**1. REPORT OF THE SELECT COMMITTEE ON APPROPRIATIONS ON CORRESPONDENCE FROM THE EXECUTIVE MAYOR OF THE OR TAMBO DISTRICT MUNICIPALITY REQUESTING INTERVENTION IN THE STOPPING OF THE MUNCIPAL INFRASTRUCTURE GRANT ALLOCATION TO THE MUNICIPALITY, DATED 28 JUNE 2017**

1. **Introduction and background**

On 22 March 2017 the Executive Mayor of the OR Tambo District Municipality in the Eastern Cape Province, Cllr N Meth, wrote a letter to the Chairperson of the NCOP, requesting the NCOP to intervene in the stopping of the Municipal Infrastructure Grant (MIG) allocation to the OR Tambo District Municipality (DM). This correspondence was referred to the Committee on 3 May 2017. Upon initial enquiries, National Treasury informed the Committee that, following extensive consultation with the Department of Cooperative Governance (DCoG) and the District Municipality (DM), a decision had been made to reduce by R90 million the DM’s MIG allocation of R609 million in the 2016/17 financial year. The reasons for this were reportedly improper reporting by the DM, non-registration of projects and the slow take-up of projects.

In order to consider the Executive Mayor’s request and to strengthen intergovernmental relations and good cooperative governance, the Committee convened a meeting at Parliament on 6 June 2017, and invited the following stakeholders:

* The OR Tambo District Municipality;
* The national Department of Cooperative Governance;
* National Treasury;
* Eastern Cape Provincial Treasury; and the
* Eastern Cape Department of Cooperative Governance and Traditional Affairs.

The meeting was attended by the Executive Mayor, accompanied by the two MMCs for Finance and Water and Sanitation and officials from the District Municipality; the Eastern Cape MEC for Finance and officials from the Eastern Cape Provincial Treasury; and officials from the National Treasury, the national and provincial departments of Cooperative Governance and the Municipal Infrastructure Agent (MISA).

The purpose of the meeting was, among others, for the Committee to assess the following with regard to the matter:

* Whether the stopping of the funds was in line with the provision of section 19(1) of the Division of Revenue Act, (Act No 3 of 2016)?
* Whether the National Treasury complied with the provisions of the Division of Revenue Act when the funds were stopped?
* Whether measures and steps were taken by both the National Treasury and the transferring department to support and strengthen the capacity of the DM as envisaged in section 154 of the Constitution?
* What were the challenges within the DM that led to the allocated MIG funds being stopped?
* What are the implications of this action on service delivery?
* What measures were put in place to mitigate against any further negative impact on service delivery within the DM as a result of the funds being stopped?
* What are the options available to the Committee in dealing with this matter?
* Are there any lessons to be learned here that could help to avoid similar incidents in future?
1. **Presentations by stakeholders**
	1. **OR Tambo District Municipality**

The OR Tambo District Municipality (DM) reported that its MIG allocation for the 2016/17 financial year had been R609 million. The DM further submitted that the project implementation plan had been compiled and submitted to the transferring department, outlining the payment schedule for the Grant to the municipality’s primary bank account. According to the DM, the project implementation plan consisted of projects that were part of the municipality’s Three Year Infrastructure Plan and Integrated Development Plan (IDP) and were registered in the MIG Management Information System (MIS). The DM acknowledged that the municipal Project Implementation Plan (PIP) had been submitted late due to capacity constraints, including the vacancy rate in the Project Management Unit (PMU) and broader infrastructure service department.

