for the requirements of the municipality be withdrawn from the municipality's Revenue Fund in accordance with section 17.

**Expenditure during financial year until annual budget is passed**

17. (1) If a municipality's annual budget is not approved before the start of the financial year to which it relates, funds may, with the approval of the MEC for local government in the province concerned, after consulting the MEC for finance, be withdrawn from the municipality's Revenue Fund in accordance with this section for the requirements of the municipality until the budget is passed.

(2) Funds withdrawn from a Revenue Fund in terms of subsection (1) –

- (a) may be used only to defray current expenditure in connection with matters for which funds were appropriated in the previous annual budget or adjustments budget; and
- (b) may not –
  - (i) during the first four months of that financial year, exceed one third of the total amount appropriated in the previous annual budget for current expenditure;
  - (ii) during each of the following months, exceed 8 per cent of the total amount appropriated in the previous annual budget for current expenditure; and
  - (iii) in aggregate, exceed the total amount appropriated in the previous annual budget for current expenditure.

(3) The funds provided for in subsection (1) are not additional to funds appropriated for that financial year, and any funds withdrawn in terms of that subsection must be regarded as forming part of the funds appropriated in the annual budget for that financial year.

#### **Municipal adjustments budgets**

18. (1) The councillor responsible for financial matters may table an adjustments budget in the municipal council as and when necessary, but must table an adjustments budget when this becomes necessary –

- (a) due to the under collection of revenue;
- (b) to appropriate funds for the reduction of debt or the funding of capital projects; or
- (c) to provide for other matters that may be prescribed.

(2) An adjustments budget, apart from the matters referred to in subsection (1) (a), (b) and (c), may provide only for –

- (a) the appropriation of funds that have become available from another sphere of government;
- (b) unforeseeable and unavoidable expenditure recommended by the municipal manager, within a prescribed framework;
- (c) the utilisation of savings between votes in terms of section 31; and
- (d) any other matter approved by the Minister.

(3) An adjustments budget must be in the prescribed format and contain the prescribed information.

(4) Section 15 (3) applies in respect of a draft adjustments budget and in such application a reference in that section to a draft annual budget must be read as a reference to a draft adjustments budget.

(5) A municipality must take into account any recommendations of the National Treasury and the relevant provincial treasury before it approves an adjustments budget.

(6) Section 16 (1) and (2) applies in respect of the approval of an adjustments budget, and in such application a reference in that section to an annual budget must be read as a reference to an adjustments budget.

**Municipalities to submit reports on state of their budgets**

19. (1) The municipal manager of a municipality must, as a financial year progresses, submit quarterly reports in the prescribed format on the state of the municipality's budget to the –

- (a) National Treasury and the relevant provincial treasury, in the case of a municipality whose name appears on the list published in terms of section 15 (3) (a);
- (b) the relevant provincial treasury, in the case of a district municipality whose name does not appear on the list referred to in paragraph (a);
- (c) to the district municipality in whose area it falls, in the case of a local municipality.

(2) A report in terms of subsection (1) must –

- (a) cover a prescribed reporting period; and
- (b) be submitted within a prescribed number of days after the end of each reporting period.

(3) When a district municipality submits its report, it must attach the reports of local municipalities within its area that were submitted to it in terms of subsection (1) (c).

(4) A report must contain the prescribed particulars and must specify the following amounts and compare those amounts in each case with the corresponding budgeted amounts for the relevant financial year:

- (a) The actual revenue received during the reporting period, and during the financial year up to the end of that period;

- (b) the actual expenditure (distinguishing between capital and operating expenditure) for that period, and for the financial year up to the end of that period; and
- (c) actual borrowings for that period, and for the financial year up to the end of that period.

#### **Unauthorised expenditure**

20. (1) Unauthorised expenditure does not form a charge against a municipality's Revenue Fund.

(2) Subsection (1) does not apply if the municipal council authorises the expenditure by resolution adopted with a supporting vote of a majority of the members.

(3) If implementation of a decision of the council or any structure or functionary of a municipality is likely to result in unauthorised expenditure, the municipal manager of the municipality will, for the purposes of subsection (1), be responsible for any resultant unauthorised expenditure unless the municipal manager has informed the council, structure or functionary in writing of the likelihood of that unauthorised expenditure.

(4) The municipal manager must in writing inform the National Treasury and the relevant provincial treasury of –

- (a) any unauthorised expenditure that has been incurred by the municipality; and
- (b) the steps that have been taken to recover or rectify the unauthorised expenditure and to prevent a recurrence.

(5) The National Treasury may regulate the application of this section by regulation in terms of section 74.

**Assignment of new functions and powers to municipalities**

21. (1) Draft national or provincial legislation that assigns an additional function or power to, or imposes any other obligation on, a municipality, must, in a memorandum that must be introduced with that legislation in Parliament or the provincial legislature concerned, give at least a three year projection of the financial implications of that function, power or obligation to the municipality.

(2) The National Treasury, the Minister responsible for local government and organised local government must be consulted before such legislation is introduced in Parliament or the provincial legislature concerned.



## CHAPTER 5

### DEBT

#### Competence to incur debt

22. (1) A municipality may incur debt only in accordance with and subject to the provisions of this Chapter.

(2) A municipality may incur short term debt only when necessary to bridge –

- (a) shortfalls within a financial year during which the debt is incurred, in anticipation of specific and realistic anticipated income to be received within that financial year; or
- (b) capital needs within a financial year in anticipation of funds deriving from specific and enforceable grant or long term debt commitments.

(3) A municipality –

- (a) must pay off short term debt within a year; and
- (b) may not renew or refinance its short term debt.

(4) (a) No lender may extend credit to a municipality for the purpose of renewing or refinancing debt that must be paid off in terms of subsection (3) (a).

(b) If a lender wilfully extends credit to a municipality in contravention of paragraph (a), the municipality is not bound by the contract in terms of which the credit was extended to the municipality.

(5) A municipality may incur long term debt only for purposes of capital investment in property, plant or equipment to be used for the purpose of achieving the objects of local government as set out in section 152 of the Constitution. Such investment may include costs of financing and professional services directly related to such investment.

### **Conditions on which municipal debt may be incurred**

23. A municipality may incur debt provided –

- (a) the debt is denominated in Rand and is not indexed to, or affected by fluctuations in the value of other currencies;
- (b) the debt is approved by resolution of the council;
- (c) the municipal manager, at least 14 days prior to the meeting of the council at which the resolution is to be considered, has published a notice in a newspaper of general circulation in the municipality or in another manner as may be prescribed –
  - (i) stating particulars of the draft resolution, including the amount of the debt, the purposes for which the debt is to be incurred and particulars of any security to be provided; and
  - (ii) inviting the public to submit written representations to the council in respect of the draft resolution;
- (d) the municipal manager, prior to the adoption of the resolution, has submitted an information statement to the council setting out the purpose for which the debt is to be incurred, the anticipated total cost of credit over the repayment period, the essential repayment terms, and particulars of any security to be provided;

- (e) the relevant resolution was adopted at a meeting of the council which was open to attendance by the public; and
- (f) where security is to be provided, the provisions of section 24 (4) have been complied with.

### Security

24. (1) A municipality may by resolution of the council authorise security to be provided for any of its debt obligations.

(2) Without detracting from the generality of subsection (1), a municipality, when incurring debt, may –

- (a) undertake to retain revenues or specific charges, fees, tariffs or funds at a particular level or at a level sufficient to meet its obligations arising from that debt;
- (b) undertake to effect payment directly from monies or sources that may become available and authorise direct access to such sources to ensure payment of those obligations;
- (c) undertake to make provision in its budgets for the payment of those obligations, including capital and interest;
- (d) undertake to deposit funds with the lender or a third party as security for the debt;
- (e) agree to specific payment mechanisms or procedures to ensure exclusive or dedicated payment to lenders, including revenue intercepts, payments into special purpose funds or accounts or other payment mechanisms or procedures;

- (f) cede as security any category of revenue or rights to future revenue specified in the financing agreement or information statement contemplated in section 23 (d);
- (g) undertake to have disputes resolved through mediation, arbitration or other dispute resolution mechanisms;
- (h) agree to restrictions on debt the municipality may want to incur in future; and
- (i) agree to such other arrangements as the municipality may consider necessary and prudent.

(3) A council resolution authorising the giving of security in terms of subsection (1) –

- (a) must determine whether the asset or right with respect to which the security is given, is necessary for providing a minimum essential municipal service; and
- (b) if so, must indicate the manner in which the availability of the asset or right for the provision of that service will be protected.

(4) If the resolution has determined that the asset or right is necessary for providing a minimum essential municipal service, the lender to whom the municipal security is given, may not, in the event of a default by the municipality, deal with the asset or right in a manner that would preclude or impede the continuation of that minimum essential municipal service.

(5) A determination in terms of subsection (4) that an asset or right is not necessary for providing a minimum essential municipal service is binding on the municipality until the secured debt has been paid in full.

### **Prohibited actions**

25. The national or a provincial government may guarantee debt of a municipality only in accordance with Chapter 8 of the Public Finance Management Act.

### **Disclosure**

26. Any person involved in the borrowing of money by a municipality must, when interacting with a prospective lender or when preparing documentation for consideration by a prospective investor –

- (a) disclose all information in that person's possession or within that person's knowledge that may be material to the decision of that prospective lender or a prospective investor; and
- (b) take reasonable care to ensure the accuracy of any information disclosed.

## CHAPTER 6

### RESPONSIBILITIES OF MUNICIPAL OFFICIALS

#### *Part 1: Municipal managers*

##### **Accounting officer**

27. (1) The municipal manager of a municipality is the accounting officer of the municipality for the purposes of this Act.

(2) The employment contract of an accounting officer must be in writing and, where possible, include performance standards. The provisions of sections 29, 30, 32 and 33, as may be appropriate, are regarded as forming part of such contract.

##### **Acting accounting officers**

28. When an accounting officer is absent or otherwise unable to perform the functions of accounting officer, or during a vacancy, the functions of accounting officer must be performed by the official acting in the place of that accounting officer.

##### **General responsibilities of accounting officers**

29. The accounting officer of a municipality –

- (a) must ensure that the municipality has and maintains –
  - (i) effective, efficient and transparent systems of financial and risk management and internal control;
  - (ii) a system of internal audit;
  - (iii) an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost-effective;

- (iv) a system for properly evaluating all major capital projects prior to a final decision on the project;
- (b) must keep full and proper records of the financial affairs of the municipality in accordance with any prescribed norms and standards;
- (c) is responsible for the effective, efficient, economical and transparent use of the resources of the municipality;
- (d) must take effective and appropriate steps to –
  - (i) collect all money due to the municipality;
  - (ii) prevent unauthorised expenditure and losses resulting from criminal conduct; and
  - (iii) manage available working capital efficiently and economically;
- (e) must without delay report all losses as result of criminal conduct to the South African Police Service;
- (f) is responsible for the management, including the safeguarding and the maintenance of the assets, and for the management of the liabilities, of the municipality;
- (g) must comply with any tax, levy, duty, pension and audit commitments as may be required by legislation;
- (h) must settle all contractual obligations and pay all money owing, within the prescribed or agreed period;
- (i) on discovery of any unauthorised expenditure, must immediately report, in writing, particulars of the expenditure to the municipal council and the Auditor-General;
- (j) must take effective and appropriate disciplinary steps against any official in the service of the municipality who –
  - (i) contravenes or fails to comply with a provision of this Act;

- (ii) commits an act which undermines the financial management and internal control system of the municipality; or
  - (iii) makes or permits an unauthorised expenditure expenditure;
- (k) before transferring any funds otherwise than in terms of a commercial or other business transaction to an entity outside the municipality, must obtain a written assurance from the entity that that entity implements effective, efficient and transparent financial management and internal control systems, or, if such written assurance is not or cannot be given, render the transfer of the funds subject to conditions and remedial measures requiring the entity to establish and implement effective, efficient and transparent financial management and internal control systems;
- (l) must enforce compliance with any prescribed conditions if the municipality gives financial assistance to any entity or person;
- (m) must take into account all relevant financial considerations, including issues of propriety, regularity and value for money, when policy proposals affecting the accounting officer's responsibilities are considered, and when necessary, bring those considerations to the attention of the municipal council;
- (n) must promptly inform the National Treasury in writing on any new entity which the municipality intends to establish, or in the establishment of which it takes the initiative, or in which it intends to acquire an interest;
- (o) is responsible for the submission by the municipality of all reports, returns, notices and other information to the relevant provincial legislature, the National Treasury, the relevant provincial treasury or the Auditor-General, as may be required by this Act; and



- (p) must comply, and take all reasonable steps to ensure compliance by the municipality, with the provisions of this Act.

**Accounting officers' responsibilities relating to budgetary control**

30. (1) The accounting officer of a municipality is responsible for ensuring that –

- (a) expenditure of the municipality is in accordance with the budget of the municipality;
- (b) effective and appropriate steps are taken to prevent –
  - (i) overspending of the municipality's budget;
  - (ii) under collection of revenue due; and
  - (iii) unauthorised expenditure.

(2) An accounting officer, for the purposes of subsection (1), must –

- (a) within 15 days of the end of each month submit to the councillor responsible for financial matters –
  - (i) information in the prescribed format on actual revenue and expenditure for that month;
  - (ii) a projection of expected expenditure and revenue collection for the remainder of the current financial year; and
  - (iii) when necessary, an explanation of any material variances and a summary of the steps that are taken to ensure that the projected expenditure and revenue remain within budget;
- (b) report to the councillor responsible for financial matters, any impending—
  - (i) under collection of revenue due;
  - (ii) shortfalls in budgeted revenue; and

- (iii) overspending of the municipality's budget; and
- (iv) any appropriate steps to be taken;

(3) The councillor responsible for financial matters must table in the council any statements and reports received from the municipal manager in terms of subsection (2) (a) and (b) at the first council meeting held after the receipt of the statement or report.

#### **Virement between votes in a budget**

31. (1) The accounting officer of a municipality may utilise a saving in the amount appropriated under a vote in a budget towards the defrayment of excess expenditure under another vote in the same budget, unless the municipal council directs otherwise.

(2) The accounting officer must as soon as possible table in the municipal council a report containing the prescribed particulars concerning the utilisation of a saving in terms of subsection (1).

#### **Information to be submitted by accounting officers**

32. (1) An accounting officer of a municipality must submit to the National Treasury, the relevant provincial treasury or the Auditor-General, such information, returns, documents, explanations and motivations as may be prescribed or as the relevant treasury or the Auditor-General may require.

(2) If an accounting officer is unable to comply with any of the responsibilities determined for accounting officers in this Part, the accounting officer must promptly report the inability, together with reasons, to the municipal council, the National Treasury and the relevant provincial treasury.

### ***Part 2: Other officials of municipalities***

#### **Delegation of powers and duties by accounting officers**

33. (1) The accounting officer of a municipality may in writing delegate any of the powers or duties entrusted or delegated to the accounting officer in terms of this Act, to an official in that municipality.

(2) A delegation to an official in terms of subsection (1) –

- (a) is subject to any limitations and conditions as may be prescribed or as the National Treasury may impose in a specific case;
- (c) may either be to a specific individual or to the holder of a specific post in the municipality; and
- (d) does not divest the accounting officer of the responsibility concerning the exercise of the delegated power or the performance of the delegated duty.

(3) The accounting officer may confirm, vary or revoke any decision taken in consequence of a delegation in terms of subsection (1), provided that no such variation or revocation of a decision may detract from any rights that may have accrued as a result of the decision.

#### **Responsibilities of other officials of municipalities**

34. An official of a municipality, subject to the directions of the municipal manager –

- (a) must ensure that the system of financial management and internal control established for that municipality is carried out within the area of responsibility of that official;
- (b) is responsible for the effective, efficient, economical and transparent use of financial and other resources within that official's area of responsibility;
- (c) must take effective and appropriate steps to prevent, within that official's area of responsibility, any unauthorised expenditure and any under collection of revenue due;
- (d) must comply with the provisions of this Act to the extent applicable to that official, including any delegations and instructions in terms of section 33; and
- (e) is responsible for the management, including the safeguarding, of the assets and the management of the liabilities within that official's area of responsibility.

## **CHAPTER 7**

### **MUNICIPAL BUDGET AND TREASURY OFFICES**

#### **Establishment**

35. (1) Every municipality must have a budget and treasury office.
- (2) Budget and treasury offices consists of –
- (a) a chief financial officer who must be an official of the municipality designated by the municipal manager to be administratively in charge of budgetary and treasury functions; and
  - (b) the staff allocated by the municipal manager to the chief financial officer for the performance of those functions.

#### **Functions and powers**

36. (1) The chief financial officer of a municipality performs the functions and exercises the powers that may be prescribed.
- (2) The chief financial officer of a municipality is accountable to the municipality's municipal manager for the performance of the functions and the exercise of the powers referred to in subsection (1).

#### **Delegation of functions and powers**

37. (1) The chief financial officer of a municipality may in writing delegate any of the powers or duties entrusted or delegated to the chief financial officer in terms of this Act to –
- (a) an official in the budget and treasury office or another official in the municipality;
  - (b) the holder of a specific post in the budget and treasury office or elsewhere in the municipality; or

- (c) the accounting authority of a municipal entity under the ownership control of the municipality.

(2) A delegation in terms of subsection (1) –

- (a) is subject to any limitations or conditions that the chief financial officer may impose;
- (b) does not divest that chief financial officer of the responsibility concerning the exercise of the delegated power or the performance of the delegated duty.

(3) The chief financial officer concerned may confirm, vary or revoke any decision taken in consequence of a delegation in terms of subsection (1), provided that no such variation or revocation of a decision may detract from any rights that may have accrued as a result of the decision.

## **CHAPTER 8**

### **MUNICIPAL ENTITIES**

#### ***Part 1: General***

##### **Performance of municipal services through corporate entities**

38. (1) A municipality may in terms of any applicable national or provincial legislation establish, or acquire an interest in, a corporate entity which as its main activity provides a municipal service in the municipality or in an area of which the municipality forms part.

(2) A corporate entity established or acquired in terms of subsection (1) performing a municipal service which is not a designated municipal service, must be wholly owned by one or more municipalities.

(3) A municipality may not establish or acquire a corporate entity solely for the purpose of raising or borrowing money.

##### **Municipal representatives serving on boards of municipal entities and other corporate entities**

39. (1) Before the council of a municipality appoints or nominates for appointment a person as a member of the board of directors or other governing body of a municipal entity, it must obtain and consider a recommendation of the municipal manager on the matter.

(2) A person appointed or nominated for appointment by a municipal council as a member of the board of directors or other governing body of a municipal entity must have the relevant skills and expertise in the services to be rendered as such a member.

(3) A councillor may be appointed or nominated for appointment by the council as a member of the board of directors or other governing body of a municipal entity but only in exceptional circumstances and provided –

- (a) the person appointed or nominated complies with subsection (2); and
- (b) the number of councillors on such a board or other body does not exceed a prescribed limit.

(4) (a) A councillor or official of a municipality may not receive compensation for serving on the board of directors or other governing body of a municipal entity under the ownership control of that municipality.

(b) Paragraph (a) does not prevent the payment of allowances to councillors or officials to reimburse them for reasonable expenses relating to the work of the municipal entity.

(5) Subsection (4) also applies to councillors or officials of a municipality serving on the board of directors or other governing body of any other corporate entity providing a service to or in the municipality.

#### **List of municipal entities**

40. (1) Each municipality must annually within one month of the end of each financial year submit to the National Treasury, the relevant provincial treasury and the Auditor-General a list of –



- (a) all municipal entities under the ownership control of the municipality as at the last day of the financial year; and
- (b) any other undertakings in which the municipality obtained an interest during the financial year.

(2) A list in terms of subsection (1) must be in the prescribed format and contain the prescribed particulars.

