



Western Cape
Government

FOR YOU

PROVINCIAL TREASURY
UNFUNDED BUDGETS, DEBT TO ESKOM & AGSA AND UNFUNDED MANDATES

Wednesday, 28 February 2023

Unfunded Budgets

Unfunded Budgets Definition and Legislative Context

- **MFMA Section 18(1)** sets out the substantive requirement for a municipal budget to be credibly funded.

“An annual budget may only be funded from realistically anticipated revenues to be collected; cash-backed accumulated funds from previous years’ surpluses not committed for other purposes; and borrowed funds, but only for the capital budget referred to in section 17(2).”

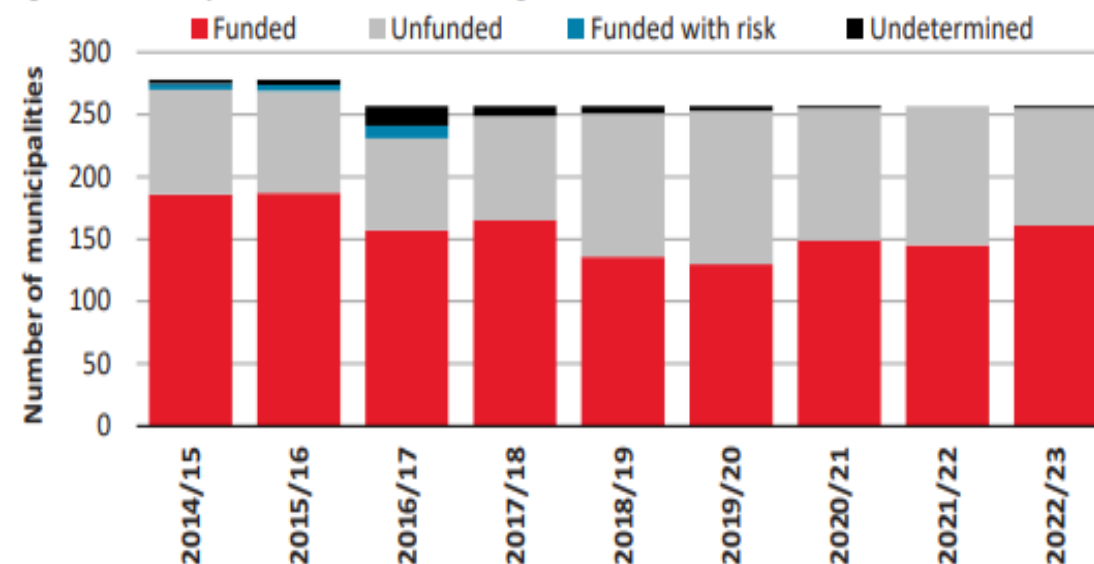
- An “unfunded” budget means that a municipality’s expenditure commitments exceed their credibly available revenue.
 - **MFMA Section 18(2)** states that revenue projections in the budget must be realistic, taking into account a) projected revenue for the current year based on collection levels; and b) actual revenue collected in previous financial years.
 - **Municipal Budget and Reporting Regulations (MBRR) 10(1)(b)** further states that the funding of an annual budget must be consistent with the trends, current and past, of actual funding collected or received.”
- It is a municipality’s own responsibility to ensure that they budget within available resources; an “unfunded” budget does not imply that another sphere needs to ‘fund’ the municipality’s expenditure.
- If a municipality fails to adopt a funded budget, a **credible Budget Funding Plan (BFP)** must be developed. This plan must be tabled and adopted by Council and be submitted to National and Provincial Treasury with its tabled and adopted budget in terms of section 24 (3) of the MFMA.
- **All municipalities are able to table a funded budget.**

Unfunded Budgets Why is it important to address?

- Unfunded budgets are an indicator of **unsustainable financial practices** and a clear indicator of future financial distress.
- The Budget Council has agreed that ensuring that municipalities do not adopt unfunded budgets is one of the **central game changers** in addressing the financial sustainability of local government.
- As a result, NT indicated their intention to **withhold equitable share allocations from any municipality that fails to adopt a credibly funded budget, or a BFP** that sets out how the budget will be brought to a funded position in future.