The DM reported that, subsequent to the submission of the Project Implementation Plan, DCoG transferred R189.9 million (first transfer) in July 2016. The DM further reported that on 11 November 2016, DCoG transmitted a letter raising concerns relating to non-compliance and non-reporting and the provincial Department of Cooperative Governance and Traditional Affairs (ECCoGTA) was included in the correspondence. According to the DM, it became clear in the response from ECCoGTA that there was a lack of communication between the provincial department and DCoG. The DM reported that a meeting to resolve the misunderstanding was requested and convened on 30 November 2016. After that meeting it was agreed that a working session would be held to look at the reports and proof of payments from July to November 2016 and another session was scheduled for 12 December 2016, having been postponed on 05 December 2016. This session reportedly confirmed that the DM had spent 80 percent of its transferred funds with proof of payments provided. However, DCoG reportedly did not recognise the expenditure for the PMU operations (salaries) and some of the expenditure on the projects that were not in the Project Implementation Plan; although the projects were part of the Three Year Infrastructure Plan and registered in the MIG MIS. Moreover, as a means to facilitate the second transfer DCoG requested the DM to officially confirm that a detailed analysis was conducted and it confirmed compliance with the requirements. This letter was sent on 16 December 2016. The DM reported that, whilst the outcomes of the meeting concurred that the second tranche transfer be implemented in line with the DM’s compliance with the requirements of the Division of Revenue Act, the MIG funds to the DM were short-transferred on 22 December 2016 by an amount of R90 million without any reasons provided.

The DM reported that projects were implemented as per contractual obligations and service providers were paid from its own funds. The DM’s Chief Financial Officer (CFO) continued to communicate with DCoG and National Treasury officials to understand the reasons for the short transfer. The matter was never resolved. While the reasons were not provided for the short transfer of the second tranche, DCoG subsequently issued another correspondence to invite the DM to a meeting in Pretoria on 19 and 20 January 2017 to discuss the intention to stop payment of the MIG funds. The CFO and PMU Manager attended this engagement, but reportedly felt ridiculed and undermined by the departmental officials. According to the DM, DCoG did not provide guidance to the DM on what it should prepare and present in the session whilst other municipalities were provided with the guidelines.

The DM was then informed by DCoG on 15 February 2017 that a sum of R90 million would be withheld and a representation was requested within seven days. After this, the DM requested a formal engagement with DCoG and with the National Treasury. The DM reported that it was during the meeting with DCoG on 21 February 2017 that the DM was informed that R90 million was withheld due to the DM spending only 21 percent of its MIG allocation by the end of December 2016, falling below the 40 percent threshold. In addition, there was a view that the DM was spending on projects that were not registered in the MIG MIS. However, the DM reported to the Committee that, at the end of December 2016, they had spent 46 percent of the total allocation and 77 percent of the transferred amount.

During this engagement, it was resolved that the DM would make a written representation to the National Treasury and that this would be supported by confirmation from DCoG that the DM had, in fact, met the 40 percent expenditure requirement by the end of December 2016. The DM reported that it did submit the representation letter, with all supporting documents attached, to the National Treasury and DCoG. After this process, the DM was reportedly shocked to see the *Government Gazette* reallocating R90 million of its MIG funds. The DM then requested urgent engagement and intervention from the relevant parties, including the Minister of Cooperative Governance and Traditional Affairs, the provincial portfolio committee, the Premier, as well as the Directors-General for DCoG and National Treasury and their provincial counterparts. The DM subsequently submitted all the requested information, but to no avail.

The DM reported to the Committee that it had now spent R542 million against the R519 million of transferred funds, leading to a deficit of about R23 million. In addition to the current deficit, contractors were on site and would be submitting invoices during the month of June. The projected expenditure for the current month was reportedly R67 million.

In conclusion, the DM requested that the Committee intervene to ensure that the people of the OR Tambo District enjoy the services they are entitled to in terms of the Constitution.

* 1. **Department of Cooperative Governance**

The Department of Cooperative Governance (DCoG) together with the Municipal Infrastructure Agent (MISA) reported that the receiving officer of a Schedule 5 grant must ensure compliance with the relevant grant framework. The MIG framework stipulates the following:

* To receive the first tranche, municipalities must have followed the process for approval of 2016/17 projects and have confirmed with DCoG their programme, project planning and implementation readiness.
* Municipalities must spend at least 60 percent of their first transfer and comply with reporting provisions before the second and subsequent transfers are made.
* Municipalities must spend 40 percent of their total MIG allocation by December 2016.
* A maximum of 5 percent of a municipality’s MIG allocation may be used for project management costs related to grant funded projects and only if a business plan for their Project Management Unit is approved.