### ***Part 2: Accounting authorities***

#### **Accounting authorities**

41. (1) Every municipal entity must have an authority which must be accountable for the purposes of this Act.

- (2) (a) If the municipal entity –
- (i) has a board or other controlling body, that board or controlling body is the accounting authority for that entity; or
  - (ii) does not have a controlling body, the chief executive officer or other person in charge of the entity is the accounting authority for that entity unless specific legislation applicable to that entity designates another person as the accounting authority.

(b) The National Treasury, in exceptional circumstances, may approve or instruct that another functionary of a municipal entity must be the accounting authority for that entity.

(c) The National Treasury may at any time withdraw an approval or instruction in terms of paragraph (b).

(d) A municipal entity must inform the Auditor-General promptly and in writing of any approval or instruction in terms of paragraph (b) and any withdrawal of an approval or instruction in terms of paragraph (c).

(3) To the extent that the accounting authority of a municipal entity is in terms of this Act accountable to the municipality exercising ownership control over it, it must discharge that responsibility through the municipal manager of the municipality.

(4) If a board or other controlling body is the accounting authority of a municipal entity, that board or other body must appoint the chief executive officer of the entity or a member of the board or body to manage the financial affairs of the entity and to perform the accountability responsibilities of the accounting authority on a day to day basis in accordance with the instructions of the accounting authority.

#### **General responsibilities of accounting authorities**

42. (1) The accounting authority for a municipal entity-

(a) must ensure that that entity has and maintains-

- (i) effective, efficient and transparent systems of financial and risk management and internal control;
- (ii) a system of internal audit under the control and direction of an audit committee complying with and operating in accordance with regulations and instructions prescribed in terms of section 78;
- (iii) an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost-effective; and
- (iv) a system through which all major capital projects are properly evaluated on the basis of their financial, economic and social impact prior to a final decision on the project;

- (b) must keep full and proper records of the financial affairs of the entity;
- (c) must take effective and appropriate steps to –
  - (i) collect all revenue due to the public entity concerned; and
  - (ii) prevent irregular expenditure, losses resulting from criminal conduct, and expenditure not complying with the operational policies of the entity; and
  - (iii) manage available working capital efficiently and economically;
- (d) is responsible for the management, including the safeguarding, of the assets and for the management of the revenue, expenditure and liabilities of the entity;
- (e) must comply with any tax, levy, duty, pension and audit commitments as may be required by legislation;
- (f) must take effective and appropriate disciplinary steps against any employee of the entity who –
  - (i) contravenes or fails to comply with a provision of this Act;
  - (ii) commits an act which undermines the financial management and internal control system of the entity; or
  - (iii) makes or permits an irregular expenditure;
- (g) is responsible for the submission by the entity of all reports, returns, notices and other information to the municipal council, as may be required by this Act;
- (h) must promptly inform the National Treasury and the relevant provincial treasury on any new entity which that entity intends to acquire or establish or in the establishment of which it takes the initiative; and
- (i) must comply, and ensure compliance by the entity, with the provisions of this Act and any other legislation applicable to the entity.

(2) If an accounting authority is unable to comply with any of the responsibilities determined for accounting authorities in this Part, the accounting authority must promptly report the inability, together with reasons, to the council of the municipality exercising ownership control over it.

**Information to be submitted by accounting authority**

43. The accounting authority of a municipal entity must submit to the municipal manager of the relevant municipality, the National Treasury, the relevant provincial treasury or the Auditor-General such information, returns, documents, explanations and motivations as may be prescribed or as the municipality, the relevant treasury or the Auditor-General may require.

***Part 3: Other officials of municipal entities***

**Delegation of powers and duties by accounting authorities**

44. (1) The accounting authority of a municipal entity may delegate, in writing, any of the powers and duties entrusted or delegated to the accounting authority in terms of this Act, to an official of that municipal entity.

(2) A delegation in terms of subsection (1) –

- (a) is subject to any limitations and conditions the accounting authority may impose;
- (b) may be either to a specific individual or to the holder of a specific post in the relevant municipal entity; and
- (c) does not divest the accounting authority of the responsibility concerning the exercise of the delegated power or the performance of the delegated duty.

(3) The accounting authority may confirm, vary or revoke any decision taken by an official in consequence of a delegation or

instruction in terms of subsection (1), provided that no such variation or revocation of a decision may detract from any rights that may have accrued as a result of the decision.

#### **Responsibilities of other officials**

45. (1) An official in a municipal entity –
- (a) must ensure that the system of financial management and internal control established for that entity is carried out within the area of responsibility of that official;
  - (b) is responsible for the effective, efficient, economical and transparent use of financial and other resources within that official's area of responsibility;
  - (c) must take effective and appropriate steps to prevent, within that official's area of responsibility, any irregular expenditure and any under collection of revenue due;
  - (d) must comply with the provisions of this Act to the extent applicable to that official, including any delegations and instructions in terms of section 44; and
  - (e) is responsible for the management, including the safeguarding, of the assets and the management of the liabilities within that official's area of responsibility.

(2) When complying with subsection (1), an official is bound by the system of financial management and internal control established by the accounting authority of the municipal entity.

***Part 4: Loans and guarantees*****Borrowing of money**

46. A municipal entity may borrow money but only in accordance with a business plan approved by the municipal council or councils exercising ownership control over it.

**Guarantees**

47. A municipality may guarantee any loan of a municipal entity under its ownership control provided the loan is reflected in the approved business plan of the entity and is disclosed in the municipality's consolidated financial statements.

## CHAPTER 9

### FINANCIAL STATEMENTS AND AUDITING

#### *Part 1: Annual financial statements*

#### **Annual report and financial statements of municipalities not controlling municipal entities**

48. (1) The accounting officer of a municipality which does not exercise ownership control over any municipal entity –

- (a) must prepare financial statements for each financial year in accordance with generally recognised accounting practice;
- (b) must reflect in those statements any financial stake the municipality may have in any other undertakings;
- (c) must submit those financial statements to the Auditor-General for auditing within two months after the end of the financial year; and
- (d) within one month of receiving the Auditor-General's audit report, must –
  - (i) table in the municipal council an annual report on the activities of the municipality during that financial year, a copy of the financial statements and the audit report;
  - (ii) submit to the National Treasury and the provincial treasury concerned copies of the municipality's annual report, the financial statements and the audit report.

(2) The Auditor-General must audit the financial statements referred to in subsection (1) (a) and submit an audit report on those statements to the accounting officer within three months of receipt of the statements.

(3) The annual report and audited financial statements referred to in subsection (1) (d) must—

- (a) fairly present the state of affairs of the municipality, its business, its financial results, its performance against prescribed financial management performance indicators and its financial position as at the end of the financial year concerned; and
- (b) include particulars of –
  - (i) any material losses through criminal conduct and any unauthorised expenditure that occurred during the financial year;
  - (ii) any criminal or disciplinary steps taken as a result of such losses or unauthorised expenditure;
  - (iii) any material losses recovered or written off; and
  - (iv) any other matters that may be prescribed.

(4) (a) Representatives of the Auditor-General, the relevant provincial treasury and the relevant provincial department are entitled to attend and to speak at a meeting of the municipal council at which the financial statements and the audit report are tabled or discussed or at which decisions concerning the financial statements and the audit report are to be taken.

(b) The municipal manager must –

- (i) give written notice of such meetings to the Auditor-General, the relevant provincial treasury and the relevant provincial department; and
- (ii) submit copies of the minutes of these meetings to the Auditor-General, the relevant provincial treasury and the relevant provincial department.



(5) The financial statements and audit report must be made public when tabled in the municipal council.

(6) The MEC for finance in the province concerned, without delay, must submit copies of the financial statements and the audit report and any particulars of corrective action referred to in subsection (3) (b) (ii) to the relevant provincial legislature.

#### **Annual report and financial statements of municipal entities**

49. (1) The accounting authority of a municipal entity must –

- (a) prepare financial statements in respect of the entity for each financial year in accordance with generally recognised accounting practice, unless the Accounting Standards Board approves another accounting standard for that entity;
- (b) reflect in those statements any financial stake the entity may have in any other undertakings;
- (c) submit those financial statements within one month after the end of the financial year to –
  - (i) the auditors of the entity for auditing; and
  - (ii) the municipality exercising ownership control over that entity;
- (d) submit within one month after receiving the report of the auditors on those financial statements to the municipality concerned and, if the Auditor-General did not perform the audit of the financial statements, also to the Auditor-General –
  - (i) an annual report on the activities of that entity during that financial year;

- (ii) the financial statements for that financial year after the statements have been audited; and
- (iii) the report of the auditors on those statements.

(2) The annual report and financial statements referred to in subsection (1) must –

- (a) fairly present the state of affairs of the municipal entity, its business, its financial results, its performance against predetermined objectives and its financial position as at the end of the financial year concerned;
- (b) include particulars of -
  - (i) any losses through criminal conduct and any irregular expenditure that occurred during the financial year;
  - (ii) any criminal or disciplinary steps taken for such losses or irregular expenditure;
  - (iii) any losses recovered or written off;
  - (iv) any financial assistance received from any organ of state in any sphere of government and commitments made by any organ of state on its behalf; and
  - (v) any other matters that may be prescribed; and
- (c) include the financial statements of any subsidiaries.

#### **Annual report and financial statements of municipalities controlling municipal entities**

50. The accounting officer of a municipality which exercises ownership control over one or more municipal entities must, in accordance with generally recognised accounting practice –

- (a) prepare consolidated financial statements for each financial year in respect of –

- (i) the municipality; and
  - (ii) all municipal entities under the ownership control of the municipality; and
- (b) reflect in those statements any financial stake the municipality or such municipal entity may have in any other undertakings.

### **Process**

**51. (1)** The accounting officer of a municipality must submit the consolidated financial statements referred to in section 50 to the Auditor-General for auditing within two months after the end of the financial year.

(2) The Auditor-General must audit the consolidated financial statements and submit an audit report on the statements to the municipality, the National Treasury and the provincial treasury concerned within three months of receipt of the statements.

(3) The municipal manager, within one month of receiving the audit report from the Auditor-General, must –

- (a) table in the municipal council an annual report on the activities of the municipality and the municipal entities concerned during that financial year, a copy of the consolidated financial statements and the audit report; and
- (b) submit to the National Treasury and the relevant provincial treasury –
  - (i) copies of the annual report, the consolidated financial statements and the audit report; and

- (ii) particulars of any corrective action taken in response to the findings of the audit report.

(4) The annual report and audited consolidated financial statements referred to in subsection (3) must—

- (a) fairly present the state of affairs of the municipality and the municipal entities concerned, their business, their financial results, their performance against prescribed financial management performance indicators and their financial position as at the end of the financial year concerned; and
- (b) include particulars of —
  - (i) any material losses through criminal conduct, any unauthorised expenditure by the municipality and any irregular expenditure by municipal entities under the ownership control of the municipality, that occurred during the financial year;
  - (ii) any criminal or disciplinary steps taken as a result of such losses, unauthorised expenditure or irregular expenditure;
  - (iii) any material losses recovered or written off; and
  - (iv) any other matters that may be prescribed.

- (5) (a) Representatives of the Auditor-General, the relevant provincial treasury and the relevant provincial department are entitled to attend and to speak at a meeting of the municipal council at which the consolidated financial statements and the audit report are tabled or discussed or at which decisions concerning the consolidated financial statements and the audit report are to be taken.

- (b) The municipal manager must –
- (i) give written notice of such meetings to the Auditor-General, the relevant provincial treasury and the relevant provincial department; and
  - (ii) submit copies of the minutes of these meetings to the Auditor-General, the relevant provincial treasury and the relevant provincial department.

(6) The consolidated financial statements and audit report must be made public when tabled in the municipal council.

(7) The MEC for finance in the province concerned, without delay, must submit copies of the consolidated financial statements and the audit report and any particulars of corrective action referred to in subsection (3) (b) (ii) to the relevant provincial legislature.

#### **Consequences of non-compliance**

52. If the municipal manager fails to submit financial statements to the Auditor-General or to table financial statements and the Auditor-General's audit report on those statements in the municipal council in accordance with section 48 or 51 –

- (a) the municipal manager must promptly table in the council a written explanation setting out the reasons why they were not submitted;
- (b) the Auditor-General may issue a special report on the delay; and
- (c) the Minister, after consulting the Cabinet member responsible for local government, may withhold the transfer of funds from the National Revenue Fund to the municipality.

## ***Part 2: Auditing of Municipalities***

### **Audit requirements**

53. (1) The accounts, annual financial statements and financial management of all municipalities must annually be audited by the Auditor-General as required by section 188 of the Constitution.

(2) An audit referred to in subsection (1) is performed in terms of the Auditor-General Act, 1995, (Act 12 of 1995), and this Act.

### **Withholding of funds**

54. If a municipality fails within a period determined by the National Treasury to take adequate steps to rectify any adverse findings of the Auditor-General in a report referred to in section 53 (3), the Minister may withhold the transfer of funds from the National Revenue Fund to the municipality.

## ***Part 3: Auditing of municipal entities***

### **Appointment of auditors**

55. (1) The annual financial statements and financial management of a municipal entity must be audited annually by—

- (a) the Auditor-General; or
- (b) a person registered in terms of section 15 of the Public Accountants' and Auditors' Act, 1991 (Act No. 80 of 1991), as an accountant and auditor, and engaged in public practice as such.

(2) A municipal entity may appoint, as its auditor, a person referred to in subsection (1) (b) only with the approval of the Auditor-General.

**Discharge of auditors**

56. (1) A municipal entity may not discharge an auditor appointed by it in terms of section 55 (2) before the expiry of that auditor's term of appointment except with the approval of the municipal council which control that municipal entity and the Auditor-General.

(2) If a municipal entity intends discharging an auditor in terms of subsection (1), it must—

- (a) give the auditor notice, in writing, setting out the reasons for the discharge; and
- (b) give the auditor an opportunity to make representations, in writing, to the municipal council or councils which control that municipal entity and the Auditor-General within 20 days of receipt of the notice.

(3) The Auditor-General must report any discharge of an auditor in terms of this section to the provincial legislature concerned.

**Duties and powers of auditors**

57. (1) An auditor appointed in terms of section 55 (2) must perform the functions of office as auditor in terms of section 20 of the Public Accountants' and Auditors' Act, 1991 (Act No. 80 of 1991).

(2) In exercising the powers and performing the duties as auditor of a municipal entity, the auditor—

- (a) has access at all reasonable times to all records, including books, vouchers, documents, plans and other property of the municipal entity;

- (b) may require from the accounting authority for that municipal entity such information and explanations as are necessary for the purpose of the audit; and
- (c) may investigate whether there are adequate measures and procedures for the proper application of sound economic, efficient and effective management.

(3) An auditor appointed in terms of section 55 (2) may consult the Auditor-General or any person in the Office of the Auditor-General concerning any matter relating to the auditing of the municipal entity concerned.

- (4) An auditor appointed in terms of section 55 (2) –
- (a) must receive notice of every meeting of the municipal entity's audit committee; and
  - (b) may attend, and participate in, any meeting of the audit committee at the expense of the municipal public entity.

### **Reports of auditor**

58. (1) The report of an auditor appointed in terms of section 55 (2) must state separately in respect of each of the following matters whether in the auditor's opinion –

- (a) the annual financial statements of the municipal entity fairly present the financial position, financial results and cash flow of the entity in accordance with section 49 (1) (a) applied on a basis consistent with that of the preceding year;
- (b) if required by the Auditor-General, the performance information furnished in terms of subsection 49 (2) (a) is fair in all material respects



and, if applicable, on a basis consistent with that of the preceding year;  
and

- (c) the transactions that had come to the auditor's attention during auditing were in all material respects in accordance with the mandatory functions of the municipal public entity determined by law or otherwise.

(2) The auditor—

- (a) must report to the municipal council or councils which control the municipal entity concerned the results of any investigation carried out under section 57 (2) (c); and
- (b) when reporting in terms of paragraph (a), must draw attention to any other matters within the auditor's investigation which, in the auditor's opinion, should be disclosed.

(3) The auditor must submit copies of the report to—

- (a) the municipal entity concerned;
- (b) the municipal council which control that municipal entity;
- (c) the National Treasury; and
- (d) the provincial treasury concerned.

**Duties and powers of Auditor-General**

**59. (1) The Auditor-General may—**

- (a) conduct an appropriate audit and report thereon if the Auditor-General considers it to be in the public interest or upon the receipt of a credible complaint; and

- (b) recover the cost of the investigation or audit from the municipal entity concerned.

(2) An audit in terms of section (1) may be carried out either by the Auditor-General or a person appointed by the Auditor-General.

(3) If the Auditor-General issues a special report in terms of subsection (1) or (2) –

- (a) the report must promptly be tabled in the municipal council responsible for the municipal entity concerned; and
- (b) the Auditor-General must submit a copy of the report to –
  - (i) the National Treasury; and
  - (ii) the provincial treasury concerned.

(4) The Auditor-General may—

- (a) claim the reasonable cost of performing the duties and exercising the powers in terms of this section from the municipal entity concerned; and
- (b) annually report to Parliament on specific and general findings regarding the accountability of municipal entities.

## **CHAPTER 10**

### **FINANCIAL EMERGENCIES**

**(Sections 60 – 77 moved to Appendix IV of the Policy Framework for  
Municipal Borrowing and Financial Emergencies as it is subject to  
enactment of a constitutional amendment)**

## **CHAPTER 11**

### **GENERAL TREASURY MATTERS**

#### **Treasury regulations, instructions and guidelines**

**78.** (1) The National Treasury may make regulations or issue instructions or guidelines applicable to municipalities and municipal entities, concerning –

- (a) any matter that may be prescribed for municipalities and municipal entities in terms of this Act;
- (b) financial management and internal control;
- (c) a framework for an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost-effective, which may include provisions disallowing councillors to be members of municipal tender boards or committees;
- (d) the establishment by municipalities of, and control over, internal trading entities and municipal entities;
- (e) the transfer of assets from a municipality to a municipal entity under its ownership control or from such entity to the municipality;
- (f) the alienation, letting or disposal of assets by municipalities;
- (g) audit committees, their appointment and their functioning;
- (h) internal audit components and their functioning;
- (i) costing framework for municipal activities;
- (j) the information to be disclosed when a municipality or municipal entity incurs debt;
- (k) the compulsory disclosure of material facts by, and duties of reasonable enquiry of, councillors, officials of municipalities or municipal entities, lenders, brokers, underwriters and other persons when a municipality or municipal entity incurs debt;

- (l) the prospectus or prescribed documents required for the issuing or trading of municipal debt instruments;
- (m) the circumstances under which further or specific disclosures are required after money has been borrowed by a municipality or public entity;
- (n) specific facts to be disclosed upon the occurrence of events material to decisions of prospective lenders and investors;
- (o) the circumstances under which documentation or information pertaining to municipal debt need to be lodged or registered;
- (p) the establishment of a registry for the registration of prescribed documentation and information pertaining to municipal borrowing;
- (u) the administration of this Act; and
- (v) any other matter that may facilitate the application of this Act.

(2) The National Treasury may by regulation determine that a contravention of, or failure to comply with, a specific regulation in terms of subsection (1) is an offence and that a person found guilty of such an offence is liable to an appropriate fine or to imprisonment not exceeding one year.

(3) A regulation, instruction or guideline in terms of this section may –

- (a) differentiate between different categories of –
  - (i) municipalities;
  - (ii) municipal entities; or
  - (iii) accounting officers; or
  - (iv) accounting authorities; or
- (b) be limited in its application to a specific category of –

- (i) municipalities;
- (ii) municipal entities;
- (iii) accounting officers; or
- (iv) accounting authorities.

#### **Audit committees**

79. (1) An audit committee –

- (a) must consist of at least three persons of whom at least the majority must not be in the employ of the municipality or municipal public entity, as the case may be; and
- (b) must meet at least twice a year.