Extract from NT's 2023 Budget Review – showing extent of unfunded budgets nationally

Figure 6.4 Municipalities with unfunded budgets



Source: National Treasury

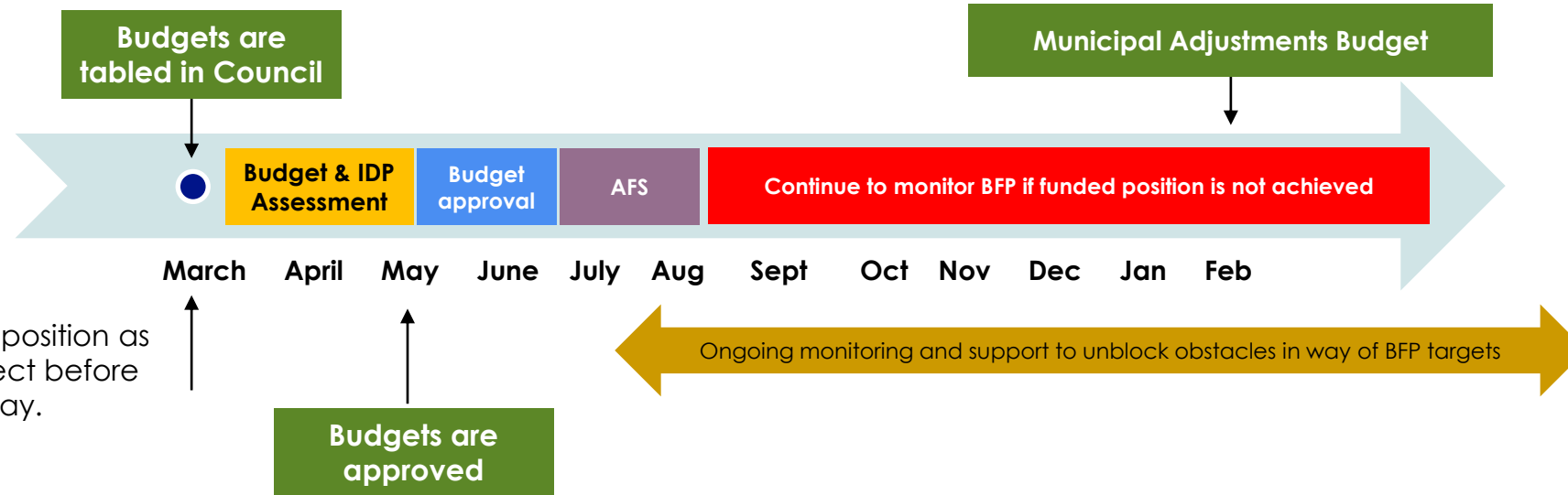
Unfunded Budgets How do we respond?

PT assess tabled budget, determine funded/unfunded position.

Recommendations are made to municipalities to make changes to achieve funded status.

Formal opportunity to try and achieve a funded budget position.