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| Should the above conditions not be complied with, the Transferring Officer (TO) may invoke stopping and reallocation procedures in terms of sections 19 and 20 of the Division of Revenue Act.The Department further reported that the OR Tambo District Municipality had a total MIG allocation of R609 million in the 2016/17 financial year, making it the highest receiving institution in the country for the MIG programme. Because the DM is a Water Services Authority (WSA), its MIG funds are only for the implementation of water and sanitation projects in the five local municipalities under the District, which are –* Ngquza Hill;
* Port St Johns;
* Nyandeni;
* Mhlontlo; and
* King Sabata Dalindyebo.

In accordance with the MIG framework, a municipality must submit its implementation plan to DCoG by 29 January 2016 and the final plan, indicating its programme, project planning, implementation readiness and allocated budget per project, by 7 June 2016. This should be done prior to the year of implementation and be informed by an Integrated Development Plan (IDP) and the municipality’s three-year capital plan. The Department reported that the DM had failed to meet both the above submission dates, meaning that the implementation readiness of the DM could not be confirmed before the start of the financial year, as required by section 10(a)(ii) of the Division of Revenue Act. Subsequently, DCoG determined the flow of funding, with the first transfer of R189.9 million being made in July 2016.The Department further reported that the DM did not provide any indication that it would consider apportioning the 5 percent of its allocation for project management-related cost, as provided for in the Grant framework. The Project Management Unit (PMU) costs for the DM was reportedly R30.4 million and could not be considered due to the non-submission of the PMU business plan for the 2016/17 financial year. The Department indicated that, at the time of the meeting, the DM had not yet submitted the PMU business plan to DCoG for approval.With regard to the requirement that a municipality must spend at least 60 percent of its first transfer and comply with reporting provisions before the second and subsequent transfers are made, the Department reported that, after issuing non-compliance letters to the DM in September, October and November, the Department issued a letter of intention to withhold the second transfer on 11 November 2016. The DM reportedly responded, indicating expenditure of 78 percent of the transferred amount of R189.9 million. According to the Department, the claimed 78 percent expenditure could not be substantiated with supporting documents and the second transfer, due in November, was withheld. During a bilateral follow-up meeting with the DM on 5 December 2016, expenditure of 68 percent on the first transfer was confirmed and the second transfer was made on 22 December 2016.At the end of December 2016, DCoG’s reports confirmed a total expenditure of 21.69 percent against the total allocation, falling below the 40 percent requirement. The DM, together with 12 other municipalities in the province, were invited to meetings in Pretoria on 19 and 20 January 2017. During these meetings, concerns were raised about the non-attendance of the Municipal Manager and the Director for Technical Services. The Department further indicated that the Chief Financial Officer and the PMU Manager, who did attend, were not prepared for the meeting and did not have a presentation or an implementation plan. The Department reported that, due to the fact that the OR Tambo DM had perpetually defaulted on the compliance requirements of the MIG processes and procedures, and that the DM’s implementation plan was not credible and only submitted for malicious compliance, R90 million of the DM’s MIG funds was stopped and reallocated to other municipalities in the province.* 1. **Eastern Cape Provincial Treasury**