(2) A single audit committee may be appointed for a district municipality and the local municipalities within that district municipality.

#### **Publishing of draft treasury regulations for public comment**

80. Draft regulations in terms of section 78 must be published for public comment in the national *Government Gazette* before their enactment.

#### **Departures from treasury regulations, instructions or conditions**

81. The National Treasury may on good grounds approve a departure from a treasury regulation or instruction or any condition imposed in terms of this Act and must promptly inform the Auditor-General in writing when it does so.

## CHAPTER 12

### FINANCIAL MISCONDUCT

#### *Part 1: Disciplinary proceedings*

##### **Financial misconduct by municipal officials**

82. (1) The accounting officer of a municipality commits an act of financial misconduct if that accounting officer wilfully or negligently—

- (a) fails to comply with a requirement of section 29, 30, 32, 33, 48 or 50;  
or
- (b) makes or permits an unauthorised expenditure.

(2) An official of a municipality to whom a power or duty is assigned in terms of section 33 commits an act of financial misconduct if that official wilfully or negligently fails to exercise that power or perform that duty.

##### **Financial misconduct by accounting authorities and officials of municipal entities**

83. (1) The accounting authority of a municipal entity commits an act of financial misconduct if that accounting authority wilfully or negligently—

- (a) fails to comply with a requirement of section 42, 43 or 49; or
- (b) makes or permits an irregular expenditure.

(2) If the accounting authority is a board or other body consisting of members, every member is individually and severally liable for any financial misconduct of the accounting authority.

(3) An official of a municipal entity to whom a power or duty is assigned in terms of section 44 commits an act of financial misconduct if that official wilfully or negligently fails to exercise that power or perform that duty.

(4) Financial misconduct is a ground for dismissal or suspension of, or other sanction against, a member or person referred to in subsection (2) or (3) despite any other legislation.

#### **Applicable legal regime for disciplinary proceedings**

84. A charge of financial misconduct against an accounting officer or an official referred to in section 82 (2) or 83 (2) or an accounting authority or a member of an accounting authority or an official referred to in section 83 (3), must be investigated, heard and disposed of in terms of the statutory or other conditions of appointment or employment applicable to that accounting officer or authority, or member or official, and any regulations made by the Minister in terms of section 85.

#### **Regulations on financial misconduct procedures**

85. (1) The Minister may make regulations prescribing –

- (a) the manner, form and circumstances in which allegations and disciplinary and criminal charges of financial misconduct must be reported to the National Treasury, the relevant provincial treasury and the Auditor-General, including—
  - (i) particulars of the alleged financial misconduct; and
  - (ii) the steps taken in connection with such financial misconduct;
- (b) matters relating to the investigation of allegations of financial misconduct;



- (c) the circumstances in which the National Treasury or the relevant provincial treasury may direct that disciplinary steps be taken or criminal charges be laid against a person for financial misconduct;
- (d) the circumstances in which a disciplinary board which hears a charge of financial misconduct must include a person whose name appears on a list of persons with expertise in municipal finances or public accounting compiled by the National Treasury;
- (e) the circumstances in which the findings of a disciplinary board and any sanctions imposed by the board must be reported to the National Treasury, the relevant provincial treasury and the Auditor-General; and
- (f) any other matters to the extent necessary to facilitate the object of this Chapter.

(2) A regulation in terms of subsection (1) may –

- (a) differentiate between different categories of –
  - (i) municipalities;
  - (ii) municipal entities;
  - (iii) accounting officers;
  - (iv) accounting authorities; and
  - (v) officials; and
- (b) be limited in its application to a particular category of –
  - (i) municipalities;
  - (ii) municipal entities;
  - (iii) accounting officers;
  - (iv) accounting authorities; or
  - (v) officials.

## ***Part 2: Criminal proceedings***

### **Offences and penalties**

86. (1) An accounting officer of a municipality is guilty of an offence and liable on conviction to a fine, or to imprisonment for a period not exceeding five years, if that accounting officer wilfully or in a grossly negligent way fails to comply with a provision of section 29, 30 or 33.

(2) An accounting authority is guilty of an offence and liable on conviction to a fine, or to imprisonment for a period not exceeding five years, if that accounting authority wilfully or in a grossly negligent way fails to comply with a provision of section 42 or 43.

(3) A councillor of a municipality is guilty of an offence and liable on conviction to a fine, or to imprisonment for a period not exceeding two years, if that councillor influences the municipal manager of the municipality to contravene a provision of this Act or to refrain from complying with a requirement of this Act.

(4) A person is guilty of an offence and liable on conviction to a fine, or to imprisonment for a period not exceeding five years, if that person –

- (a) wilfully gives incorrect, untrue or misleading information material to an investment decision relating to municipal borrowing;
- (b) contravenes a provision of section 22(4);
- (c) fails to comply with section 26; or

## CHAPTER 13

### MISCELLANEOUS

#### **Limitation of liability**

87. No person shall be liable in respect of anything done in good faith under this Act.

#### **Exemptions**

88. (1) The Minister, by notice in the national *Government Gazette*, may exempt any municipality or municipal entity, or any category of municipality or municipal public entity, from any specific provision of this Act for a period and on conditions determined in the notice.

(2) A notice granting an exemption from a requirement of this Act that something must be done before a specific date may specify a more lenient date for compliance with the requirement.

#### **Transitional provisions**

89. (1) Anything done in terms of a provision repealed by section 90 which can be done in terms of a provision of this Act, must be regarded as having been done by in terms of this Act.

(2) All municipalities must within three months of the date on which this Act takes effect submit to the National Treasury a list of all corporate entities in which the municipality has an interest, specifying –

- (a) the name and address of the entity;
- (b) the purpose, extent and other particulars of the interest; and
- (c) whether the entity is under the ownership control of the municipality.

**Amendment of legislation**

**90.** (1) Section 10G of the Local Government Transition Act, 1993 (Act 209 of 1993), and section 26 of the Promotion of Local Government Act are hereby repealed.

(2) Schedule 5 of the Municipal Structures Act is hereby amended by the insertion in item 11 after paragraph (a) of the following paragraph:

“(A) interfere in the financial management responsibilities of the accounting officer and chief financial officer of the municipality;”.

**Short title and commencement**

**91.** This Act is called the Municipal Finance Management Act, 2000, and takes effect on 1 July 2001 except those provisions determined by the Minister by notice in the national *Government Gazette*, which will take effect on a date determined in the notice.

## **MEMORANDUM ON THE OBJECTS OF THE MUNICIPAL FINANCE MANAGEMENT BILL**

### **Introduction**

Local government financial management is currently legislated for by the Local Government Transition Act, Act 209 of 1993 (LGTA). This Act which regulated the transitional phase is destined for repeal after the next local government elections. The Municipal Systems Bill that deals primarily with administrative issues will supersede part of the LGTA. The issues relating to financial management will be replaced by the Municipal Finance Management Bill. Some of the matters dealt with in the Municipal Finance Management Bill have a longer term impact, but a number are also particularly important for the immediate transitional period. The Municipal Finance Management Bill is a critical element in the transformation of local government that is currently underway within the policy framework established by the White Paper on Local Government.

Norms and standards for financial management in the national and provincial spheres of government were provided by way of the Public Finance Management Act, 1999 (Act 1 of 1999), the implementation of which is currently being phased in. The Municipal Finance Management Bill is the equivalent legislation for the local sphere of government.

### **Content**

The purpose of the Municipal Finance Management Bill is fivefold:

- To regulate municipal financial management;
- To set requirements for the efficient and effective management of the revenue, expenditure, assets and liabilities of municipalities and municipal entities;
- To define responsibilities with regard to municipal financial management;
- To determine a financial management governance framework for municipal entities; and,
- To put in place a municipal borrowing framework.

The Bill covers the following areas:

**Chapter 1** provides definitions of key concepts and outlines who the legislation applies to as well as conditions under which amendments may be made.

**Chapter 2** deals with the intergovernmental aspects of local government financial management. It defines the major relationships between the different spheres of government as they pertain to municipal financial management. The provisions in this chapter enable national and provincial government to monitor local government finances, to prescribe relevant norms and standards for municipalities and to delegate powers.

**Chapter 3** sets out conditions for municipal revenue and investments. It requires each municipality to establish a Revenue Fund, into which all monies received by municipalities must be paid. The municipal manager is made accountable for the Revenue Fund and must ensure compliance with the

relevant requirements in the legislation. Various procedures are outlined for the control, withdrawal and investment of funds. The National Treasury is granted powers to prescribe a framework for municipal cash management and the management of investments by local governments.

**Chapter 4** defines a process of annual budgeting for municipalities (within a framework of multi-year budgeting), including provisions for regular reporting to their councils and the national and provincial governments. The guiding principle is that municipalities will assume responsibility for detailed budgeting, within a nationally determined macro-economic framework. Provision is made for budget adjustments and for the shifting of funds between budget votes in the course of a municipality's financial year, subject to certain reporting requirements. Limitations – based on the previous year's budget – are placed on municipalities' expenditures in the event of them not having passed their budgets. The provisions regarding budgets and budgeting aim to establish a clear link between the assignment of functions to municipalities and the allocation of resources to such bodies. Councils are made ultimately responsible for passing budgets, within the framework set for intergovernmental relations around financial management in the local sphere of government.

**Chapter 5** deals with the borrowing of money by municipalities. It limits short-term borrowing to bridging operating cash shortfalls or to bridge capital requirements, on the basis of anticipated income streams, grants or long term debt in waiting. It requires that short-term debt be paid off annually. Long-term borrowing is limited to funding of capital investment. It also sets requirements for the authorisation of municipal debt, without national or provincial approval and spells out the conditions for providing security. The chapter rules out

guarantees of municipal debt by national and provincial governments, other than what is provided for in the Public Finance Management Act. Disclosure requirements for the borrowing of money by a municipality are also set out.

**Chapter 6** defines the responsibilities of officials involved in municipalities' financial management. The municipal manager is designated as a municipality's accounting officer, with some general and specific responsibilities related to developing and maintaining effective, efficient and transparent systems of financial and risk management and internal control, budget and expenditure control, the control of assets and liabilities, and reporting. Written employment contracts and performance standards are required for the accounting officer. Part 2 of the chapter sets out conditions for the delegation of powers and duties by municipal accounting officers to other officials and outlines the implications this has for such other officials.

**Chapter 7** requires that municipalities establish Treasury and Budget Offices, under control of a Chief Financial Officer, who, in turn, are enabled to delegate some specific responsibilities to officials who report to them.

**Chapter 8** allows municipalities to retain or establish a variety of corporate entities in terms of other relevant legislation, but also makes it possible for statutory and regulatory limitations and requirements to be imposed on such entities. These conditions concern accounting, auditing, asset transfers, debt management, governance, reporting and disclosure, decision-making, mandates and operational scope, planning and budgeting and investments. Every municipal entity is required to have an accounting authority who will be accountable for the execution of such conditions.



**Chapter 9** outlines requirements and procedures for local governments' financial statements and auditing. The municipal manager must, in accordance with generally recognised accounting practice, ensure that annual consolidated financial statements are issued and submitted to the Auditor-General and the national and relevant provincial Treasury. The relevant MECs must, in turn, submit copies of the statements, the audit report and particulars of corrective action to their provincial legislatures. Stringent conditions are set to ensure compliance by all relevant parties with these requirements.

**Chapter 10 ( Removed as it is subject to the passage of a constitutional amendment)**

**Chapter 11** deals with a number of general treasury matters. These are the assignment of powers to the National Treasury to make regulations or issue instructions or guidelines relevant to the Act or specific aspects of municipal financial management in general and for borrowing by municipalities or municipal entities. Provisions are also set for the creation of audit committees.

**Chapter 12** is concerned with financial misconduct within municipalities. It defines the concept of financial misconduct with reference to the various relevant clauses in other chapters of the Bill, and relevant to municipal officials as well as the accounting authorities and officials of municipal entities. A legal regime is provided for disciplinary proceedings and the Minister of Finance is empowered to make regulations prescribing procedures in this regard. Part 2 of the chapter provides for criminal proceedings against accounting officers, accounting authorities and officials.

**Chapter 13** provides for miscellaneous aspects. It limits liability in respect of anything done in good faith in terms of the legislation, allows the Minister to exempt municipalities and municipal entities from specific provisions of the legislation, and sets out transitional arrangements for the phasing in of the legislation and for repeal thereof.

### **Conclusion**

The legislative reforms and transformation framework as articulated in the White Paper on Local Government is incomplete without a firm foundation for financial management reforms. The Municipal Finance Management Bill provides such a foundation for orderly and sound financial management principles and practices in the local sphere of government.



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**NOTICE 2739 OF 2000**

**POLICY FRAMEWORK FOR  
MUNICIPAL BORROWING AND  
FINANCIAL EMERGENCIES**

**Department of Finance**

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## 1. INTRODUCTION: BACKGROUND AND OBJECTIVES

### 1.1 Background

Municipalities are fast emerging as the fulcrum of South Africa's newly created system of multi-sphered government. First, the Constitution recognizes local government as an independent sphere with its own unique set of roles and importance. Second, it is central to the implementation of Government's growth strategies. For example, over 80% of the nation's GDP is urban based, with the economic nodes concentrated in the country's metropolitan centres. The governance and management of these areas is obviously critical to achieving government's broader economic objectives. Similarly, there is greater recognition that non-urban local governments will play an essential role in facilitating Government's push for integrated rural development. Third, the delivery of basic municipal services to all communities - urban and rural - is dependent on the effective performance of local government. Finally, at the political level, the 1999 national election campaign revealed the importance communities gave to their interface with local councils and administration - an interface that may well signal the strength of South Africa's new democracy.

In sum, the final shape, capacity and performance of local governments in South Africa will have direct implications for the political, social and economic fabric of the society.

Recognizing this, government published the *White Paper on Local Government* in March 1998. The intention of that document was to provide a general framework for the formulation of more detailed policies and legislation on a range of matters, including the fiscal and financial structure of the local sphere. As with the document on fiscal transfers from central to local government (*The Introduction of an Equitable Share of National Revenue for Local Government*, published by the Department of Finance in 1998), the document that government publishes today is a detailed follow-up to the White Paper. It expands on the framework for municipal finance and focuses, in particular, on the design of the regulatory framework for local government borrowing. In addition it deals in detail with the related matter of central government's response to the financial and fiscal difficulties that the municipal sector confronts. *The central objective of this document is thus twofold: first, to provide the policy framework for the overall financial structure of the local sphere and the borrowing powers of municipalities; and, second, to outline government's main initiatives in respect of municipalities which face financial crisis.* Any consequential legislation will be tabled in Parliament during 2000, while the envisaged fiscal programmes will be introduced from fiscal year 2000/01 onwards.

### 1.2 Imperatives underlying policy framework

Four key factors have driven the formulation of the policy framework presented here:

- First, *the Constitution* – at S. 230 – both grants to municipalities the right to borrow and creates the expectation that these rights will be coherently regulated by legislation passed by central government. To date, central government has not developed a sufficiently thoroughgoing regulatory framework, established in law, in this area. In particular, the elements of existing legislation which address local authority borrowing issues (e.g. Section 10G of the Local Government Transition Act, as amended) do not properly take account of the changed institutional and policy environment which now exists. There is thus currently a partial regulatory and legislative vacuum in respect of the financial structure of the local sphere and the borrowing powers and obligations of municipalities. This document is meant to provide the policy basis for the legislation and regulations which will address this vacuum.
- Second, and due in part to the existing vacuum, *the municipal debt market has stagnated*. Studies conducted by the Department of Finance indicate that between March 1998 and March 1999 direct private sector lending to municipalities grew by only R1,84bn. Of this, almost R500m was accounted for by one institution (INCA.) Moreover, over 80% of this growth took the form of short-term lending. The long term debt market – which is especially critical for providing financial resources for municipalities for investment in infrastructure which is critical to both economic and social development (water, power, roads and waste) – has largely dried up.
- Third, *policy imperatives* dictate the need for clear legislation on borrowing powers. Government has repeatedly emphasised (e.g. in the *Municipal Infrastructure Investment Framework*, 1995, and later in the White Paper) that private finance will need to form an important source of funding for capital investments in the municipal sector. But, unlike the pre-1994 era, such funding will not be guaranteed by the central fiscus. Instead, municipalities will have to raise private finance on their own books and bear the responsibility for servicing the debt. *This policy shift from national guarantees to local responsibility for private debt now requires the introduction of a legal and regulatory framework that clarifies the rights and obligations of borrowers and creditors*. Without it, a broad municipal finance market may be extremely slow to develop with market players remaining unwilling to make investments in the municipal sector. Ultimately government's delivery goals will remain hostage to policy uncertainty.
- Finally, many municipalities have encountered *increasing financial difficulties* in recent years. For a number of reasons it is important that government respond systemically to this situation. First, it is obviously critical that the delivery of essential services - which is threatened in some cases - is maintained. In acting here, however, central government cannot allow itself to get drawn into a succession of ad hoc responses it has neither the capacity nor the fiscal resource to sustain. In other words, central government needs to respond in a manner which provides municipalities' with the incentives to perform their functions effectively and manage their fiscal and financial affairs prudently. Third, in the absence of such a response it is unlikely that local



government will be able to attract significant investment from the private sector.

### 1.3 Context: local government reform

As outlined in the White Paper, local government in South Africa is undergoing a major process of restructuring and transformation in a number of different areas. The overall objective is to give municipalities sufficient resources and capacity to carry out their extensive responsibilities in respect of the development and management of the services for which they are accountable. There are three key dimensions to this transformation.

- At the *institutional* level, the process has involved the amalgamation of the racially fragmented local authorities and the creation of democratic municipal governments. Currently a demarcation process is underway to redefine the boundaries and numbers of the local governments, and legislation such as the Municipal Systems Bill is currently under consideration by government. As a result of these initiatives it is expected that the total numbers of municipalities will greatly reduce. Metropolitan centres will see the emergence of metropolitan governments and a uni-city structure. In addition, outside these metropolitan nodes, the roles and functions of district councils are being redefined especially in relation to smaller primary municipalities and rural local governments.
- Supporting this overall institutional change is the evolving *fiscal framework* for the local sphere. This includes the preservation and strengthening of the local tax bases (rates and levies) and the rationalisation of municipal authority to change tax rates and implement user-charges. In addition, Government has replaced the ad-hoc intergovernmental grants of the apartheid era with a more efficient, equitable, and predictable system of recurrent ("equitable share") and capital (CMIP) transfers. Changes to the municipal accounting system (the introduction of GAMAP) are also gradually being introduced as part of the Public Finance Management Act. Finally, the local budgeting process is being developed to ensure that local governments are placed in the overall MTEF and budgetary framework as an independent third sphere of government. Such changes will facilitate greater transparency in the fiscal management of local governments.
- The third aspect, the *financial framework*, which is the focus of this report, sets out the policy and regulatory environment that will guide and structure access by local governments to debt finance.