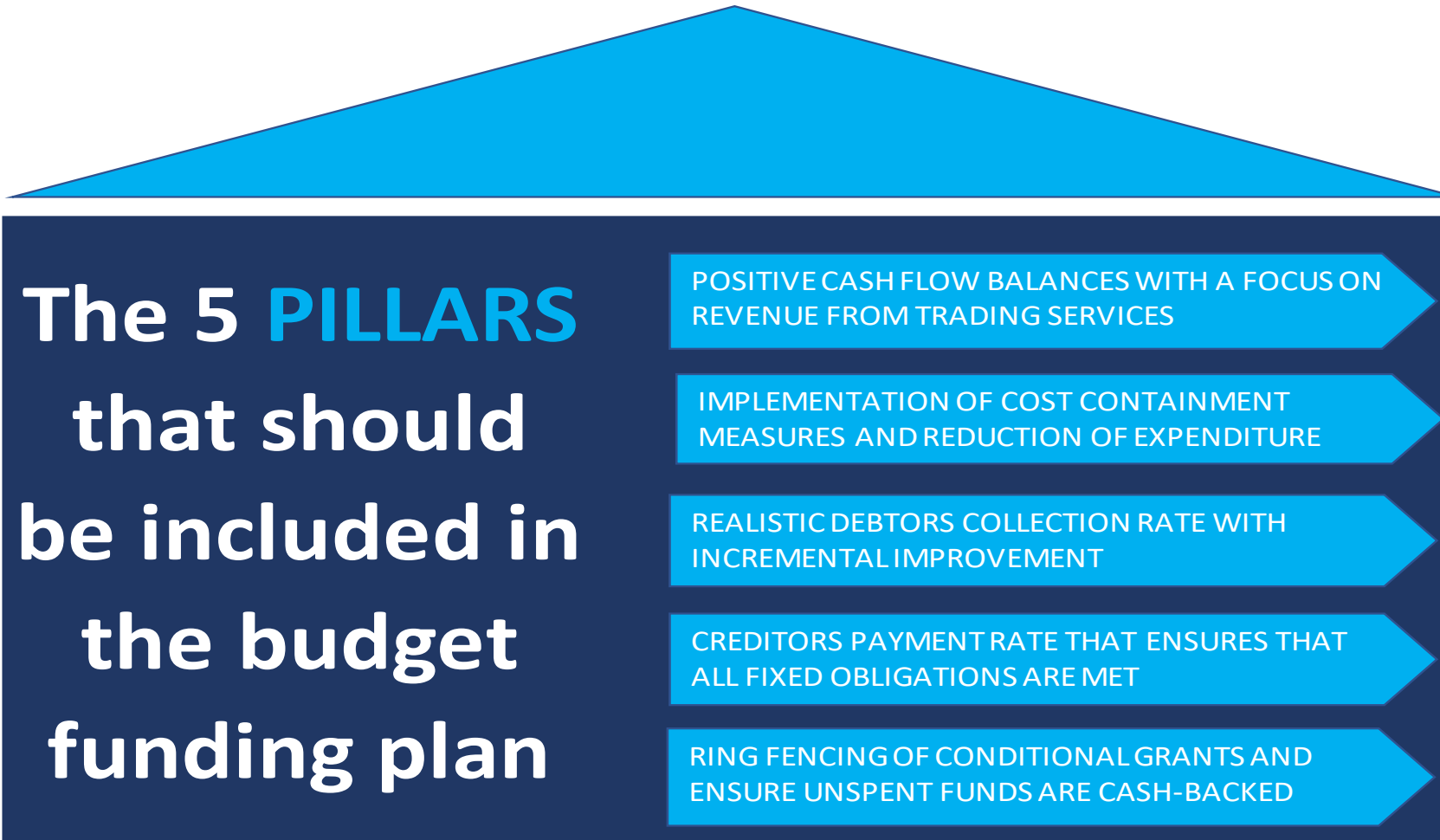
If this is not possible, the BFP must continue to be implemented and revised for the next annual budget.



Ideal time to address position as it allows time to correct before approval in May.

Any municipalities with unfunded budget required to adopt a Budget Funding Plan setting out additional measures to address the unfunded budget