The Eastern Cape Provincial Treasury (ECPT) reported that, subsequent to receiving the invitation from DCoG to the above-mentioned meetings in Pretoria on 19 and 20 January 2017, ECPT and the provincial Department of Cooperative Governance and Traditional Affairs (ECCoGTA) met and agreed to facilitate a joint session with all 13 affected municipalities in East London on 17 January 2017. An amount of R119 million was potentially going to be stopped in Eastern Cape municipalities, of which R90 million was from the OR Tambo DM. Although the DM was among those municipalities invited to this joint session to prepare for the 19 and 20 January sessions in Pretoria, the DM did not attend this provincial session. ECPT further reported that two senior officials from ECPT and ECCoGTA accompanied the identified municipalities to the meetings in Pretoria. The two officials from the DM had not prepared any formal presentation, saying they had been unaware of what was expected of them. On 19 January the meeting resolved to give the DM a second chance to, assisted by MISA, prepare a presentation for the following day. However, the DM still did not have sufficient or adequate information, like proof of payment, or an implementation plan to convince the panel that they had spent at least 40 percent of the total allocation by 31 December 2016. In addition, the DM reportedly implemented projects that were not in the Project Implementation Plan submitted to DCoG.Subsequent to the meetings in Pretoria, National Treasury informed the DM of its intention to stop MIG funds on 16 February 2017. In its response, the DM could still not convince the National Treasury that it had spent enough to avert a stopping of funds, and R90 million was ultimately stopped. *Government Gazette* No 40707 Vol 621, dated 22 March 2017, was issued for the stopping and reallocation of the MIG funds.* 1. **National Treasury**

National Treasury reported that the stopping and reallocation of MIG is a requirement of the Division of Revenue Act, intended to assist fast-spending municipalities and alleviate pressures against slow-spending ones. Stopping is done in terms of sections 19 and 20 of the Act, and requires consultation between the Transferring Officer and the municipalities. National Treasury further reported that it had received a letter from DCoG, dated 1 February 2017, requesting National Treasury to stop a portion of the MIG allocation of under-performing municipalities, including OR Tambo DM. The recommendation to stop R90 million was based on the following:* Poor monthly reporting;
* Late appointment of service providers;
* Spending less than 40 percent of transferred allocations;
* Lack of commitment; and
* Poor performance.

National Treasury reported that it then wrote to all affected municipalities affording them an opportunity to make written representations. The response from the OR Tambo DM was that their MIG spending was in fact at 46 percent; that there had been a misunderstanding between the DM and DCoG with respect to non-registered projects; and that the slow spending was a result of the late transfer of the second tranche. National Treasury assessed the letter and supporting documents from the DM and found that –* ORTDM still submitted unregistered projects in its motivation;
* Some contractors were still to be appointed in February;
* Expenditure figures reported through section 71 differed from those of DCoG;
* 2017/18 projects amounting to about R40 million would be moved to the 2016/17 financial year; and
* Projects worth 150 million were still in the feasibility and design stage.

National Treasury further reported that it had been engaging on a regular basis with the CFO of the DM, exchanging reports and reasons for the stopping of the MIG. The DM had also written to National Treasury on a number of occasions to motivate against stopping and specifically responding to the concerns raised. Treasury’s main concern was the low reported expenditure against the expenditure claimed by the DM. The subsequent reports from DCoG suggested that the current spending was sitting at 59 percent.National Treasury informed the Committee that the stopping of the R90 million could not be reversed at this stage, as the financial year had ended. A concerted effort by all stakeholders was needed to support the DM and the DM should avail itself for site inspections and verification of expenditure. An improved performance on the MIG in the 2017/18 financial year would qualify the DM for additional MIG funding through the stopping and reallocation process. Finally, National Treasury proposed that government improved on the process for stopping and reallocation, as well as on consultation. 1. **Observations**