Taken together, the institutional, fiscal, and financial frameworks form the policy basis for the establishment of an independent and accountable tier of local government as envisioned in the Constitution and the White Paper. These three dimensions are closely connected. For example, without clarity on the institutional aspects of the demarcation and amalgamation process, local governments will find it difficult to access private finance. The demarcation and amalgamation process will determine the potential fiscal base of the new municipalities and will hence have a major impact on their creditworthiness. Similarly, the fiscal framework will determine the overall revenues of the local



government and hence the level of fiscal resources that are potentially available to gear in private finance. *Put differently, by clarifying the rights and obligations of creditors, borrowers, and other tiers of governments, the financial framework will enable local authorities to pledge their fiscal base that emerges from the institutional and fiscal frameworks in an efficient and accountable manner.*

#### **1.4 Limits of the financial framework**

Three important limitations to the scope of this exercise need to be noted:

- Another aspect of the institutional reform of local governments is the use by municipalities of public private partnerships (PPPs) to deliver municipal services. PPP structures (such as water concessions) may facilitate direct access to private capital through the revenue base of the service in question rather than via the balance sheet of the local government. Regulating this practice is an important aspect of the financial framework of local governments. This document does not address this issue in any detail. It is being dealt with separately as part of the Municipal Services Partnership (MSP) process which is managed by the Department of Provincial and Local Government.
- The financial framework inevitably raises the issue of access by municipalities to concessional loan finance by local governments, the primary source of which is the Development Bank of Southern Africa. This document does not deal with this matter in any detail. It is a critical and complex area that will require systematic attention once the overall borrowing framework is in place.
- Finally, it is important to recognise that the financial framework will not, by itself, make local authorities creditworthy. A coherent policy and legal framework is necessary condition for this, and it may create incentives for municipalities to operate in a manner which promotes their creditworthiness, but ultimately this is a matter between local politicians, local officials and local voters. Central government can create an environment in which good financial management is rewarded – through facilitating access to capital markets by well-managed local authorities, for example – but it cannot take over the function of local financial management from municipalities themselves.

## 2. OVERALL VISION

### 2.1 Problem statement

Municipalities in South Africa have constitutional responsibility for ensuring the delivery and management of local services which are key for both economic growth and social equity, including bulk and reticulated electrical power, water and sanitation, roads and waste removal. In addition they have responsibilities for community facilities (such as sports fields) and, to a limited extent, some social services (such as health clinics.) It is a commonplace that significant investment in the infrastructure necessary for the delivery of these services and facilities is required. The *Municipal Infrastructure Investment Framework* (1997), estimated that an amount of between 67bn and R114bn (1996 prices) would be needed over a 10 year period. Estimates from other sources have produced similar figures.

Stimulating such investment – as well as direct participation through contributions from the fiscus – has been a cardinal principle of government's overall policy towards the municipal sector from 1994. Government initiatives in this area include the Consolidated Municipal Infrastructure Programme (CMIP) and its progenitors, the introduction of the equitable share of national revenue for local authorities, the Community Water Supply and Sanitation Programme, the establishment and capitalisation of the Municipal Infrastructure Investment Unit, the Municipal Services Partnerships policy framework, and so on.

While mechanisms such as PPPs offer ways in which such investment can take place outside of the balance-sheet of local authorities in respect of some local services (with the local authority playing a regulatory rather than a delivery role in respect of a water concession, for example), it is obvious that it is neither possible nor appropriate for all the required investment to take place in this form. It is also clear that in certain sectors – local roads, for example, or many community facilities – the scope for off balance-sheet investment is much more limited than in others (such as water and sanitation.)

Ensuring access by local authorities to sufficient investment capital to allow them to play their constitutionally mandated role is thus a critical element both of the overall structure of governance in SA and to government's delivery objectives. The policy framework outlined here focuses on how this is to be done in an optimal manner.

The market context in which this framework has been formulated constitutes part of the problem it needs to address. As has already been pointed out, access by municipalities to private capital has become increasingly constrained. In recent times there have been only a limited number of new municipal bond issues and few of the previously issued municipal bonds are being traded. A somewhat better primary market remains for municipal short-term debt (such as overdrafts or more formal loans of short fixed maturity), but loan structures of this type are not necessarily well suited for providing capital on the terms which local authorities need for investment in large infrastructure projects with long construction and depreciation tenors. In addition, a number of the larger banks are lending to municipalities through complicated lease structures which provide

tax incentives for the lending institutions which were never intended by central government, with deleterious effects on the central fiscus (and, possibly, unintended consequences at the local level.)

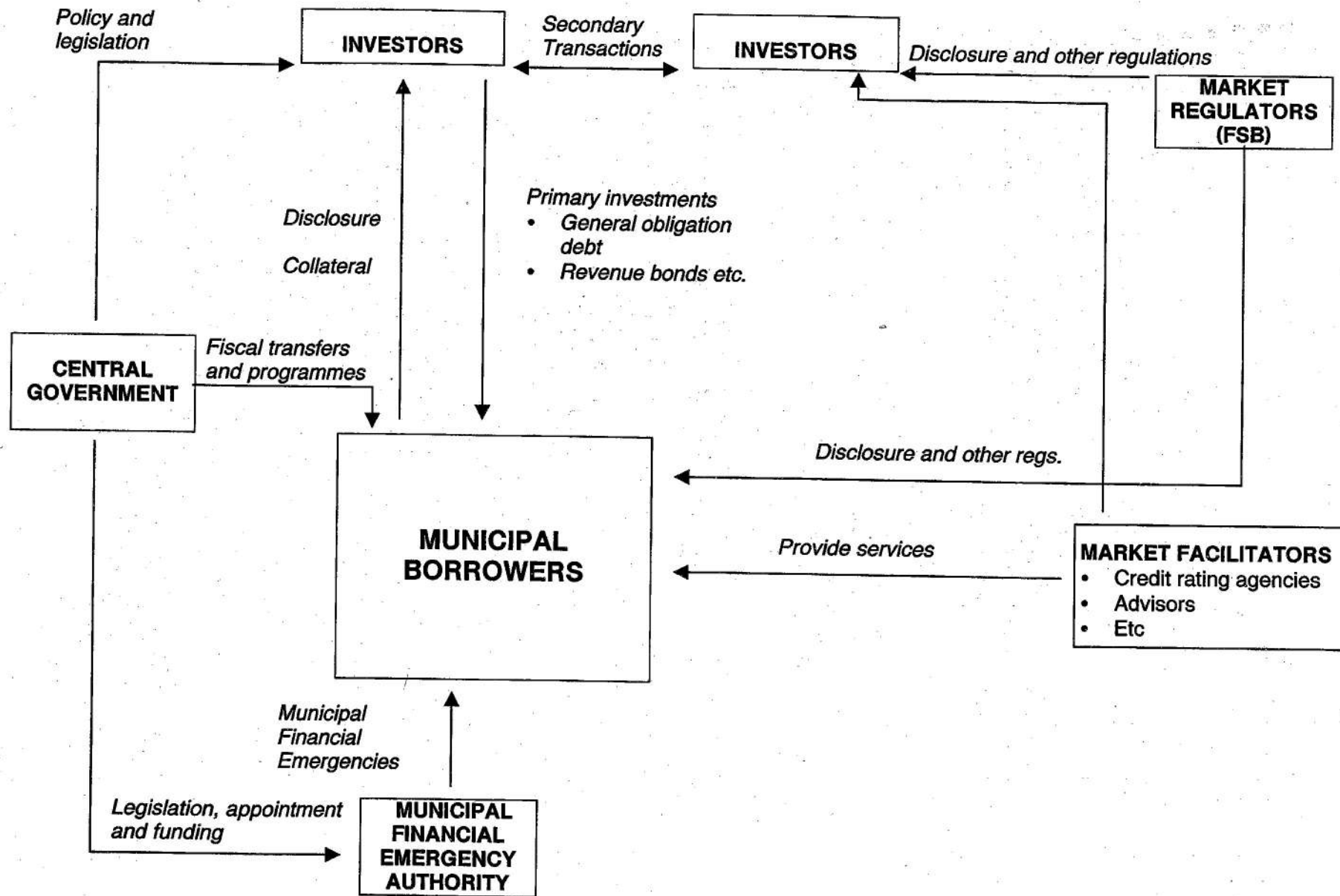
The final important element that this document addresses is the increasing deterioration of the financial and fiscal stability of the municipal sphere. This is closely related to the ability of municipalities to access private capital in that it constitutes the single most important factor underlying decreasing municipal creditworthiness, hence the stagnation in the municipal debt market outlined above. Obviously, however, this situation has implications which extend far beyond the ability of municipalities to borrow and which go to the very core of governance and delivery in SA. It is thus crucial that central government respond to the situation in its own right. In doing so, however, it is important that any responses support the overall financial framework for local government. Government policy in these contiguous areas needs to be coherent and mutually supporting rather than internally contradictory. This document outlines an overall framework which is based on this principle.

## **2.2 Vision**

In this context, and for reasons which are given in detail below, government believes that access by municipalities to private capital markets is an important element of ensuring an efficient system of local government. Ultimately government wishes to promote the emergence of a vibrant and innovative primary and secondary market for short and long term municipal debt.

It is important to stress, however, that in pursuing this goal, central government wishes to avoid the apartheid-era practice of generally underwriting municipal borrowing and, in effect, transferring municipal liabilities onto itself. Government's central objective is not to produce a short-term inflow of "soft" or subsidised funds to municipalities. It is, rather, to develop a sustainable market for municipal debt where risk is properly priced. In the long term an environment needs to emerge where loan finance becomes increasingly available and decreasingly costly to municipalities because the regulatory and institutional frameworks encourage appropriate behaviours, municipalities are increasingly well managed, and ancillary market facilitators are increasingly active.

The main elements of this system are simply described in Diagram 1. It is important to recognise that the existing – residual – municipal debt market in South Africa is largely an intermediated one i.e. most loans are originated and held by banks and other financial intermediaries. In the long term, and because it has the potential to lower the cost of capital to the municipal sector, government wishes to see this market supplemented by the development and expansion of a securities market, where municipalities – particularly the larger ones – are issuing debt in the form of bonds which may then be traded in the secondary market. The framework outlined below is specifically designed to encourage this. But it is also meant to promote the growth of a market for other forms of debt (i.e. bank lending), which, from a practical perspective, is where much of the growth in the municipal debt market is likely to lie in the short and medium term.



**DIAGRAM 1: MAIN ELEMENTS OF MUNICIPAL DEBT MARKET**

## 2.3 Points of departure

The points of departure for this vision - and the detailed policy framework which underpins it - fall into two main categories: the general policy principles which need to be considered in designing such a system; and the existing legal and institutional structure of the local sphere.

### 2.3.1 Policy principles

There are five main reasons why access to financial markets is considered important for local authorities. These may be summarised as follows:

- *Access to capital.* Local governments in SA are responsible for infrastructure that requires large, "lumpy" capital investments on a periodic basis. Given the extensive needs in SA, financing this investment on a "pay-as-you-go" or "taxation-in-advance" basis is usually neither possible nor efficient. Particularly where the need for capital greatly exceeds what is available on a grant basis from the central fiscus, access to capital markets can provide municipalities with the capital resources necessary to finance infrastructure investments efficiently.
- *Inter-temporal equity.* The benefits of the infrastructure investments that municipalities make often endure for extensive periods and accrue to future generations of taxpayers and consumers. It is equitable for such generations to bear some of the costs of these benefits. Financing investment over time with funds accessed from capital markets allows for this.
- *Efficiency.* Because capital markets allocate capital resources on a commercial basis, capital is allocated efficiently. Moreover, the opportunity costs of capital provide incentives to ensure efficient standards of delivery and discourage "overbuilding" and wasteful investment.
- *Accountability.* Markets tend to punish poor fiscal and management performance through pricing (pushing up interest rates or making capital increasingly scarce.) This can promote accountability and fiscal discipline at the local level. It may also provide other stakeholders (national government; the provinces; aid agencies and so on) with a convenient means to assess the relative performance of municipal governments.
- *Short-term matching of revenues and expenditures.* In the short term - for example within a given financial year - municipal revenues and expenditures are seldom completely congruent in time. Short-term borrowing allows municipalities to deal with this lack of synchronicity.

International experience suggests that achieving these benefits depends on the method of access and the conditions under which this access occurs. In principle there are two main routes here: local governments can access capital markets through "on-lending" from central government, most often through a



public intermediary (a financial parastatal), or they may access the markets directly.

In SA the DBSA, which is increasingly active in the municipal market, already represents one "indirect" access mechanism. As already recorded, the interface between this mechanism and the private market in respect of municipal debt is an important issue which will require further attention once the policy framework outlined below is established in legislation. The DBSA aside, there are three broad reasons that government wishes to facilitate direct access by municipalities to the capital markets:

- *Limitation of implicit or contingent liabilities.* It is important to protect central government from ultimately inheriting the debts of local government. When subsovereigns borrow through central government the debts of these bodies easily become the implicit or contingent liabilities of central government. Policy and legislation need to ensure that central government is not perceived as banker of last resort. This is necessary for prudent fiscal management at the national level and is fundamental to government's ability to maintain its macro targets. It is also needed to ensure that municipalities face strong incentives to improve their own management and creditworthiness, knowing that it is unlikely that central support will be forthcoming to compensate for local mismanagement or policy errors.
- *Systemic discipline.* International experience suggests that the indirect borrowing route can result in situations where credit allocation decisions become increasingly less commercial in character. Under such conditions, capital does not necessarily flow to the most productive uses, but to those players which are politically the most astute. In other words the efficiency and accountability outcomes mentioned above become diluted. Incentives for inefficient and wasteful decision-making can replace those which encourage the productive use of capital and tight financial management.
- *Expanding investment resources.* Subsovereign borrowing via the state can result in the "squeezing out" of private capital from the municipal sector, thereby narrowing the aggregate resource available for investment. Moreover, central control of borrowing can also create incentives for local governments to elude these restrictions through innovative off-budget schemes. Centralised borrowing, therefore, does not necessarily increase the ability of central government to control the liabilities of local government, but it may simultaneously diminish the overall financial resource base for investment in worthy projects.

In sum, direct access to capital markets offers the potential for a more transparent, market-based system to develop where there is a greater chance of achieving the benefits of accessing capital markets discussed above. However, it is also true that moral hazard problems – which arise from the assumption by capital markets that borrowing by local governments is ultimately backed by central government – may also develop where there is direct borrowing by subsovereigns from private financial markets. Ultimately, such problems can never be eliminated completely. The basic objective of the detailed policy framework given below is to ensure that such risks are managed through an

appropriate regulatory framework while allowing market discipline to guide the allocation of capital in order to maximise the potential benefits that this offers.

### **2.3.2 Legal and institutional structure**

The existing legal (constitutional) and institutional structure of the local sphere is relatively coherent in its fiscal aspects. Broadly speaking, expenditure responsibilities, policy authority and revenue raising powers are congruent. For example, 90% of municipal revenues are generated internally through rates and service charges - the balance being transferred from central government in the form of subsidies and agency payments - and local authorities have wide discretionary powers over the use of these revenues. Moreover, although this needs to be regulated by national legislation, the constitution gives to local government sufficient autonomous fiscal powers for municipalities to pledge their tax base in order to borrow for capital investment programmes. This constitutional and institutional structure offers a solid basis for the development of the decentralised, direct-access framework system that is outlined below.

It should also be noted that the bulk of local revenues (about 60% in aggregate) are generated by the "trading services" - electricity, water, sanitation and refuse removal. This is due largely to the unique role that municipalities in SA play in the direct delivery of such services (which roles may alter as the structure of these industries changes over time.) The important point, however, is that it is in these areas where the need for large scale capital investment - hence borrowing capacity - lies.

## **2.4 The policy framework and the overall vision**

The policy framework presented here thus represents a relatively harmonious integration between sound public finance principles and the overall policy direction of government as presented in the White Paper and subsequent documents. This is possible because of the fundamentally coherent fiscal structure of local government as defined in the constitution. The overriding theme that characterises this framework is the decentralisation of fiscal, borrowing and expenditure powers in a co-ordinated fashion. In particular, *the policy framework needs to clarify the rules of the game in three areas: municipal borrowing powers and procedures; information disclosure and market regulation; and executive, administrative and legal procedures when municipalities encounter financial difficulties.* Sections 3, 4 and 5 outline government's approach in each of these areas.

## **2.5 The policy vision and market segmentation**

In respect of their access to capital markets municipalities in SA are typically divided into three broad categories:

- Those which do not require external assistance to obtain commercial loans or access to the bond market. Most current estimates put this number at about 100 to 150 (of a total of about 850) at the current time;

- Those which are not currently viable credits, but which are not rendered incapable of becoming creditworthy by structural factors (such as an insufficient tax base);
- Those which are poor candidates for private capital investment due to fundamental structural weaknesses which are likely to persist for the mid- to long term.

The impact of the institutional restructuring currently underway – particularly the redemarcation of municipal boundaries – on the number of municipalities which fall into each of these categories remains to be seen. Ideally, from a financial point of view, the number falling into the third group will be significantly reduced or even eliminated completely. Notwithstanding these developments, this policy framework does not assume that all local governments will develop the capacity to access capital markets. For example, it is possible that certain municipalities may remain incapable of accessing capital markets in the medium to long term, even after the new policy framework has been introduced and consolidated.

For a number of reasons the market segmentation described above validates rather than undermines this financial framework as a complement to the institutional and fiscal reforms described earlier. First, for fiscally weaker municipalities, the CMIP program and the equitable share subsidies – which benefit poorer rather than richer municipalities – provide an important source for funding infrastructure investment and the recurrent costs of basic service delivery. Put differently, intergovernmental grants – which do not impose a financial burden on the recipient municipality – are a more appropriate mechanism for funding investment in very poor municipalities than is credit which they cannot afford.

Second, a vibrant and broad municipal bond market will enable more municipalities to draw on private finance for capital investments allowing fiscal funds channeled through CMIP and other grant mechanisms to be better targeted at the poorer cases.

Finally, a dynamic municipal financial market will in turn enable market investors greater ability to diversify their risks and hence fund a wider range of municipalities than is currently possible.



### **3. MUNICIPAL BORROWING POWERS AND PROCEDURES**

This broad area may, in turn, be broken down into four sub-areas: the entities that may issue debt; their powers to do so and any restrictions on these; the type of debt that may be issued; and the use to which debt finance may be put. These are dealt with in turn.

#### **3.1 Entities authorised to issue debt**

At S 230 the Constitution gives a general power to municipalities – which may be regulated by national legislation - to issue debt. In regulating this authority two initial questions arise: should certain municipalities have more circumscribed powers than others and, if so, why? And what of the borrowing powers of entities which are not, strictly speaking, municipal governments but which nevertheless form part of the municipal sphere (e.g. a municipal corporate enterprise which is financially “ringfenced” from the municipality itself?)

In respect of the former, South Africa has a tradition of classifying (or “grading”) municipalities for various reasons. In respect of legislatively limiting the ability of some municipalities to issue debt, however, there is little justification for pursuing this approach. There are two broad reasons for this:

- First, there seems to be no need to limit borrowing by legislative or administrative action. In fact, in SA the main problem is lack of access to credit, not overborrowing by uncreditworthy municipalities. Now that there are clearly no sovereign guarantees to municipal debt, the market has clearly demonstrated that it will be selective in extending credit to municipalities, and is best placed to distinguish good from bad credits.
- Second, practices which promote creditworthiness should be encouraged. Classifying a municipality in a way that incentivises it to seek assistance from central government and avoid responsible borrowing on its own would have precisely the opposite of the effect that Government wishes to achieve. Artificially limiting market access runs counter to the basic policy goal of maximizing private investment and encouraging good financial management in order to achieve that access.

The optimum policy approach, therefore, is to avoid legal distinctions amongst municipalities as to their powers and duties with respect to borrowing.

With respect to those entities which are not municipalities per se, local and international experience suggests that, in addition to private service providers, municipal services may be effectively delivered by a variety of agencies – such as municipal corporations - which are not themselves municipal governments, but which operate under the broad ownership or control of such governments.

As indicated in the “*Egoli 2002*” plan to restructure Johannesburg and restore its fiscal health, such entities can play an important role in developing municipal infrastructure. The issuance of debt by such entities should therefore be allowed, but only insofar as, and subject to the qualifications which follow, they do not

borrow against the revenue streams or assets of the municipality itself or any other municipal entity. Although municipalities should be permitted to underwrite or guarantee the debt of municipal entities, such underwriting should constitute an act of municipal borrowing. Any such guarantees will need to be issued by the municipality according to the procedures applicable to municipal borrowing, and will need to be transparently recorded as liabilities on the municipal balance sheet. In addition, the practice of establishing entities specifically for the purposes of borrowing should be specifically prohibited.