Budget Funding Plan Core Components



Budget Funding Plan Monitoring implementation

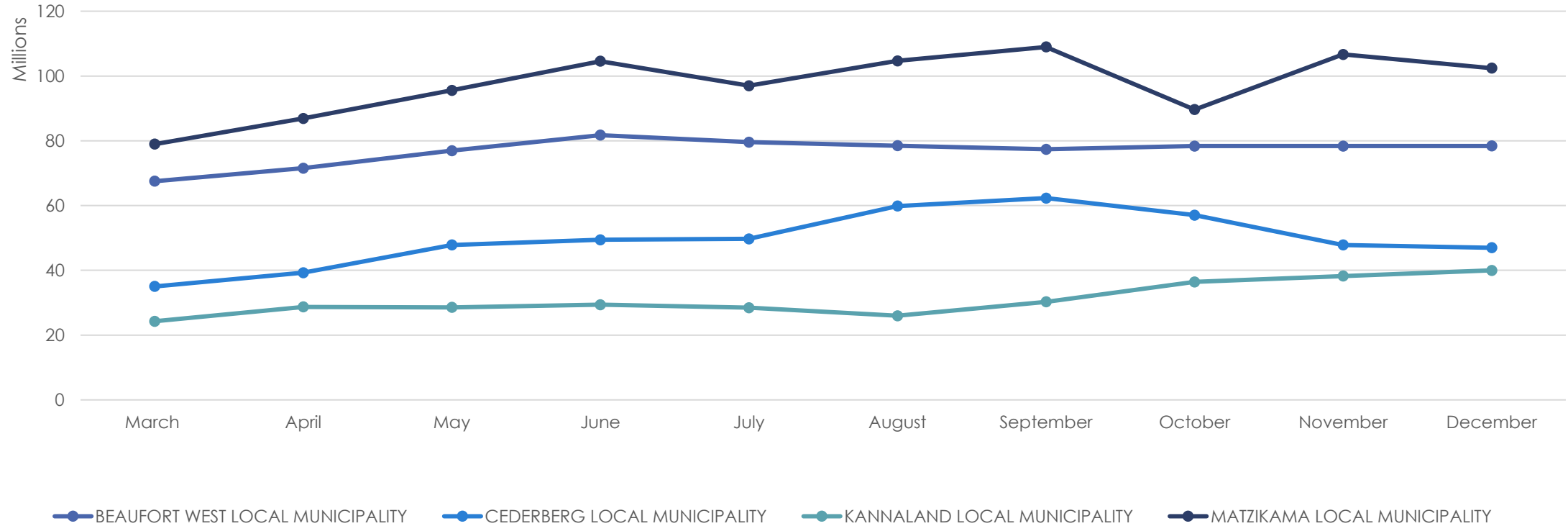
| 21-Feb-23 | Activity | Activity Detail | Status | Due Date | Date Achieved | Comments / Reasons / remedial action |
|---|---|--|-----------------|-----------|--|---|
| Improved Monthly Collection Rate | Meter verification, TID & data collection project | Start processes for meter verification, TID & data collection project - Specs for tender | Target Missed | 14-Jun-22 | | The revenue department is busy with the drafting of the specifications. Delays were caused by feedback and AFS & Y/E processes. Needs consultation with the technical dept and no Elec manager. |
| | Meter verification, TID & data collection project | Tender to be awarded and project commencement | Target Missed | 12-Aug-22 | | Specifications delayed. |
| | Meter verification, TID & data collection project | Phase I - To be specified during specs evaluation/assessment | Target Missed | 31-Oct-22 | | |
| | Meter verification, TID & data collection project | Phase II - To be specified during specs evaluation/assessment | Target Missed | 31-Jan-23 | | |
| | Meter verification, TID & data collection project | Phase III - To be specified during specs evaluation/assessment | Not Due | 31-Mar-23 | | |
| | Tender for issuing of summonses to be awarded | Referred back to evaluation for clarity on pricing | Target Missed | 31-Jul-22 | | Specifications to ber amended Tender to be readvertised |
| | Bulk SMS's - Credit Control / Check with SAMRAS credit control module | SMS's can be done internally (part of FMG support Plan) | Target achieved | 31-Aug-22 | | SMS's now Departmentally managed |
| | SAMRAS - Credit Control Module activate and support | Dependent availability of SAMRAS (part of FMG support Plan) | Target Missed | 30-Sep-22 | | To be discussed with SOLVEM - delay year end and audit |
| | Implement auxiliary services | Needs debtor cleansing before can be truly effective | Target Missed | 31-Oct-22 | | |
| | Exception reporting - Improved | System in place to ensure technical department address issues escalated | Target Missed | 1-Aug-22 | | In progress |
| | Action against biggest Debtors | Dependent on summons processes (can start with notices to be issued & addressing disputes) | Target Missed | 31-Aug-22 | | IN progress Notices rest out departmentally Tender to be readvertised |
| | Strengthen internal capacity | Appointment Customer Care Clerk | Target achieved | 1-Jun-22 | | Clerk appointed |
| | Strengthen internal capacity | Appointment Accountant - Debtors | Target Missed | 1-Aug-22 | | Position advertised - applications received not satisfactory - |
| | Adding additional pay-points / Indigent registration | VWD - (tools of trade to be issued) | Target Missed | 1-Jul-22 | | Equipment obtained - Process in progress |
| | Adding additional - Indigent registration (temporarily - Maxi Hall) | Zoar (tools of trade to be issued) | Target achieved | 1-Jul-22 | | Library being used |
| Adding additional - Indigent registration (temporarily - Bergsig Library) | Czd (tools of trade to be issued) | Target Missed | 1-Jul-22 | | Equipment obtained - Process in progress | |