The Committee made the following observations/findings based on its deliberations and submissions received: **3.1 Reasons for the stopping of funds to OR Tambo District Municipality**The stopping of the funds was in line with the provisions of section 19 of the Division of Revenue Act, which stipulate that National Treasury may in its discretion or at the request of a transferring officer stop transfers listed in schedules 4 and 5 pertaining to anticipated under-spending on programmes or allocations in the financial year by a municipality.The chronology of events and the issuance of non-compliance letters to the OR Tambo DM by the Department of Cooperative Governance (DCoG) indicate that the OR Tambo DM was not ready to implement its Municipal Infrastructure Grant projects at the beginning of the 2016/17 financial year. Despite constant reminders from DCoG for the submission of MIG Project Management Unit expenditure, which is 5 percent of the MIG allocation, the OR Tambo DM did not comply and therefore any expenditure on PMU costs will be non-compliant. **3.2 The procedure followed when the MIG funds to OR Tambo DM were stopped.**The National Treasury submission shows that engagements were held with the District Municipality on 11/01/2017, 15/02/2017 and 03/03/2017. The records further show that submissions and representations made by the DM were duly considered by the National Treasury.**3.3 The challenges within the DM that led to the allocated MIG funds being stopped.*** As of 7 June 2016 the DM had not yet confirmed to DCoG the projects that would be funded through the 2016/17 MIG allocations.
* On 20/09/2016, 17/10/2016, and 11/11/2016 letters were issued by DCoG to the DM for non-compliance with monthly reporting on the performance of the MIG.
* The OR Tambo DM was one of the municipalities whose MIG spending was found to be below 40 percent by 31 December 2016.
* The non-compliance with the monthly reporting on the MIG funds led to a situation where the figures captured by DCoG and National Treasury were different from what the DM had in its records.
* The DM had capacity constraints due to vacancies in certain key positions such as the finance and projects departments. The inaccurate reporting by the DM might also be an indication that senior officials within the DM do not have the required skills or competencies for financial and project management.
* When requested to motivate why funds should not be stopped -
* The DM listed unregistered projects in its submission;
* Some contractors were still to be appointed in February 2017;
* Expenditure figures reported by the DM through section 71 of the Municipal Finance Management Act, 2003, differed from those of DCoG;
* 2017/18 projects to the tune of R40 million would be moved to 2016/17; and
* Projects worth R150 million were still in the feasibility and design stage.

**3.4 Measures and steps taken by both the National Treasury and relevant departments to support and strengthen the capacity of the DM as envisaged in section 154 of the Constitution.**Both National Treasury and Provincial Treasury as well as ECCoGTA and DCoG waited too long before intervening despite warning signs about capacity challenges within the DM. On the other hand, the Committee noted with concern the failure by municipal officials to attend meetings aimed at addressing challenges within the DM. Furthermore, there has been no indication of the DM’s desire or willingness to request any support from other spheres of government.**3.5 The actual spending of the MIG by the DM.**On 23 November 2016 the DM could not provide documents to support its claim of 68 percent expenditure on the MIG. On the other hand, the figures by National Treasury and DCoG showed the MIG expenditure to be 23.11 percent.There is still no consensus among the parties as to the actual expenditure performance of the DM to date and this can be attributed to the following:* Incorrect and improper reporting by the DM; and
* Inadequate verification systems by both the transferring provincial Department of Cooperative Governance and the Eastern Cape Provincial Treasury.

At the time of the meeting the parties were still consulting in order to reach consensus as to the actual MIG expenditure by the DM.**3.6 Implications of the stopping of funds on service delivery.**Under-spending compromises service delivery and the stopping of funds unfortunately worsens the situation. On the other hand, inaccurate reporting has the potential to compromise value for the money spent and might lead to negative audit findings related to irregular and unauthorised expenditure.**3.7 Measures put in place to mitigate against any further negative impact on service delivery within the DM as a result of the funds being stopped.**Out of the R2.96 billion MIG allocation for the 2016/17 financial year to the Eastern Cape, R119 million was stopped from eight under-performing municipalities, of which R90 million was stopped in the OR Tambo DM and R124 million was reallocated to 11 municipalities within the Province.The Minister of Finance has indicated that, although the stopped funds have already been re-allocated, the National Treasury will consider additional allocations to the DM in the new financial year, while the first transfers will be increased to accommodate any shortfalls.**3.8 The options available to the Committee in dealing with this matter.**The stopping of the R90 million MIG funding to the OR Tambo DM cannot be reversed because the financial year has ended. The Committee, however, will consider how additional allocations can be secured to ensure that the DM is duly funded within the new financial year to accommodate any shortfalls.**3.9 Lessons learned that could help avoid similar incidents in future.**Despite the good intentions and the rationale behind the clause in the Division of Revenue Act on the stopping of funds, such a step is a punitive process that unfortunately has unintended negative consequences. The process itself compromises service delivery to innocent recipients who have no control over the actions that led to the stopping of the funds. The process might also contribute to future under-spending as the spending process is slowed down. The process might also harm intergovernmental relations between the spheres of government involved.As can be seen from the chronology of events in this matter, the circumstances leading to the stopping of funds are an indication of some failures in certain legislative requirements with regard to cooperative governance and financial controls.There is therefore a need to strengthen any future clauses regarding the stopping of funds by requiring the approval of such action by Parliament as is the case in section 216(3) of the Constitution when funds to a province are being stopped.The National Treasury was under pressure to finalise the process of stopping the funds due to the end of the financial year approaching.The stopping of funds to the DM was contributed to by capacity constraints within the municipality as well as inadequate verification systems by both the transferring provincial Department of Cooperative Governance and the Provincial Treasury.**3.10 Failure by the municipal officials to perform as expected.**By failing to report appropriately, the municipal manger and senior managers, as well as all relevant officials, committed financial misconduct. In terms of section 171(1) of the Municipal Finance Management Act, Act No 56 of 2003, the accounting officer of a municipality commits an act of financial misconduct if that accounting officer deliberately or negligently provides incorrect or misleading information in any document to an organ of state. 1. **Recommendations**