### 3.2 Powers to issue debt

There are two distinct levels to the question of debt-issuance powers: whether or not any governmental entity (national or provincial government) *beyond the municipality* should have any overriding authority (through approval or review procedures) over municipalities' power to issue debt; and who, *within the municipality*, should be empowered to issue debt, and how.

With respect to the former, the existing approach, as embodied in the LGTAA should be retained i.e. borrowing should be authorised by the municipal council without any requirement for national or provincial approval<sup>1</sup>. There are three chief reasons for this:

- First, this approach is consistent with the fiscal constitution of the local sphere. Because most borrowings will be secured by revenues which are raised locally, because municipal debt is not underwritten by the central fiscus, and in the context of a hard municipal budget constraint, there is little moral hazard danger with allowing municipalities these powers. In fact, ensuring that borrowing decisions are local decisions will strengthen local accountability, a principle which is stressed repeatedly in the White Paper and which is pointed to as one of the primary virtues of allowing subsovereigns access to capital markets.
- Second, it removes any implicit national or provincial government liabilities - which might easily arise if these spheres authorise local borrowing - and thus follows the overall policy stance of government in avoiding implicit or sovereign guarantees.
- Third, as argued in respect of the classification of municipalities, investors - whose funds are at risk when lent - aided by credit rating agencies and the new accounting rules are much better placed, and have much stronger incentives, to assess whether any municipality is capable of borrowing than is any organ of government.

With respect to the latter - authorisation within the council - borrowing should be authorised by the municipal council at the recommendation of the chief executive. To facilitate efficient management, however, councils should be authorized to delegate to the chief executive the power to borrow for a short term

<sup>1</sup> The approach taken here will not derogate from the existing powers of the Minister of Finance in the LGTAA to limit the budget growth - hence, indirectly, borrowing volumes - of the municipal sector from year to year for national economic reasons.

up to a limit specified by council. Such delegation may be useful in providing the CEO with the needed flexibility to manage daily operations more efficiently without sacrificing council oversight and accountability.

In order to maximise public accountability and sound fiscal management, local authorities should only issue long-term debt once a written debt policy and a capital improvement strategy (which may form part of its Integrated Development Plan) are in place. The debt policy determined by Council would establish the overall limits and general direction to executive officials in the planning and issuance of debt. Similarly, an investment plan should broadly prioritise a municipality's capital needs.

### 3.3 Types of debt that may be issued

The question of the type of debt, or debt instrument, that municipalities may issue – and any regulation thereof – is best approached by examining the kinds of security that may be given by municipal borrowers<sup>2</sup>. Until recently, most South African municipalities have given only unsecured general promises to pay, and most lenders have accepted whatever remedies they have at law. Increasingly, however, and following trends elsewhere in the world with established municipal debt markets, the parties are exploring ways of enhancing a creditor's security by contract. Pledges of particular physical assets, of receivables, and of particular revenue streams have all been used. The provisions which allow this under the LGTAA – which permit the local council to "furnish any security" for a loan is a very broad, open-ended authorisation whose limits have not yet been explored. It will be necessary, as part of the new legislation which will govern municipal borrowing, to spell out in greater detail what powers municipalities have to pledge security in order to collateralise debt.

Government's overall policy position on this matter is characterised by two broad principles:

- The contracting parties should be allowed broad leeway to craft security provisions that meet their needs. In addition to the conventional "full faith and credit" (general obligation) provisions, this should include special security arrangements including the pledging of assets, of local tax and tariff revenue streams, of intergovernmental grants or transfers, and tax and tariff level covenants;
- Certain limits should, however, apply. Specifically, municipalities should not be permitted to pledge assets deemed essential to the maintenance of public health and safety, nor should they be allowed to pledge revenue streams to the extent that this may compromise their ability to deliver certain essential services, which will need to be defined in law.

<sup>2</sup> It should be noted here that security (in the sense of collateral) and remedies are aspects of the same question. Debt markets require clarity about both. Before they invest, creditors want to know what their remedies or security will be in the event of default. The remedy issue forms the subject of section 5 of this document. This section focuses specifically on the question of security insofar as it determines the type of debt instrument issued.

In legislating revenue pledges it may be necessary to distinguish between the rules that apply to old general debt and those that apply to new debt issues. Creditors with general obligation claims against municipalities may see the value of their collateral diminished by the issuance of instruments which "ringfence" certain revenues as security for the new debt issued. Legislation will need to ensure that existing debt holders are not unfairly prejudiced by a deepening of municipalities' rights to enter into covenants of this type.

### 3.4 The use and quantum of debt issued

Most countries place limitations on the use of debt by local governments, with a distinction usually made between short and long term debt. Any dividing line between the two is arbitrary, but for the purpose of this document short term debt is defined as that which is payable within a year and long term debt is that with a maturity of more than 12 months.

The rules about the type of debt – duration and purpose – that can be raised in today's market are determined by the new Constitution, the LGTAA, and Department of Finance Regulation No. 412. Under these rules, municipalities may borrow long-term for "capital expenditure which has been budgeted for and approved by council." In addition, short-term borrowing for operating capital is permitted subject to the constraint that municipalities settle their account by the end of the current fiscal year by legislation, and within 12 months in terms of the Constitution.

With regard to short term debt, policy needs to reconcile two competing imperatives. On the one hand, municipal revenue flows are not evenly spread over the year (some property taxes are paid annually, for example), and access to debt finance may be necessary to supply sufficient working capital to allow municipal managers reasonable operational flexibility. On the other, it is important to ensure that short term debt does not become an indirect way of financing operational deficits over time, which are both problematic from the point of view of prudent fiscal management and prohibited by the Constitution.

In order to achieve this, municipalities should be able to bridge operating cash short-falls in anticipation of – and at levels appropriate to – specific and realistic future income streams to be realised within the fiscal year. In addition, municipalities should be allowed to bridge capital requirements in anticipation of specific and realistic grants to be received or long term debt to be issued within the fiscal year. Following current practice, however, short-term debt should be paid off annually with appropriate safeguards against immediate reborrowing. Enforcement of this should be directed at both borrowers and lenders. For example, lenders should be precluded from extending new short-term credit if a borrower is not in compliance with the relevant restrictions.

With respect to the permitted uses of long term debt, a fairly cautious approach has been adopted as is the case at present, such borrowings should be used only to fund capital investment in property, plant and equipment. If experience with municipal borrowing is positive in the medium term after the new framework has been legislated, permitted usages could be expanded (to include, for



example, the funding of retrenchment programmes.) In no event, however, should long term debt be used to finance current account budget deficits.

As regards the amount of long term debt that a municipality may issue, consideration has been given to developing a general "rules" based control that could be used to impose a countrywide limit on municipal borrowing. For example, a limit to annual debt service payments in relation to revenues could be set for the municipal sector, and varied annually by regulation if necessary.

After careful consideration government has decided not to pursue this route. There are four main reasons for this:

- First, it is technically difficult to develop a realistic and implementable set of measures which will both achieve this effect and which are impervious to manipulation by municipalities themselves. In the case referred to above (debt service burden:revenues), for example, revenue projections may easily be adjusted to suit any given municipalities' preferred outcome. Whilst it may theoretically be possible to curtail such manipulation, the practical implications of regulating such a system in the SA context make such a course difficult to contemplate in reality.
- Second, such an approach implies that government is better able to make credit judgements than are investors whose funds are at risk. Obviously, if municipal debt was implicitly or explicitly underwritten by central government, setting credit limits would make sense. In the absence of such underwriting, however, and in the context of hard municipal budget constraints, the markets are best placed to judge the capacity of any given municipality to borrow.
- Third, it would be extremely difficult to set a limit which is appropriate for all municipalities at any given time. A prudent limit in Durban, for example, is unlikely simultaneously to be appropriate for Parys. Any national limit is likely to only suit a few, "average" cases: it will inevitably be too low for some - who may require major investments at a given time, or who may have accumulated reserves in certain areas - and too high for others which are on the margin of creditworthiness. In the latter cases in particular, establishing a limit could be seen by both municipalities and the markets as an implicit permission or endorsement to borrow to that level.
- Finally, although ratio tests may conceivably be applied to fund general debt, they will generally not make sense when applied to self-financing or "enterprise" projects, and they could restrict the ability of rapidly growing areas with bright prospects (e.g. Midrand in the late 1990s) to expand services to meet demand.

Government has therefore decided to eschew establishing municipal credit limits by legislation or regulation as they are unnecessary, impractical to implement, and run contrary to the decentralist policy orientation of its overall approach to municipal borrowing. The amount of borrowing municipalities incur is a matter best left to them and the markets to decide. If, however, municipalities overborrow and if, as a result of that overborrowing, investors find it difficult to

recover their investments they will both need to face the full consequences of their decisions.

### 3.5 Summary of policy

Government's policy framework in respect of the borrowing powers and procedures of municipalities may be summarised as follows:

- To give all municipalities equal borrowing powers in law. Legal distinctions between municipalities or categories of municipalities will be avoided insofar as their powers and duties in respect of borrowing are concerned;
- To allow municipal entities to borrow, although the extent of such borrowing will remain a decision of the municipality itself. Insofar as the borrowings of municipal entities are underwritten by the municipality, the issuing of any and all such guarantees will constitute an act of municipal borrowing and the resultant liabilities will be recorded on the municipal balance-sheet as such;
- To allow municipal borrowers and lenders broad leeway to craft security provisions which meet their needs (including revenue bonds, tariff covenants etc.), provided that minimum essential services – which need to be clearly defined – are maintained at all times;
- To nevertheless ensure that existing debtholders are not unfairly prejudiced by a deepening of municipalities' rights to enter into new security covenants;
- To require that borrowing be authorised by municipal councils at the recommendation of the chief executive, without a requirement for national or provincial approval of such borrowing
- To provide that short-term borrowing may be authorised either by council resolution in each individual instance or by a general resolution that the chief executive may borrow up to specified limits;
- To allow municipalities to determine their own debt levels;
- To ensure that borrowing is not used as a source of funding for current budget deficits;
- To limit short-term borrowing to the amount required to bridge operating cash shortfalls in anticipation of specific and realistic future income streams to be realised within the fiscal year and/or to bridge capital requirements in anticipation of specific grants to be received or long term debt to be issued within that fiscal year;
- To prohibit the borrowing of money in foreign currencies;
- To require that short-term debt be paid off annually, and remain paid off for some reasonable period, with both borrower and lender responsible for enforcement;
- To limit long-term borrowing to funding of capital investment in property, plant and equipment.

#### **4. THE OPERATION OF THE PRIMARY AND SECONDARY MUNICIPAL DEBT MARKETS: DISCLOSURE, REGULATION AND MARKET FACILITATORS**

##### **4.1 Overview**

For a healthy municipal securities market to develop, pricing and trading mechanisms (e.g. exchange and listing operations, settlement and clearing practices) must operate efficiently. Slow and imprecise mechanisms drive up transaction costs and add to the risks for investors. Fortunately, South Africa has a relatively sophisticated financial sector with up-to-date exchange and clearing operations. There are no fundamental impediments, from a mechanical or regulatory point of view, to the development of a vibrant municipal securities market. Satisfactory infrastructure exists to support the development of both over-the-counter and exchange-based trading, and clearing and settlement procedures are adequate and straightforward. Republic of South Africa bonds and large parastatal issues, conceptually similar to municipal securities, trade easily within the existing framework. Settlement is handled electronically, with delivery of funds against bonds, and within three days of trade, in accordance with international practice. Government does not believe that any change to the operation of the actual market is required as a matter of policy.

However, the lack of clear and sufficient information about municipal finances is an impediment to municipal lending generally, and even more so to a market for municipal securities. Although tradable municipal debt instruments are common, there is a very limited market for municipal securities. This is largely due to potential investors' concerns about the ability and willingness of municipalities to honour their long-term obligations. The availability of information obviously affects the attractiveness of debt securities. Inadequate information can inhibit lending - as investors are unable to measure or quantify risks - and drive up the cost of borrowing. Ensuring the availability of information which would allow investors to satisfy themselves as to municipal creditworthiness is therefore critical both to expanding the overall volume of investment in the municipal sector and in shifting to the character of the market from a predominantly bank-based model - where both liquidity constraints and loan structures are not particularly appropriate for large capital investment in infrastructure - to a securities-based model.

One strength of a securities-based municipal debt market is that it is more broad-based than a bank-lending model, and can generate and aggregate investment capital from multiple sources. Municipal securities markets can attract funds from individuals, investment funds (unit trusts), bank and non-bank financial institutions, pension funds, and others. Securities markets can generate more total capital both by aggregating smaller investments and by assuring liquidity and flexibility to investors whose needs change.

While bank lenders in one-on-one transactions should be able to look out for their own interests effectively, investors in securities often lack the knowledge (and the leverage) to protect their interests. Accordingly, governments world-wide usually regulate the sale and trading of municipal securities for the protection of investors. The regulation of debt markets, including requirements for public

disclosure by municipal borrowers, is especially important for the development of municipal securities markets.

This section focuses on improvements to the operation of the municipal debt marketplace that are required if primary and secondary markets are to be simultaneously stimulated.

#### 4.2 Disclosure

Certain basic shifts in government's approach to municipal borrowing imply that greatly improved disclosure of local government finances and operations will be critical to the re-ignition of the South African municipal securities market. Two of these are particularly important: first, the withdrawal of any implicit or explicit central underwriting of municipal debt means that credit assessments need to be taken far more seriously than in the past. Second, the likely proliferation of types of loan structure will inevitably mean that more complex and nuanced assessments will become necessary before credit judgements are made. Knowledge of the particulars of each municipality or project will be needed to calculate risk versus reward and make individual investment decisions in a market setting. In sum, from the standpoint of creditworthiness and security pledged, the market for local government securities that is to be re-established in South Africa will be much more information-driven and dependent than previously was the case.

The primary purpose of disclosing such information is to enable investors to make informed investment decisions and to allow the market to effectively allocate capital through pricing<sup>3</sup>. Better information will make capital markets operate more efficiently, and enable investors to distinguish good credits from bad. The main target of such information is obviously the investor. Individual and institutional investors need information to evaluate municipal debt quality. The party which is ultimately responsible for disclosure is the party which wishes to attract the debt finance and which is thus responsible for debt service payments (the municipality.) However, borrowers can be assisted – or even largely superseded – in collecting, packaging and transmitting information by underwriters and brokers, and even by governmental authorities depending on the nature of the information that is to be furnished.

Increasingly in world practice disclosure relating to securities is not a once-off event. Disclosure in connection with the original offering is often supplemented by requirements for continuing disclosure to the market for as long as the debt is outstanding. Such continuing disclosure may be on a periodic recurring basis (sending out or otherwise making available current financial reports and other

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<sup>3</sup> Aside from the immediate needs of the bond market, effective democratic government will depend on regular reporting of the operating results and financial condition of local governments in a consistent format – hence the existing reporting and auditing requirements now found in South Africa regarding local government finances. This report does not deal with this sort of disclosure, which may, of course, be of assistance to investors in making credit decisions. It focuses, rather, on disclosure of information that is intended specifically for the securities market. However, as discussed below, because of the economic interests involved and the importance of thoroughness and timeliness, disclosure can have substantial beneficial impacts throughout local government operations.



operating data) and/or episodic disclosure when events occur that may have a material impact on the borrower's creditworthiness. Disclosure can be required by (1) central governmental fiat, (2) securities market regulation, (3) as a by-product of the operation of the market through contract between issuers and lenders (usually as part of a borrowing contract that contains covenants as to issuer behaviour) or (4) market practice and convention.

Government believes that a combination of these approaches is best suited to the South African situation where a voluntary and market based disclosure system – with the burden for disclosure ultimately falling on the borrower – is underpinned by effective securities regulation that provides a baseline of disclosure and common procedures and penalties for those that are reckless or untruthful.

This system envisages three interrelated components:

- A law - or aspects of a law - which would prohibit fraud in connection with the issuance of any municipal debt, would affirmatively require the disclosure of information material to an investment decision, would authorise regulations to specify fraudulent acts and material information, and regulate disclosure a disclosure documentation. The eventual establishment of a repository for disclosure information and a registry for debts, defaults, and security interests could also be authorised by legislation.
- Regulations adopted pursuant to the law would specify specific acts that would be considered fraudulent, and the minimum information that would count as "material" (e.g. financial statements and projections, pending litigation, or defaults). As the market develops, regulations would probably become more detailed and a registry could be established. Regulations could also provide exceptions to disclosure requirements in the case of private placements with sophisticated investors;
- Eventually, industry *guidelines or standards* could be developed which would reflect the market participants' expectations for disclosure, with the detail and flexibility that government regulatory approaches could not achieve. This would be a non-governmental function. These guidelines would likely be adopted and periodically revised by an organisation such as IMFO or by an association of bond dealers and investors.

Violations of the law or regulations would be actionable by the aggrieved party in a civil suit, and would subject the violator to criminal sanctions. While the law would be relatively permanent, FSB regulations would evolve over time to increase minimum disclosure requirements as the capacity to develop and present information evolves and as particular practices requiring regulation are identified.

There would be no criminal penalty for non-compliance with industry standards. The standards would exist primarily to establish the acceptability of disclosure documentation in trade, i.e. its merchantability. These standards could provide model formats for disclosure, and describe particular information deemed appropriate for particular types and structures of financing. They would likely be

developed and revised constantly, in a way that government legislation and regulation could and should not be.

Balancing the disclosure regulations with market activity will be an ongoing challenge. The goal is to assure investor confidence in municipal securities without hindering the development of a municipal securities market by over-regulation. Thus, government intends to take a step-wise approach to the evolution of regulations and institutions to support municipal securities disclosure. While basic disclosure and protection against fraud is critical, it is important not to burden the market with overly stringent disclosure regulations too early in its development. As the volume of municipal securities issues increases, an official, or officially-sanctioned repository system for filing and dissemination of disclosure information would be established. Because some or all disclosure obligations could be satisfied by filing disclosure information centrally, such a repository system can make it easier for municipal issuers to comply with initial and continuing disclosure requirements. A public repository system can also make it easier for potential investors, rating agencies, and news services to access the information. However, government believes that it need not be established until and unless there is sufficient industry demand to make such an operation self-financing.

#### **4.3 Market institutions and actors**

As noted in the introductory comments to this section, satisfactory institutional mechanisms exist to support both over-the-counter and exchange-based trading. Government sees no reason to limit trading to any one venue, and encourages continued evolutionary improvements in the efficiency and transparency of pricing and trading mechanisms.

Objective credit ratings of municipal securities by independent credit rating agencies are a key support for an active market in municipal securities. They help individual and institutional investors make judgements about credit quality without the burden of investigating and analysing each issue. Several private agencies are already developing informational databases on a large number of municipalities, and rating the credit quality of a smaller number. These agencies have evolved substantially over the last several years. They need reliable data from potential municipal issuers, including audited financial statements, and clear and well-documented projections about future conditions. Improving municipalities' capabilities in these areas, and reporting in accordance with new accounting rules, will provide these agencies with increasing impetus.

Other functions important to healthy municipal bond markets either already exist or are likely to evolve without support from government. As a matter of policy, government encourages the evolution and specialisation of these functions:

- Financial advisors can assist municipalities in developing and implementing financial strategies.
- Underwriters can help package and pre-sell initial issues of municipal debt to a wide range of investors.

- Legal counsel to assist various actors and to assure compliance with disclosure regulations is available, though experience will be gained over time.
- Bond insurers are likely to begin operations in South Africa as the volume of municipal debt increases. Such insurers can greatly facilitate the evolution of markets by removing most of the risk from the investor.
- Existing financial institutions can play the role of trustee, paying agent, and registration agent, which are important in assuring predictability and objectivity.