Outstanding Municipal Debt: Eskom & AGSA

All Provinces Outstanding Debt to Eskom (January 2023)

| Province | Arrears > 30 days | % of arrears | % of sales |
|--------------------------------------|-------------------|---------------|---------------|
| Eastern Cape | 2,867,208 | 5.1% | 7.7% |
| Free State | 18,442,419 | 32.8% | 4.5% |
| Gauteng | 7,938,602 | 14.1% | 36.9% |
| KwaZulu-Natal | 841,420 | 1.5% | 19.3% |
| Limpopo | 1,108,405 | 2.0% | 2.7% |
| Mpumalanga | 16,658,011 | 29.6% | 5.1% |
| North West | 4,525,886 | 8.0% | 5.7% |
| Northern Cape | 3,578,134 | 6.4% | 1.9% |
| Western Cape | 275,045 | 0.5% | 16.1% |
| Total Excluding Sales Accrual | 56,235,130 | 100.0% | 100.0% |

Western Cape Outstanding Debt to Eskom (December 2022)



Repayment agreements in place for all 4 municipalities

Role of Provincial Treasury in addressing Eskom debt situation

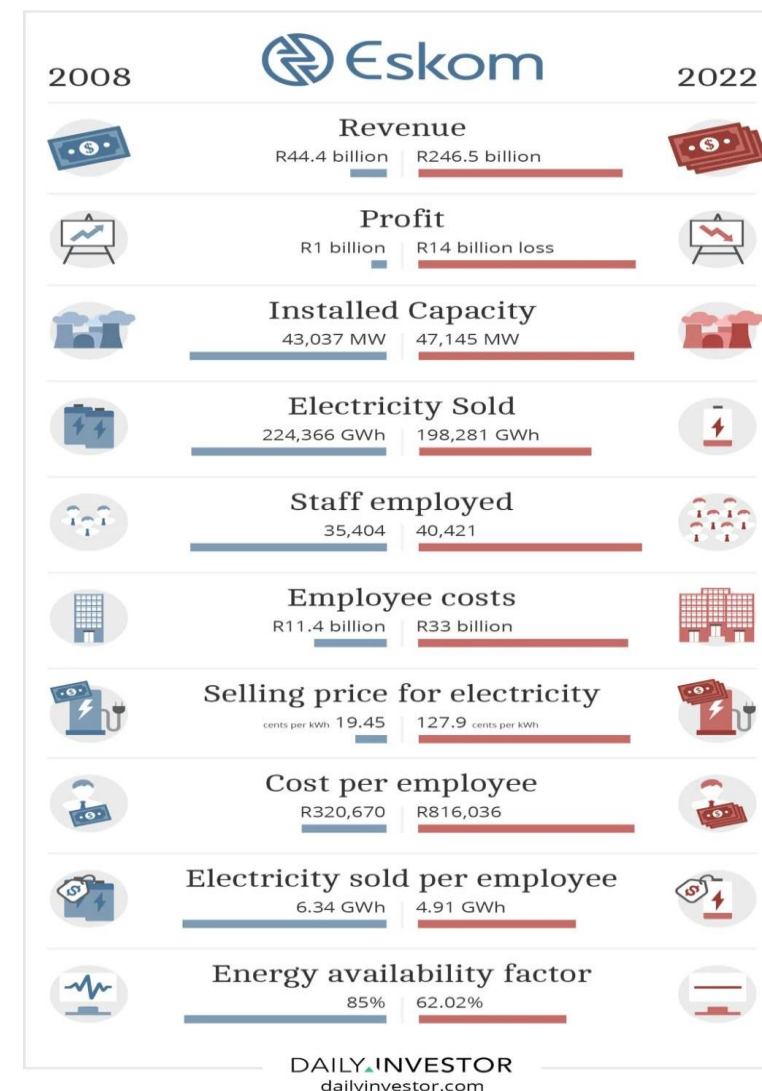
RELATIONSHIP BUILDING

- Engaging in good faith key to broker successful negotiations.
- Open, honest and frank conversations allow parties to understand that **municipal sustainability in best interest of all**.
- Facilitate discussions between Eskom/municipalities to **negotiate credible and affordable payment arrangements**.

ASSISTANCE TO MUNICIPALITIES

Best approach is to assist municipalities to avoid going into arrears.

- Actively **monitor payment of creditors** via IYM processes.
- Guidance on **setting cost-reflective tariffs (incl pursuing grant funding to support cost-of supply studies)** to safeguard payment of bulk purchases.
- Support towards **Debtor Management** to ensure timeous collection of electricity service charges.
- Assistance to manage cashflows for Eskom payments as part of Budget Funding Plans.



Western Cape Outstanding Debt to **AGSA** (January 2023)

| Municipality | Total | Current | 60 – 120 days | +120 days | Audit fee exceeds 1% as per AG? |
|----------------------|-------------------|------------------|------------------|-------------------|---------------------------------|