After considering and deliberating on the request from the OR Tambo District Municipality for the NCOP to intervene in the stopping of R90 million of its Municipal Infrastructure Grant (MIG) funding, and hearing submissions from stakeholders, the Select Committee on Appropriations recommends as follows:* 1. Steps should be taken and measures put in place by the National Treasury, the Department of Cooperative Governance (DCoG) and the Eastern Cape Department of Cooperative Governance and Traditional Affairs and Eastern Cape Provincial Treasury to support and strengthen the capacity of the OR Tambo District Municipality, as envisaged in section 154 of the Constitution. The national Department of Cooperative Governance should facilitate the process and provide a progress report to Parliament within 30 days after the adoption of this Report by the House.
	2. Within 30 days after the adoption of this Report by the House, the National Treasury, the Department of Cooperative Governance, the Eastern Cape Department of Cooperative Governance and Traditional Affairs, the Eastern Cape Provincial Treasury and the OR Tambo District Municipality (DM) should report to Parliament on the actual Municipal Infrastructure Grant spending by the DM to date. In addition, they should report this expenditure to the Eastern Cape Provincial Legislature on a quarterly basis and to the NCOP every six months.
	3. The National Treasury, the Department of Cooperative Governance and the Eastern Cape Department of Cooperative Governance and Traditional Affairs and Provincial Treasury should put in place adequate verification systems on Municipal Infrastructure Grant spending for all the municipalities within the province.
	4. The National Treasury should consider additional allocations to the OR Tambo District Municipality in the new financial year after the actual spending has been determined and the spending is justified. National Treasury should report on this to Parliament within 30 days after the adoption of this Report by the House.
	5. The OR Tambo District Municipality (DM) should conduct a skills audit among its staff to ascertain whether the senior officials and all other financial officials meet the prescribed financial management competency levels. The DM should report on this to Parliament within three months after the adoption of this Report by the House.
	6. The OR Tambo District Municipality (DM) should ensure that officials responsible for the inaccurate reporting are held accountable for their poor performance. Within three months after the adoption of this Report by the House, the DM must report to Parliament on steps taken in this regard.
	7. The OR Tambo District Municipality should at all times adhere to the reporting timeframes of the Municipal Finance Management Act.
	8. The National Treasury should consider strengthening the provisions of the Division of Revenue Act by including the following:
* Making provision for the need of approval by Parliament when funds to municipalities are stopped as is the case in section 216(3) of the Constitution when funds to a province are being stopped.
* Including clauses to improve on the process for stopping and reallocation of funds and also improve on consultation processes. The National Treasury should lead this process and report to Parliament on developments within three months after the adoption of this Report by the House.

Report to be considered. |