#### **4.4 Summary**

Government's policy position in this area may be summarised as follows:

- To require borrowers –
  - By law, to disclose all information material to an investment decision. Materiality will be defined by Regulation
  - To disclose the specific information defined in the Regulations
  - To act in accordance with market standards on disclosure in order to attract investment
- To require continuing disclosure at least annually, and on the occurrence of a material event that could affect the security of an investment
- To apply disclosure standards and penalties equally to bond exchange and OTC transactions
- At such future time as a bond registration and repository system may become appropriate, to establish these
- To support the growth and evolution of market facilitators such as credit rating agencies, underwriters, bond insurers and so on.

## 5. MONITORING, INTERVENTION AND REMEDIES

### 5.1 Background

Fiscal crisis in local government is not new in South Africa. The creation of black local authorities in the early 1980s largely segregated the problem along racial lines: core white municipalities not responsible for high-need low-revenue black residential areas found it relatively easy to manage their finances without problems, while black local authorities were almost uniformly in fiscal crisis from the dates of their creation. A variety of ad hoc measures was taken to keep essential services running in black local authority areas – including intergovernmental transfers and loans, assignation of Regional Service Council revenues and even, on occasion, grants from the private sector. On the other hand, the larger white municipalities – which benefited from a substantial revenue base and implicit central guarantees – had reasonable credit ratings in the market and could raise loans when they needed them. Smaller municipalities were assisted by the government's Local Authorities Loan Fund. It was taken for granted that black local authorities could not raise funds in the market at all; such capital programmes as were undertaken were financed by grants or loans from the government or the Development Bank of Southern Africa.

Amalgamation of formerly segregated jurisdictions in the mid-1990s, accompanied by a heightened emphasis on service delivery, meant that the problems of black local authorities were imported into the new municipalities. The new structural circumstances have been compounded by a range of other difficulties – a lack of experience and capacity; non-payment of local taxes and service-charges, the persistence of an opaque accounting system etc. – which have aggravated the overall problem.

Thus at 31 December 1998, Project Viability found that 151 municipalities were in fiscal crisis, with about 200 more suffering from financial problems which did not then amount to a crisis, but which may contain the seeds of serious difficulties later. The main reasons were found to be institutional (no coherent framework for operations), financial (in every possible respect – accounting, internal controls, cash flow and asset management and credit control), lack of community co-operation in the form of non-payment, poor management of the revenue base and poorly maintained, inefficient infrastructure. From an economic point of view, it is particularly alarming that some of the largest local authorities are experiencing severe fiscal difficulties. In 1997 Johannesburg had urgent need of a large loan (R585 million) from the DBSA; less than two years later, it is again in difficulty. More recently, it has been reported that Pretoria faces increasing financial problems. And an increasing number of medium-sized towns (such as Welkom) appear to be drifting into effective bankruptcy.

Finally, although both common law and aspects of existing statute give investors certain rights when municipalities default on their debt service obligations, neither the legal nor institutional channels for recourse are particularly robust. Moreover the distinctive nature of municipalities – as opposed to corporate entities in the private sector, for example – creates a situation where the recovery of bad debts necessarily assumes a different character than it does conventionally in the



private sector. For example, municipalities cannot be liquidated and, for public interest reasons, it is important that certain essential services (e.g. provision of water and sewerage reticulation) always be kept in operation. Moreover, unlike a Board of Directors, municipal councils are organs of democratic governance with certain rights and obligations created and specified in the Constitution. Conventional debt recovery processes are thus not adequate or entirely appropriate to the municipal environment.

Yet, from a policy perspective remedial processes through which investors can reliably deal with debt defaults by municipalities are critical to the broader objective of stimulating a municipal debt market as uncertainty in this area negates the ability of creditors to analyse and quantify investment risk and thus acts as a major constraint on market appetite for municipal credit. It also prevents the accurate pricing of risk and thus inhibits the efficient allocation of capital by the market. Lack of clear lender remedies is one of the major barriers to municipal lending in South Africa today and it urgently needs to be addressed.

## 5.2 Objectives

Thus far government has responded to these problems with a number of legal and programmatic initiatives, ranging from Project Viability and the Municipal Support Programme to interventions made in terms of s. 139 of the Constitution. But the systemic nature of the crisis renders ad hoc solutions to the problems of individual local authorities inadequate. What is needed instead is a systematic programme of assistance to local authorities, designed to advise, support and (where necessary) to supervise them in strengthening their financial position. It is also critical that such a programme provide municipalities with incentives which promote sound fiscal management and do not draw either investors or municipal borrowers into behaviours that will deepen rather than alleviate the problem via the credit system.

In other words, given the nature and scale of municipal financial problems - and the importance of wider efforts to complete the overall reform of the municipal fiscal and financial system - it has become imperative that government establish a thoroughgoing and coherent policy, legal and institutional framework for dealing with municipalities in financial distress. This document outlines the key elements of that framework. It is important to stress, however, that in doing so it builds on rather than replaces existing programmes and law. Although some major new steps are outlined, these need to be seen in the context of what government is already doing. The basic objective is as much a systemisation and rationalisation of all of government's efforts in this area into an integrated framework which supports the other aspects of the fiscal and financial framework as it is to add new programmes and institutions to respond to the problem.

The overall structure of the system is outlined in Diagram II. Two critical elements of the system should be noted:

- First, government is putting in place an integrated but diverse set of measures which combine monitoring support, capacity building and direct expenditure of significant sums from the fiscus with other measures which involve executive and legal interventions when municipalities experience

financial difficulties. It is important to stress that these interventions will only be invoked as a last resort i.e. when, following the full range of grants and capacity building measures applied to any given municipality earlier, it nevertheless cannot avoid a financial crisis. The more drastic intervention measures will only be used in a worst case scenario and it is expected that they will only be required occasionally;

- Second, although the emphasis in this document – and particularly in the following section – is on state sponsored measures to deal with municipal financial problems, this does not imply that it is, or should be, only up to central government to deal with such issues. The overall financial system described in this document – including those provisions which are designed to promote the proliferation of different sorts of loan structure and security – is designed to encourage municipalities and investors into voluntary arrangements whereby they may resolve financial problems before, or during, any involvement by central government. The intervention measures described below, for example, will inevitably be painful experiences for both municipalities and investors. It will be in their mutual interests to work together to avoid them.

### 5.3 Legal, institutional and programmatic initiatives

Government is responding to the problems described above with a number of initiatives, two of which are new and will be implemented in FY 2000/01. The others are already in place, but will be broadened and strengthened from 2000/01 on. In general terms, these initiatives can be divided into three main categories: expenditure, support and monitoring programmes; executive and administrative interventions; and legal remedies.

#### 5.3.1 *Expenditure, support and monitoring programmes*

##### Existing situation

Government has three key programmes of this type: Project Viability; the Municipal Support Programme and Financial Support Grants:

- Since 1995 the Department of Provincial and Local Government has been monitoring the finances of municipalities through a quarterly survey known as *Project Viability*. Responses to the questionnaires are captured, assimilated and analysed at national level. The primary focus of the analysis is on the short-term liquidity of municipalities. In order to assess the liquidity situation of municipalities a number of direct and indirect high level indicators are used. The basic purpose of the survey is to indicate to the Department which municipalities appear to be running into financial difficulties.

Once a municipality has been identified as having financial difficulties the relevant Province is informed and a detailed management audit is conducted to determine the magnitude of the problem and formulate a stabilisation programme. The MECs for Local Government may then either instigate a Section 139 or LGTAA intervention (see below) and/or use the facilities of the Municipal Support Programme to address capacity problems within the municipality in order to restore financial stability.

Provinces have so far conducted about 300 management audits of which about 250 have shown that, unless urgent measures are taken, a sizeable number of municipalities may experience complete financial collapse.

Project Viability is an important governance tool. The project has experienced a number of problems, but these have more to do with response rates and the veracity of the information provided than with the fundamental structure of the programme.

- The aim of the *Management Support Programme* (MSP) is to stabilise financially distressed municipalities. This is done through capacity building and developing the administrative and financial systems necessary to restore the municipality into a viable entity. In addition, the programme assists municipalities to restore sound financial practices, cash funded budgets, sound accounting systems and internal controls.

The MSP budget for FY 1999/00 is R75m. The funds are sourced from the Transitional Grant amounts on the budget of the Department of Provincial and Local Government and transferred to Provinces for expenditure on MSPs in their provinces.

The MSP has also experienced a number of difficulties since inception, mainly related to the capacity of provinces to implement and monitor the programme effectively. However these appear not to be fundamental, and government believes that with certain management improvements it should be able to deliver on its objectives successfully.

- In 1999/00 an additional R62m was also transferred to Provinces for expenditure on general Financial Support for local authorities confronting financial difficulties. Of the three programmes discussed here, this has confronted the most difficulties. First, criteria for the allocation of funds are not clear or uniform. It is thus not evident that municipalities most in need are those which are actually benefitting. Second, the funds are largely given out on an unconditional basis, which does little to create incentives for sound financial management at the local level. Third, as with the MSP, a lack of capacity at the provincial level has tended to inhibit the effective use and management of this resource.

#### New initiatives

No fundamental changes are required in respect of *Project Viability*. However, Government does need to explore various ways in which the difficulties

experienced as regards response rates can be addressed. In addition, the possibility of a wider distribution of the disaggregated PV data needs to be fully assessed.

Similarly, no basic alteration to the structure of the *MSP* is necessary. In fact, government intends to spend increasing amounts on this programme over the 2000/01 MTEF period, such that total expenditure on the programme by 2002/03 will have been doubled. In addition, the management of the programme by Provinces and by central government will be improved.

Important changes are planned with respect to the *Local Government Support Grant*. On the one hand government intends to phase out the existing under-funded and ad hoc programme over the new MTEF (i.e. by 2002/03.) On the other hand, the programme will be replaced with a new far more substantially funded and better-designed initiative, the *Financial Restructuring Grant (FRG)* from 2000/01 on. This programme will be managed directly from central government rather than via the provinces. Clear and uniform criteria for grant allocations will be established. Essentially, grant funds will be made available from central government to a recipient local authority in exchange for commitment to a normalisation (budgetary restructuring) plan, the clear objective of which must be to pre-empt a fiscal crisis and restore budgetary balance. The continuing flow of grant funds will be conditional upon the progressive implementation of the agreed restructuring plan. Municipalities will be required to offer a credible analysis of the causes of their fiscal distress, as well as evidence of a viable plan to address this. The municipal Council will need to agree to this plan in the form of a Resolution. The plan will in all crucial respects be similar to the budget restructuring plan which would be produced in the case of municipal Financial Emergency (see below), but will be voluntarily proposed by the municipality concerned in exchange for the receipt of grant funds which will assist it in undertaking a budgetary restructuring.

Government will decide on the funding level of the FRG annually as part of the national budgeting process. Because there are limits to the amount that can be made available for this form of pre-emptive restructuring the programme criteria will give preferential access to those local authorities whose collapse would imply a significant risk for the country as a whole.

Further details regarding the FRG are given in Appendix I.

### 5.3.2 *Executive interventions*

#### Existing situation

Section 139 of the Constitution, read in relation to other relevant provisions (e.g. Sections 44 and 155) state that provincial and national government have the legislative and executive authority to see to the effective performance by municipalities of their functions. These sections provide for provincial government – and, if this is not done effectively – national government to intervene in the affairs of local authorities when they fail to do so. Such failure clearly includes – and is often manifest in – the development of a fiscal crisis.



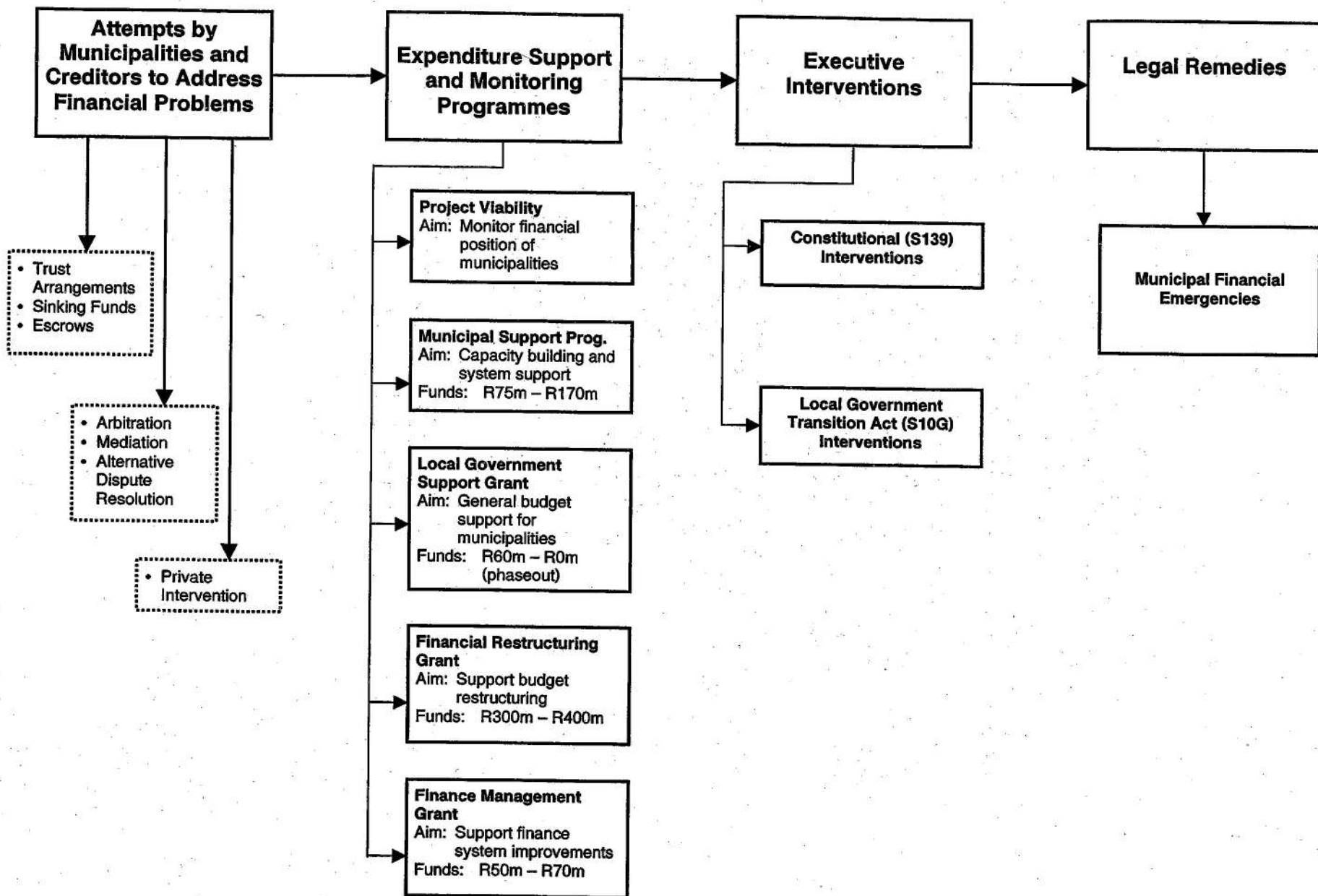
In addition, section 10G(2)(m) of the LGTAA provides for a provincial MEC to issue instructions to a municipality to take measures to rectify its financial position when this position has become unsound. In both these cases the purpose of the intervention is to restore the municipality to a proper level of functioning, not as a permanent take-over of municipal functions or obligations.

In recent years both national and provincial governments have used these provisions to intervene in a number of different cases. More than 30 LGTAA instructions have been issued in KwaZulu-Natal, for example, and eight S 139 interventions were initiated in 1999. These have not had particularly successful outcomes. In no case (aside from Butterworth which is unique for legal and technical reasons) has any S 139 intervention been uplifted because the municipality has effectively been restored to financial health.

The reasons for this are diverse and complicated. However, an overall assessment of the brief history here points to a number of key lessons:

- The likelihood of an intervention being successful is largely a function of the severity of the problem it confronts. Where the problems are limited in scope and depth, the interventions have a better chance of leading to a turnaround within a reasonable period of time. Where the problems are fundamental or structural in character, the interventions have a more limited chance of success, at least in a short period of time;
- Both national and provincial governments have limited capacity to manage and implement such interventions. While some implementation capacity can be brought in from the private sector in terms of the MSP, this does not eliminate the importance of managing and monitoring the intervention on the part of the intervening authority. For provinces which are often struggling with their own budgets and capacity shortages, this can be a major difficulty. And central government also has limited resources in this regard;
- The existence and use of these procedures have not led to a restoration of private sector confidence in the municipal debt market. The existing executive and administrative intervention provisions have not obviated the need for a process, overseen by the judiciary, to ensure that creditor claims are properly addressed in the case of default. Moreover, the more that central and provincial government is drawn into responsibility for dealing with the consequences of poor municipal decision-making and fiscal management, the greater the prospect of moral hazard problems arising;

DIAGRAM II: SYSTEM FOR MUNICIPALITIES IN FINANCIAL DISTRESS



- The existing intervention procedures are complicated and messy and are not necessarily conducive to effective rectification. This is partially because the existing constitutional and legal provisions are not entirely optimal, particularly with respect to situations where interventions fail to bring about the desired results. If such problems are to be avoided a system with clear and clean procedures and authorities is needed.

#### New government initiatives

These problems will largely be addressed by the new legal remedies discussed below. These aside, government does not believe that the existing executive intervention provisions are in need of any fundamental revision. However, two adjustments are important:

- A uniform set of procedures for S. 139 interventions needs to be developed;
- Provincial and national government need to expand their capacity to monitor and manage such interventions.

### 5.3.3 *Legal remedies*

#### Existing situation

The existing position regarding legal remedies available to private sector investors should municipalities run into financial difficulties and default on their obligations is referred to at several points above. The key features of the current situation may be summarised as follows:

- Common law and statute allows creditors to approach the courts for redress in the event of default. This channel, however, offers a remedy that is neither comprehensive nor appropriate to municipal circumstances. First, the only real redress available to creditors in this instance is the attachment of municipal assets to settle outstanding liabilities. By definition, most assets held by municipalities (roads, water systems etc.) are not practically "attachable" for these purposes. And the inevitable politicisation any process whereby available assets are attached mean that such recourse is not a viable route to satisfy legitimate creditor claims.
- In the context of these limitations, and because it is not legally or practically possible to liquidate a municipality, the ability of creditors to satisfy their claims in the event of default is likely to be very closely tied to the ability of the fiscal position of any municipality to be restored to normality. This requires the development and successful implementation of a "turn around plan" (budgetary restructuring.) However the current legal and institutional situation in South Africa does not allow for this in respect of local government. The administrative and executive interventions referred to above are obviously one means through which a turn-around could be effected, but there is no appropriate provision for a due legal process to satisfy legitimate

and enforceable claims should these fail or should municipalities default notwithstanding such interventions.

Put in the context of the borrowing framework outlined earlier, the corollary of moving towards a modern, decentralised framework for municipal finance where moral hazard is minimised, capital is allocated efficiently, risk is properly priced and incentives for prudent financial management are real is a clear legal and institutional framework for dealing with municipal default and bankruptcy.

It should be stressed here that the ultimate objective of this is not investor protection at all costs. If investors make poor credit decisions they should take the losses that this implies. But it does entail putting in place a legal and institutional process which allows investors to make proper credit judgements and which is potent enough to ensure that the problems causing a municipal fiscal crisis are thoroughly addressed.

It may also be stressed that the necessity for this sort of framework does not derive exclusively from imperatives related to capital market development for municipalities. The system outlined below has been driven also by the need to ensure that there is an effective means of addressing municipal financial emergencies – even where no or little borrowing has occurred – when all other means have failed and when there is no prospect of the situation improving without far-reaching steps being taken. Unfortunately, this situation seems to be becoming increasingly common in SA today.