| Beaufort West | 17,466,702 | 1,208,777 | 2,787,255 | 8,467,436 | Yes |
| Kannaland | 12,896,007 | 303,505 | 437,612 | 8,226,625 | Yes |
| Laingsburg | 11,607,592 | 2,415,906 | 873,182 | 5,466,331 | Yes |
| Prince Albert | 7,308,736 | 65,127 | 452,874 | 4,860,108 | No |
| Total | 49,279,037 | 2,905,415 | 4,550,923 | 27,020,500 | |

Public Audit Act: Audit Fees in Excess of 1 %

- S23(6) of the Public Audit Act (as amended) states that if the audit fee exceeds one percent of the total current and capital expenditure of such auditee for the relevant financial year, such excess must be defrayed as a direct charge against the National Revenue Fund.
- Defraying excess audit fees however subject to determination by AGSA/NT as to whether an auditee has financial difficulty to pay the fee in question.
- Calculation done annually, but assumption that it applies universally. Municipalities therefore do not always make sufficient provision for monies owed in annual budgets.

| Example | R | | Municipality A |
|---------------------|------------|-------------------------|----------------|
| Auditee expenditure | 10,000,000 | | 84 972 326 |
| 1% of expenditure | 100,000 | | 849 723 |
| AGSA audit fee | 150,000 | | 2 574 426 |
| Auditee liability | 100,000 | 1% of total expenditure | 849 723 |
| NT liability | 50,000 | + meeting the criteria | 1 724 703 |

Public Audit Act: Audit Fees in Excess of 1 %

PROVINCIAL TREASURY ACTION STEPS

- Continue to **closely monitor accumulation of outstanding debt**: Formally communicated debt position to high-risk municipalities; emphasized need for compliance with MFMA S65(e) and cautioned that non-payment places at risk financial sustainability of AGSA.
- Engaged AGSA to gain **clarity on calculation**, application and communication.
- Attendance of AGSA at and **participation in various inter-governmental forums**.
- **Involvement in 2021/22 calculation** process to provide insights into financial position of vulnerable municipalities.

Unfunded Municipal Mandates

Un/under-funded Mandates Definition

- *[Obligated to] perform a function, action or programme for which you do not receive funding.*
- Situations where sub-national governments are legally mandated in terms of the Constitution/policy to undertake specific functions, but do not receive funds from national or provincial revenues in order to perform these functions.
- Distinction between:
 - **Unfunded mandate:** No funding received, despite legal obligation to perform function.
 - **Under-funded mandates:** Funding is less than actual costs for a function assigned.
 - **Non-mandated functions:** Function a municipality performs without being legally required to.
- In practice these categories overlap. For example, some municipalities choose to provide services at a higher standard than required. There also is no prescription for how general municipal revenues must be used to fund their functions.
- **Not all additional functions are unfunded mandates! Legal framework does offer lawful mechanisms through which powers and functions are allocated (assignment, delegation & agency).**

Unfunded Mandates Constitutional obligation to assign functions

Government of the Republic

40. (1) In the Republic, government is constituted as national, provincial and local spheres of government which are distinctive, interdependent and interrelated.
- (2) All spheres of government must observe and adhere to the principles in this Chapter and must conduct their activities within the parameters that the Chapter provides.

Principles of co-operative government and intergovernmental relations

41. (1) All spheres of government and all organs of state within each sphere must—
 - (a) preserve the peace, national unity and the indivisibility of the Republic;
 - (b) secure the well-being of the people of the Republic;
 - (c) provide effective, transparent, accountable and coherent government for the Republic as a whole;
 - (d) be loyal to the Constitution, the Republic and its people;
 - (e) respect the constitutional status, institutions, powers and functions of government in the other spheres;
 - (f) not assume any power or function except those conferred on them in terms of the Constitution;
 - (g) exercise their powers and perform their functions in a manner that does not encroach on the geographical, functional or institutional integrity of government in another sphere; and
 - (h) co-operate with one another in mutual trust and good faith by—
 - (i) fostering friendly relations;
 - (ii) assisting and supporting one another;
 - (iii) informing one another of, and consulting one another on, matters of common interest;
 - (iv) co-ordinating their actions and legislation with one another;
 - (v) adhering to agreed procedures; and
 - (vi) avoiding legal proceedings against one another.

Powers and functions of municipalities

156. (1) A municipality has executive authority in respect of, and has the right to administer—
 - (a) the local government matters listed in Part B of Schedule 4 and Part B of Schedule 5; and
 - (b) any other matter assigned to it by national or provincial legislation.
- (2) A municipality may make and administer by-laws for the effective administration of the matters which it has the right to administer.
- (3) Subject to section 151(4), a by-law that conflicts with national or provincial legislation is invalid. If there is a conflict between a bylaw and national or provincial legislation that is inoperative because of a conflict referred to in section 149, the by-law must be regarded as valid for as long as that legislation is inoperative.
- (4) The national government and provincial governments must assign to a municipality, by agreement and subject to any conditions, the administration of a matter listed in Part A of Schedule 4 or Part A of Schedule 5 which necessarily relates to local government, if—
 - (a) that matter would most effectively be administered locally; and
 - (b) the municipality has the capacity to administer it.
- (5) A municipality has the right to exercise any power concerning a matter reasonably necessary for, or incidental to, the effective performance of its functions.

Unfunded Mandates Legal framework for assignment of functions

Sections 9 & 10 of the Municipal Systems Act (1998)

(c) publish the draft legislation in terms of section 154(2) of the Constitution.