#### New initiatives

Government believes that the key to this is the institution of a set of statutory procedures, overseen and authorised by the judiciary, whereby an administrative agency with some independence from the executive, oversees fiscal and financial “turn-arounds” analogous to judicial managements in the private sector but designed for the particular circumstances of the municipal sector. The municipal turn-around plans will be developed and implemented by an Administrator equipped with the necessary powers on a case-by-case basis.

An overview of the nature of this procedural framework is given here with further details provided in Appendix I. This framework draws on a combination of existing SA practice regarding judicial managements and liquidations in the private sector, and international experience in countries such as the USA (Financial Control Boards) and New Zealand which have attempted – often successfully – to come to terms with municipal financial failure.

- A Municipal Financial Emergency Authority (MFEA) will be established as a separate agency to oversee the administration of municipal financial emergencies in a manner analogous to the Master of the High Court in respect of judicial managements. The head of the MFEA will be appointed by the Minister of Provincial and Local Government and will have a small professional and support staff. The MFEA will supervise recovery plans for municipalities where a situation of Financial Emergency has been declared. The MFEA will appoint and oversee an Administrator who will develop and implement such a plan in each case. The MFEA itself will be funded from the

budget of the Department of Provincial and Local Government, but will not itself form part of the Department. In general, the costs of the Administrators employed in respect of any Financial Emergency will be recovered from the budget of the local authority concerned.

- On application by affected parties, a Financial Emergency may be declared by a judge of the High Court where certain minimum conditions exist – such as a loan default – and where there is a serious fiscal and financial problem within the municipality which has no reasonable prospect of resolution otherwise. The Court will also have the powers, under certain extreme conditions, to order extraordinary relief (such as the modification or suspension of creditor claims) and to terminate the Financial Emergency. Generally speaking, a situation of Financial Emergency would only come into play after the support and executive processes discussed earlier have been exhausted.
- Where a Financial Emergency has been declared the MFEA must appoint an Administrator, who will generally be contracted in from the private sector or civil society, to develop and implement a recovery plan for the municipality. The Administrator shall intervene in the affairs of the municipality to the extent appropriate to the municipality's condition, using the least intrusive practical means to effectively address the situation. Where the municipality takes necessary actions to the satisfaction of the Administrator, the Administrator need not exercise its powers in lieu of the municipality. The primary objectives of the intervention by the Administrator are to restore fiscal integrity and full democratic local governance as soon as possible.
- Nevertheless the Administrator will have ultimately have all the powers of a municipal council. These include the following:
  - > To establish, or to require the municipality to establish, a recovery plan to address:
    - any immediate fiscal crisis,
    - any longer term financial problems, and
    - any management problems
  - > To establish and disestablish any committees or consultative bodies as Administrator deems useful
  - > To approve, disapprove, modify, or make expenditures
  - > To approve, disapprove, modify, or incur new debt
  - > To establish or amend, in connection with an approved recovery plan:
    - property rates and other taxes
    - charges, fees, and tariffs
    - other revenue measures
    - a budget for the municipality
    - accounting procedures for the municipality
  - > To collect all revenues due to the municipality
  - > To take custody of all funds of the municipality
  - > To take custody of, safeguard, and operate all municipal property, plant, and equipment
  - > To undertake accounting reviews and make accounting revisions, in accordance with applicable law, and to audit municipal funds



- > To hire, fire, and manage all municipal employees, subject to the provisions of the labour laws and such collective bargaining agreements as may exist
- > To negotiate with organised labour, and to agree upon modifications to the terms of any collective bargaining agreement of the municipality
- > To negotiate with creditors, and to agree upon modifications to the terms of any agreement with regard to debt of the municipality
- > To liquidate assets which are not essential for the provision of basic services.
- > To do all things necessary to the implementation of the recovery plan, subject only to the limits of the executive and legislative power of the municipality

#### 5.4 Summary

Government's policy initiatives in respect of municipalities in financial distress may be summarised as follows:

- To modify Project Viability to address newly demarcated municipalities
- To refocus and expand the Municipal Support Programme to support the transition to the newly demarcated municipalities
- To expand the Financial Support programme into a Finance Restructuring Grant as a structured and focused conditional grant programme run directly by central government
- To standardise procedures regarding normal (i.e. S 139 of the Constitution and S 10G of the LGTAA) provincial and central government interventions in the affairs of a local authority when it runs into financial crisis
- To establish by statute a set of procedures, authorised by the judiciary and overseen by a Municipal Financial Emergency Authority, to deal with municipalities when, notwithstanding all other interventions, they run into a situation of financial crisis.

## **6. CONCLUSION: THE POLICY FORMULATION AND LEGISLATIVE PROCESS**

The policy framework elucidated in this document was ultimately the product of a Task Team chaired by the Department of Finance and representing a number of key stakeholders in the local sphere, including the South African Local Government Association, the Department of Provincial and Local Government, the DBSA and the Banking Council of South Africa. The Team was advised by a number of local and international technical experts (see Appendix II.) The work of these experts was supplemented by investigation undertaken by the Departments of Finance and Provincial and Local Government on the issue of municipalities in financial distress.

The document is thus based on extensive consultation with a wide range of stakeholders in both the public and private sectors in South Africa. It also draws significantly on the international experience in the area of municipal finance in both developed and developing countries.

As outlined earlier, in order to implement the policy framework elucidated here, government intends to pass legislation in 2000. In this context, this document has been published for two main reasons: first, to outline government's current policy position on these matters; and, second, to provide the general public – and particularly those sectors with a direct interest in local government – with the detailed thinking underlying the draft legislation which is published simultaneously with the document. This may assist those individuals and organisations who wish to comment either on the legislation itself or on the policy which underlies it.

## **APPENDIX I: NEW CENTRAL GOVERNMENT INITIATIVES IN MUNICIPAL FINANCE**

This Appendix sets out details of the two new initiatives proposed in sections 5 of the main document: the Financial Restructuring Grant and the Municipal Financial Emergency programmes.

### **1. Financial Restructuring Grant (FRG) programme: overview**

The FRG is a conditional grant programme, administered by the Department of Finance, designed to facilitate budget and associated institutional where such restructuring may have positive externalities at the national level.

Funds will be used in accordance with a budget restructuring plan – proposed by the affected municipal Council and approved by the Department – designed to improve the financial position of the recipient municipality within a specified period. The actual formulation and implementation of the plan will be the task of project managers appointed and accountable to the applicant Council.

The FRG programme will be funded from the national budget. Allocations will be made as part of the normal MTEF process. Given budgetary constraints the grant programme will be focused on those municipalities where financial and institutional improvements will have particularly positive impacts on the national economy.

Eligibility for FRG assistance will thus initially be restricted to municipalities with annual budgets exceeding R500 million. This restriction is necessary in order to avoid duplicating the support offered by the Local Government Support Grant (associated with the Municipal Support Programme) and because there are limits to the amount of national funding that can be made available to support this form of restructuring.

Eligible municipalities will be required to motivate for assistance through providing:

- a) A credible analysis of the causes of their financial position;
- b) Evidence of concerted efforts improve their situation over a period of at least six months prior to application;
- c) A restructuring plan that clearly indicates the restructuring actions, the resources necessary to implement these, the associated time frames, the financial implications of each action and an overall financial plan which projects these – and demonstrates the overall improvement in financial health of the municipality – over a three year period. The total size and length of the grant, and timing of disbursements will need to be included here, as will verifiable benchmarks and conditions against which disbursement of the grant should be made in relation to revenue or expenditure targets and other milestones.
- d) A proposed management team for plan implementation, including any external consultants.
- e) Evidence of Council commitment to the plan.



The Department of Finance will assess the plans submitted by eligible municipalities, primarily for viability. Should the Department find the plan to be a credible solution, it will negotiate a grant agreement with the municipality that will bind it to the implementation of the plan. Beneficiary municipalities will be required to submit ongoing progress reports, although the Department will also commission independent evaluations. Non-compliance with the grant agreement will result in suspension or termination of the grant, repayment of the entire grant, or subjection to the more stringent municipal finance emergency procedures.

Allocations will be made on a multi-year basis, to a maximum of three years, subject to the availability of funds in the outer years. The full amount, annual allocations and timing of the disbursements should be proposed by the applicant municipality, but will be subject to review by the Department of Finance.

## **2. The Municipal Financial Emergencies and the Municipal Financial Emergency Authority**

Government will establish a set of statutory procedures – and an institutional framework for managing these – to deal with municipalities in financial crisis i.e. where a High Court declares a state of Financial Emergency. The basic objective of these procedures will be to manage the affected municipality back to a position of financial health so that it may function sustainably and pay its debts.

Financial Emergencies will result only in worst case scenarios and only where the full range of other measures – including the FRGs (if the affected local authority receives one) - has failed to halt financial decline.

In detail, the institutional and procedural framework government will establish in legislation is as follows.

### ***Municipal Financial Emergency Authority***

The MFEA will be a specialist and autonomous administrative instrument of state and will operate at an arms length from government in a manner analogous to the Master of the High Court. The head of the Agency will be appointed by the Minister of Provincial and Local Government.

In respect of any Municipal Financial Emergency, as declared by a judge of the High Court (see below), the MFEA will be authorised to:

- Take such measures as it may deem necessary and advisable to determine the nature and extent of the emergency, and to supervise the formulation and implementation of a recovery plan for the municipality;
- Appoint an Administrator to temporarily exercise control over some or all of the executive and legislative authority of the municipality;
- An Administrator may be any legal person, and shall be appointed with primary regard to financial and management expertise in the municipal sphere.

- Require regular reports of such an Administrator.
- Establish the compensation for such an Administrator.
- Require that the compensation and expenses of the Administrator be paid by, or recovered from, the municipality.
- Approve or disapprove any recovery plan developed by such an Administrator.
- Apply to the High Court for a declaration that a financial emergency no longer exists in the municipality.

### **Parties**

Any of the following parties may file an application with the High Court alleging the existence of one or more of the conditions listed in 1(c), below, and requesting the declaration of a financial emergency:

- A creditor
- The Municipal Manager or Chief Financial Officer
- The municipal council
- The MEC responsible for Finance or Local Government
- The Minister of Finance
- The Minister of Provincial and Local Government
- Organised labour

### **Minimum conditions**

The threshold for the declaration of a Municipal Financial Emergency will be the existence of one or more of the following conditions:

- i) There has been a default on a municipality's financial obligations, including failure to make any payment as and when due to a supplier, an employee, or a creditor
- ii) There has been a default by a municipality on a promise or agreement made in connection with borrowing
- iii) Actual current expenditures have exceeded actual current revenues for 3 fiscal years or more.
- iv) A municipality has experienced an operating deficit in the prior fiscal year in excess of 10% of actual operating revenues

### *High Court powers and procedures*

However, the finding of a Financial Emergency will not follow automatically from the existence of the above conditions. On application of by any party listed above, the High Court will make a determination as to whether (a) the above conditions exist, and (b) there is a serious fiscal or financial problem within the municipality which prevents the municipality from meeting its obligations. The Court is not obliged to declare an Emergency if it is satisfied that the municipality has taken steps that have a reasonable chance of resolving any fiscal or financial problem.

In connection with a declaration of financial emergency, if the High Court determines that irreparable harm to the municipality or to creditors would otherwise occur, the Court may on a temporary, emergency basis not to exceed 90 days, stay litigation or execution by any creditor.

The following parties shall be given notice and an opportunity to be heard (to the extent practicable if the application is heard as a matter of urgency), in the event of an application under this section:

- the municipal council
- the municipal manager
- the Chief Financial Officer, and
- the MEC for Finance or Local Government and the National Minister of Finance and Minister of Provincial and Local Government.

### Powers of the Administrator

The Administrator shall intervene in the affairs of the municipality to the extent appropriate to the seriousness of the municipality's condition. The Administrator shall use the least intrusive practical means to effectively address the condition of the municipality, co-operating with the municipal council and officials to the extent possible. Where the municipality takes necessary actions to the satisfaction of the Administrator, the Administrator need not exercise its powers in lieu of the municipality. The primary objectives of the intervention are to restore fiscal integrity and full democratic local governance as soon as possible.

Notwithstanding, the Administrator may exercise so many of the following powers (and associated responsibilities) as are needed:

### Extraordinary relief

In rare and exceptional circumstances, where the Administrator believes that there is no possibility of a recovery plan succeeding with only the powers and duties described in subsection 1(e) above, the Administrator, with the

concurrence of the MFEA, may apply to the High Court for extraordinary relief in the form of:

*Coordination with other provisions*

The financial emergency approach outlined above is independent of the redetermination of municipal boundaries by the Municipal Demarcation Board pursuant to the Local Government: Municipal Demarcation Act, and the consequences of such a redetermination under the Structures Act. However, legislation will provide that a redetermination of boundaries under the Demarcation Act, and the subsequent §12 notice, automatically ends the financial emergency unless (a) a resulting municipality is at least 50% made up of the old municipality, or (b) within 15 days of the §12 notice, a party named in 1(b) above applies for an extension of the emergency declaration to the newly established municipality, and demonstrates to the satisfaction of the court that financial, fiscal, or management conditions are such that a financial emergency will also exist in the newly established municipality.

The financial emergency approach outlined above does not affect the dissolution of a municipal council in accordance with section 34 of the Structures Act. If a municipal council is dissolved, a new election will be held, but its powers will be limited by any recovery plan that may have been approved by the MFEA until the conditions giving rise to the state of financial emergency are determined by the High Court to no longer exist.

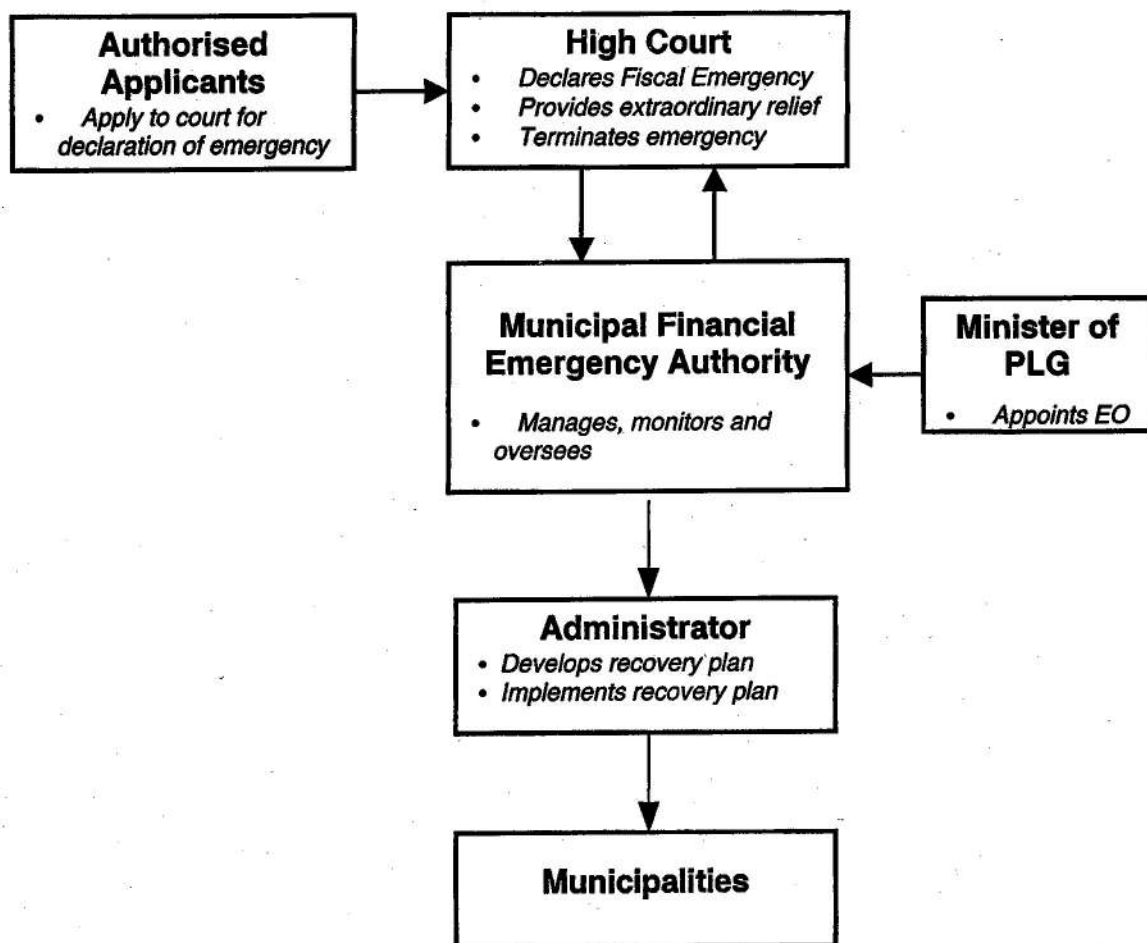
To the extent that any recovery plan approved by the MFEA relieves the municipal council of executive obligations and vests them in the Administrator, the provisions of Sec 139 of Constitution would become inapplicable since the municipality would no longer have any "executive obligation in terms to legislation."

## **Constitutional amendment**

In order to ensure that the system outlined above is immune to constitutional challenge, S 13 will need to be amended to authorise national legislation to (a) establish structures and procedures to deal with financial emergencies in municipalities and (b) to provide for these structures to exercise executive and legal authority on behalf of the municipality to the extent necessary to deal effectively with the emergency. The proposed amendment is available in Appendix III and the supporting provisions for inclusion in the Municipal Finance Management Bill are available in Appendix IV.

## **Overview**

The system described above is expressed in simple form in the following diagram:



## **APPENDIX II: TASK TEAM AND ADVISORS**

The Task Team convened by the Department of Finance comprised the following individuals:

### *Stakeholders*

Roland White (Chairperson), Department of Finance  
Mandla Maleka, Department of Finance  
Jackie Manche, Department of Constitutional Development  
John Douw, SALGA  
Bethuel Jwili, IMFO  
Barry Jackson, DBSA

### *Local advisors*

Enos Banda, Zader Financial Services  
Gert Steenkamp, Consultant  
Daan Wandrag, Imali Capital  
Alan Yorke, Deloitte and Touche

### *International advisors*

Roy Bahl, Georgia State University  
Junaid Ahmad, World Bank  
John Zohrab, Highway Technologies.

The team oversaw a research and policy formulation exercise conducted by a consortium led by Research Triangle International. The consortium members included Matthew Glasser (leader), Thomas Cochran, Michael DeAngelis, Marlene Hesketh (RMB), Ronald Johnson, Chris Kapp, John Petersen and Paddy Roome. Marie du Plooy and Plaatjie Mahlobogoane were seconded to the consortium by the Department of Finance.

**APPENDIX III: PROPOSED CONSTITUTIONAL AMENDMENT**

(Insert in Chapter 13 after section 216 of the Constitution of the Republic of South Africa)

National legislation must -

- (a) establish structures and procedures to deal with financial emergencies in municipalities; and
- (b) provide for these structures to exercise legislative and executive authority on behalf of a municipality to the extent necessary to deal effectively with the emergency.



## **APPENDIX IV: FINANCIAL EMERGENCIES PROVISIONS FOR INCLUSION IN MUNICIPAL FINANCE MANAGEMENT BILL**

The following sections will be included in the Municipal Finance Management Bill. They require enactment of the proposed constitutional amendment.

### **ARRANGEMENT OF CHAPTERS**

#### **Chapter 10**

##### **Financial emergencies**

- 60. Establishment
- 61. Functions
- 62. General powers
- 63. Appointment and responsibilities of Executive Officer
- 64. Acting Executive officer
- 65. Staff
- 66. Pension rights
- 67. Funds
- 68. Delegation
- 69. Application for declaration of a financial emergency
- 70. Appointment of administrator for municipality
- 71. Recovery plan
- 72. Powers of administrator
- 73. Application for termination of a declaration of financial emergency
- 74. Effect of boundary redetermination
- 75. Application for extraordinary relief
- 76. Suspension of municipal obligations
- 77. Termination of municipal obligations and proportional settlement of claims

#### **Chapter 1**

**“administrator”**, in relation to a municipality in a financial emergency, means a person appointed in terms of section 70 as the administrator for that municipality;

**“court”** means a High Court having jurisdiction, and includes any court superior to the High Court;

**“Emergency Authority”** means the Municipal Financial Emergency Authority established in terms of section 60;

**"Executive Officer"**, in relation to the Municipal Financial Emergency Authority, means the person appointed as the Executive Officer of that Authority;

**"financial emergency"** means a financial emergency within the meaning of Chapter 10;

**"recovery plan"** means a plan prepared and approved in terms of section 71;

## **Chapter 5**

**22.** (6) A municipality in respect of which a financial emergency has been declared, may incur long term debt to support financial restructuring, if so provided in the approved recovery plan.

## **Chapter 10**

### ***Part 1: Establishment, functions and administration of Municipal Financial Emergency Authority***

#### **Establishment**

**60.** (1) A Municipal Financial Emergency Authority is hereby established as an institution outside the public service but within the public administration as envisaged in section 195 of the Constitution.

(2) The Emergency Authority is a juristic person.

#### **Functions**

**61.** The Emergency Authority must oversee the administration of municipalities declared to be in a financial emergency with a view to normalising their financial affairs, and for this purpose –

- (a) must perform the duties and may exercise the powers assigned to the Authority in terms of this Act;
- (b) may monitor the implementation of recovery plans;
- (c) may suspend, dismiss or discharge administrators, when necessary;
- (d) may collect information on financial emergencies and best practices in resolving financial emergencies; and
- (e) must prepare and submit annual reports to the Minister responsible for local government on its activities

#### **General powers**

**62.** The Emergency Authority may do all that is necessary or expedient to perform its functions effectively, which includes the power to –

- (a) determine its own staff establishment and the terms and conditions of employment for its staff within any policy framework determined by the Minister responsible for local government in consultation with the Minister of Finance;
- (b) appoint employees and seconded personnel to posts on its staff establishment;
- (c) obtain the services of any person by agreement, including any state department, functionary or institution, to perform any specific act or function;
- (d) open and operate its own bank accounts, subject to the Public Finance Management Act, 1999 (Act 1 of 1999);

- (e) perform legal acts, or institute or defend any legal action in its own name;
- (f) engage in any lawful activity, whether alone or together with any other person; and
- (g) do anything that is incidental to the exercise of any of its powers.

#### **Appointment and responsibilities of Executive Officer**

**63.** (1) The Minister responsible for local government, acting with the concurrence of the Minister of Finance, must appoint a person as the Executive Officer of the Emergency Authority.

- (2) A person appointed as the Executive Officer holds office –
- (a) for an agreed term not exceeding five years, but which is renewable; and
  - (b) on terms and conditions set out in a written employment contract which must include terms and conditions setting performance standards.

(3) The Executive Officer –

- (a) manages the Emergency Authority;
- (b) is responsible for the performance by the Authority of its functions and the exercise of its powers; and
- (c) takes all decisions of the Authority in the performance of its functions and the exercise of its powers, except those decisions of the Authority taken in consequence of a delegation or instruction in terms of section

**68.**

#### **Acting Executive Officer**

**64.** When the Executive Officer is absent or otherwise unable to perform the functions of office, or during a vacancy in the office of Executive Officer, the Minister responsible for local government may designate another employee of the Emergency Authority, or a person seconded to the Authority, to act as Executive Officer.

#### **Staff**

**65.** (1) The staff of the Emergency Authority consists of –

- (a) the Executive Officer of the Authority; and
- (b) persons in the service of or seconded to the Authority.

(2) An employee of an organ of state may be seconded to the Emergency Authority by agreement between the Authority and such organ of state.

(3) Staff members referred to in subsection (1) (b) and persons seconded to the Emergency Authority perform their duties subject to the control and directions of the Executive Officer.

#### **Pension rights**

**66.** The Emergency Authority is regarded to be an employer for the purposes of the Government Employees' Pension Law, 1996 ( Proclamation 21 of 1996), in regard to employees who elects to become members of the Government Employees' Pension Fund.

**Funds**

- 67.** (1) The funds of the Emergency Authority consist of –
- (a) money appropriated annually by Parliament for the purposes of the Authority;
  - (b) any government grants made to it; and
  - (c) any other money legally acquired by it.

(2) The Emergency Authority may accept donations but only with the approval of the Minister responsible for local government.

**Delegation**

- 68.** (1) The Executive Officer of the Authority may delegate, in writing, any of the powers or duties entrusted to the Authority in terms of this Act to a member of the staff of the Authority.

- (2) A delegation in terms of subsection (1) –
- (a) is subject to the limitations or conditions that the Executive Officer may impose; and
  - (b) does not divest the Executive Officer of the responsibility concerning the exercise of the delegated power or the performance of the delegated duty.

(3) The Executive Officer may confirm, vary or revoke any decision taken in consequence of a delegation in terms of subsection (1), provided that no such variation or revocation of a decision may detract from any rights that may have accrued as a result of the decision.

***Part 2: Declaration, administration and termination of financial emergencies*****Application for declaration of a financial emergency**

- 69.** (1) An application to court for a declaration that a municipality is in a financial emergency may be made by –

- (a) a creditor of the municipality;
- (b) the council, the municipal manager or the chief financial officer of the municipality;
- (c) the MEC for finance in the province;
- (d) the MEC for local government in the province;
- (e) the Minister;
- (f) the Minister responsible for local government; or
- (g) organised labour.

- (2) An application in terms of subsection (1) may be made only if one or more of the following conditions exist:
- (a) the municipality has defaulted on the payment of an amount due and payable to a creditor or, if an amount has been prescribed, above that prescribed amount;
  - (b) the municipality has defaulted on an agreement providing security for any debt of the municipality;
  - (c) the municipality's actual current expenditure have exceeded actual current revenue for at least the three preceding financial years; or
  - (d) the municipality had an operating deficit in excess of a prescribed percentage of actual operating revenues in the most recent financial year for which financial statements have been prepared.

(3) In considering an application in terms of subsection (1), the court may declare that a municipality is in a financial emergency if –

- (a) at least one of the conditions listed in subsection (2) exist;  
and
- (b) there is a serious fiscal or financial problem in the municipality that impedes the municipality from meeting its obligations.

(4) The court is not obliged to declare a that a municipality is in a financial emergency if it is satisfied that the municipality has taken steps that have a reasonable prospect of resolving the fiscal or financial problem referred to in subsection (2) (b).

(5) If the court declares that a municipality is in a financial emergency it must order the Emergency Authority to appoint an administrator for the municipality.

(6) Without derogating from the rules of court –

- (a) any application in terms of this section must be heard by the court as promptly as possible; and
- (b) notice of the application must be given to –
  - (i) the mayor of the affected municipality, where applicable;
  - (ii) the municipal manager of the municipality;
  - (iii) the chief financial officer of the municipality;
  - (iv) the MEC for finance in the province;
  - (v) the MEC for local government in the province;
  - (vi) the Minister; and
  - (vii) the Minister responsible for local government.

(7) If the court declares that a municipality is in a financial emergency, it may order that legal proceedings by any creditor and the execution of any process against the municipality be stayed for a period not exceeding 90 days to allow for the appointment of an administrator and the preparation of a recovery plan for the municipality.

#### **Appointment of administrator for municipality**

**70.** (1) The Emergency Authority must give effect to a court order issued in terms of section 69 (5) and promptly appoint an administrator for the municipality.

(2) The Emergency Authority must determine the compensation of the administrator, and may require that the compensation and expenses of the administrator be paid by, or recovered from, the municipality.

(3) A person appointed as an administrator must have appropriate financial and management experience and skills to address any problems underlying a financial emergency.

#### **Recovery plan**

**71.** (1) The administrator appointed for a municipality must –

- (a) conduct a sufficiently detailed investigation into the municipality's condition to determine the underlying fiscal or financial problems; and



- (b) prepare and submit a recovery plan to the Emergency Authority as soon as possible, but in any event within the time frames determined by the Authority.
- (2) When preparing the recovery plan the administrator must consult –
  - (a) the municipality; and
  - (b) the municipality's creditors, following a procedure that may be prescribed.
- (3) The recovery plan must –
  - (a) be designed to restore the municipality to a sound financial and fiscal condition as soon as possible, and to restore its creditworthiness;
  - (b) identify the underlying fiscal or financial problems of the municipality;
  - (c) describe a general strategy for addressing these problems;
  - (d) describe, so far as is reasonably possible, the specific actions intended to be taken by various parties;
  - (e) describe the anticipated time frame for recovery, and milestones to be achieved;
  - (f) identify the principal objectives of the plan, and methods for achieving those objectives; and
  - (g) identify which of the administrator's powers referred to in section 72 may be used in implementing the plan.
- (4) The administrator must –
  - (a) submit a copy of the recovery plan to the municipality, the Emergency Authority and the parties involved in the court proceedings in which the financial emergency was declared; and
  - (b) allow public access to the recovery plan in the prescribed manner.
- (5) Councillors, officials and staff of the municipality must co-operate with the administrator in investigating the financial emergency and in developing and implementing the recovery plan.
- (6) The Emergency Authority must approve the plan if it complies with subsection (3).
- (7) The administrator must report to the Emergency Authority, the municipality and creditors at such intervals or upon the reaching of such milestones as the Authority may determine from time to time.
- (8) Reports must be in the prescribed form.
- (9) (a) The administrator may amend a recovery plan as the need may arise.
  - (b) The administrator must –
    - (i) submit a copy of the amendment of the recovery plan to the municipality and the Emergency Authority; and
    - (ii) allow public access to the amendment in the prescribed manner.
  - (c) The Emergency Authority must approve the amendment if the recovery plan as amended would still comply with subsection (3).

(10) The administrator must endeavour to bring the municipality to a sound financial and fiscal condition as soon as possible.

**Powers of administrator**

**72.** (1) The administrator appointed for a municipality has access to any structure, functionary, official, premises, documents or records of the municipality.

(2) To the extent permitted in the recovery plan and subject to subsection (3) and any other applicable legislation, the administrator may exercise on behalf of the municipality any of the municipality's executive or legislative power necessary to restore the municipality to a sound financial and fiscal position.

(3) A recovery plan –

- (a) may not permit the liquidation of assets needed for the provision of minimum municipal essential services; and
- (b) may provide for the suspension of the remuneration and other benefits of members of the council or officials should they fail to co-operate in the implementation of the recovery plan.

(4) When exercising the powers permitted in the recovery plan, the administrator must consider the least intrusive practical means to effectively address the financial emergency, allowing the structures and functionaries of the municipality to act where they can and are willing to do so in a timely and responsible manner.

**Application for termination of a declaration of financial emergency**

**73.** (1) An application to court for the termination of a declaration of financial emergency may be brought by –

- (a) the Executive Officer;
- (b) the council of the affected municipality; or
- (c) the applicant in the application to declare a financial emergency.

(2) Without derogating from the rules of court, notice of application for the termination of a declaration of financial emergency must be given –

- (a) in the prescribed manner to all creditors to whom the municipality owes an amount in excess of a prescribed amount;
- (b) to any creditor who filed the original application for declaration of a financial emergency;
- (c) to the municipal manager and chief financial officer of the municipality;
- (d) to the MEC for finance in the province;
- (e) to the MEC for local government in the province;
- (f) to the Minister;
- (g) to the Minister responsible for local government; and
- (h) in the prescribed manner to organised labour.

(3) Should the court find that a financial emergency no longer exists, the court must terminate the declaration of financial emergency and discharge the administrator appointed for the municipality.



**Effect of boundary redetermination**

- 74.** (1) If the boundaries of a municipality under a declaration of financial emergency are redetermined in terms of the Local Government: Municipal Demarcation Act, 1998 (Act 27 of 1998), and the MEC for local government in the province issues a notice in terms of section 12 of the Municipal Structures Act regulating the legal, practical and other consequences of the total or partial disestablishment of the existing municipality, then the declaration of financial emergency –
- (a) automatically extends to any resulting municipality having at least 50 percent of its territorial area within the former municipality; or
  - (b) automatically terminate upon the issuance of the MEC's notice, and be of no further force and effect, as to any resulting municipality having less than 50 per cent of its territorial area within the former municipality.
- (2) An automatic extension in terms of subsection (1) (a) may be terminated in accordance with section 73 at any time.
- (3) An automatic termination in terms of subsection (1) (b) may be avoided where a party named in section 69 (1) –
- (a) files an application with the court within 15 days of publication of the MEC's notice in terms of section 12 of the Municipal Structures Act; and
  - (b) demonstrates to the satisfaction of the court that financial, fiscal, or management conditions are such that a financial emergency will also exist in the newly established municipality.

**Part 3: Additional remedies****Application for extraordinary relief**

- 75.** (1) If the administrator on reasonable grounds is of the view that the financial emergency cannot be resolved by the application of sections 71 and 72 alone, the administrator may, after consulting the Executive Officer, apply to a court for an order –
- (a) to stay legal proceedings by any creditor and the execution of any process against the municipality for a period not exceeding 90 days at a time;
  - (b) to suspend the obligations of the municipality to its creditors until the declaration of the financial emergency is terminated; or
  - (c) to terminate the obligations of the municipality to its creditors, and to settle claims proportionally, taking into account the preference of claims.
- (2) Without derogating from the rules of court, notice of an application for extraordinary relief under this section must be given –
- (a) in the prescribed manner to all creditors to whom the municipality owes an amount in excess of a prescribed amount;
  - (b) to any creditor who filed the original application for a declaration of a financial emergency;
  - (c) to any creditor whose rights would be affected by the extraordinary relief;
  - (d) to the municipal manager and the chief financial officer of the municipality;
  - (e) to the MEC for finance in the province;
  - (f) to the MEC for local government in the province;
  - (g) to the Minister;
  - (h) to the Minister for local government; and

- (i) in the prescribed manner to organised labour.

#### **Suspension of municipal obligations**

**76.** (1) Before granting an application in terms of section 75 (1) (b), the court must be satisfied that –

- (a) the municipality cannot meet its obligations to its creditors; and
- (b) all assets and rights not necessary to provide minimum essential municipal services have been liquidated for the benefit of meeting creditors' claims.

(2) If the court grants an application referred to in subsection (1), it must give preference to the rights of secured creditors as to assets or rights with which they are secured, provided that such security was given in good faith and at least six months prior to any application in terms of section 69 for a declaration of financial emergency.

#### **Termination of municipal obligations and proportional settlement of claims**

**77.** (1) Before granting an application in terms of section 75 (1) (c), the court must be satisfied that –

- (a) the municipality cannot meet its obligations to its creditors and would not be able to do so in the foreseeable future;
- (b) all assets and rights not necessary to provide minimum essential municipal services have been liquidated for the benefit of meeting creditors' claims; and
- (c) all employees have been discharged except those that are affordable in terms of reasonably projected revenues.

(2) If the court grants an application referred to in subsection (1), it must –

- (a) give preference to the rights of secured creditors as to assets or rights with which they are secured, provided that such security was given in good faith and at least six months prior to any application in terms of section 65 for a declaration of financial emergency; and
- (b) treat unsecured claims as concurrent and order that such claims be settled proportionally.

### **Chapter 11**

**78.** (1)

- (q) the administration of financial emergencies;
- (r) the assignment of additional duties and powers to the Emergency Authority;
- (s) the suspension, dismissal or discharge of administrators appointed for municipalities declared to be in a financial emergency;
- (t) the settlement of claims against a municipality following an order of court in terms of section 73;

### **Chapter 12**

**86.** (4)

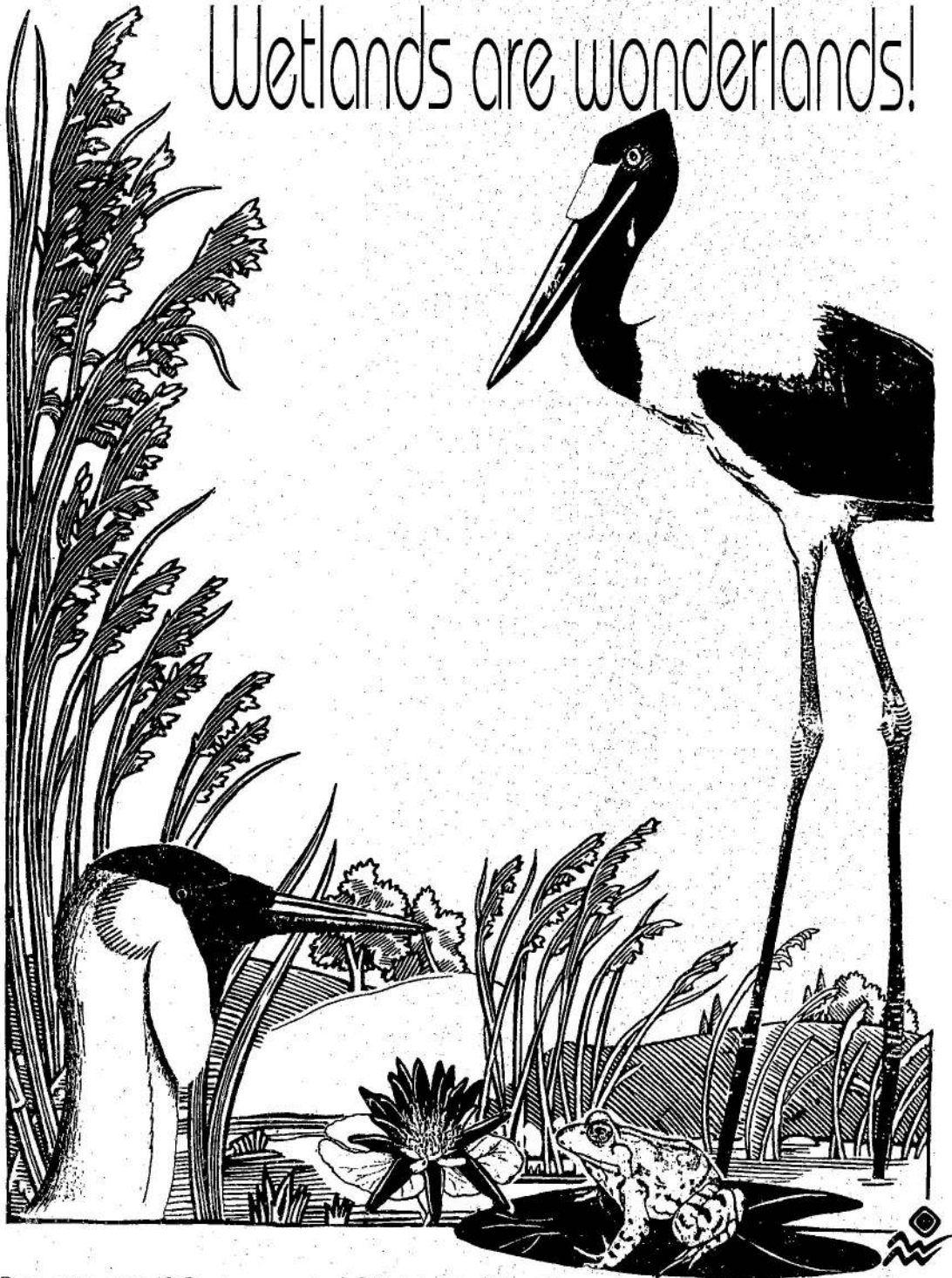
- (d) obstructs, or fails to co-operate with, an administrator in the fulfilment of the administrator's duties under this Act.

**Chapter 13**

**90. (2)** Schedule 3 of the Public Finance Management Act is hereby amended by the insertion in Part A after item 17 of the following item:

**"17A. Municipal Financial Emergency Authority".**

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