(2) An MEC initiating the assignment of a function or a power by way of provincial legislation to municipalities in the province generally must, before the draft legislation providing for the assignment is introduced in the relevant provincial legislature—

(a) consult the MEC responsible for finance in the province, the MEC for local government in the province and organised local government representing local government in the province;

(b) consider any assessment by the Financial and Fiscal Commission in terms of subsection (4); and

(c) publish the draft legislation in terms of section 154 (2) of the Constitution. 10

(3) The Cabinet member, Deputy Minister or MEC initiating the national or provincial legislation referred to in subsections (1) and (2), must take appropriate steps to ensure sufficient funding, and capacity building initiatives as may be needed, for the performance of the assigned function or power by the municipalities concerned if—

(a) the assignment imposes a duty on the municipalities concerned; 15

(b) that duty falls outside the functional areas listed in Part B of Schedule 4 or Part B of Schedule 5 to the Constitution or is not incidental to any of those functional areas; and

(c) the performance of that duty has financial implications for the municipalities concerned. 20

(4) The Cabinet member, Deputy Minister or MEC initiating the national or provincial legislation referred to in subsections (1) and (2), must request the Financial and Fiscal Commission to make an assessment of the financial implications of the legislation.

(3) The Cabinet member or MEC initiating the legislation or agreement referred to in subsections (1) and (2), respectively, must take appropriate steps to ensure sufficient funding, and capacity building initiatives as may be needed, for the performance of the assigned function or power by the municipality concerned if—

(a) the assignment of the function or power imposes a duty on the municipality concerned;

(b) that duty falls outside the functional areas listed in Part B of Schedule 4 or Part B of Schedule 5 to the Constitution or is not incidental to any of those functional areas; and

(c) the performance of that duty has financial implications for the municipality concerned.

Unfunded Mandates Functional Assignment Considerations

- Functions that are best performed locally should be devolved to lower levels, taking into account capacity and competency of individual municipalities.
- Delegation agreements should be in place, in writing (SLA, MOA, MOU).
- Cost-benefit analysis before accepting a mandate.
- All delegations by higher spheres must be accompanied by a credible account of how the service is to be funded.
- Effective decentralisation and local independence require appropriate fiscal autonomy.
 - Conditional grants/transfers to be limited to national policies that are executed at local government, e.g., health, environmental protection, social development, etc.
 - Funding should largely be from local taxes/fees/charges for cost recovery purposes.
 - National transfers can supplement own-revenue (unconditional grant support allows for municipal discretion on application towards core functions).

Unfunded Mandates Why the confusion?

- Managerial & Oversight Overlap:** S157(7) of the Constitution (National and provincial legislative authority to monitor and ensure effective performance by municipalities of their functions) vs S156(3) and S151(1) which states that such regulation cannot compromise or impede municipality's ability to govern or exercise its powers.
- Participatory competencies** which requires all spheres to work together to perform a specific function.
- Specific Concurrent Competencies:** S44(1) and Schedule 4 of the Constitution.
- Vaguely defined competencies:** Ambiguity results in overlap in practice, uncertainty about ambit.
- Historical ownership** not shifted in new dispensation.
- Own-initiative** and frustration with lack of progress by other spheres.

| Functional Concurrence | |
|--|--|
| Provincial/National | Local |
| Provincial Roads (4A) | Municipal Roads (5B) |
| Provincial Traffic (5) Road Traffic Regulation (4A) | Traffic & Parking (5B) |
| Health Services (4A) | Municipal Health Services (4B) |
| Public Transport (4A) | Municipal Public Transport (4B) |
| Pollution control (4A) Environment (4A) | Air pollution (4B) Municipal Health Services (4B) |
| Regional Planning & Development (4A) Urban & Rural Development (4A) Provincial Planning (5A) | Municipal Planning (4B) |
| Tourism (4A) | Local Tourism (4B) |

Unfunded Mandates

Examples of functions where issues have been raised.

- Housing
- Libraries
- Museums
- Public safety
- Vehicle & Driving Licensing
- Disaster Management
- Environmental & Coastal Management
- Sport & Recreation
- Welfare services (ECD, homelessness)
- Small scale fisheries
- SMMEs
- Informal Trading
- Fire Fighting
- Traffic services
- Pollution
- Tourism & Destination Marketing
- Local nature reserves

Sectors responsible for these functions have their own agreements, funding sources, structures & processes etc. in place to perform associated duties.

There is therefore no one-size fits all solution and functional assignment. Disputes must be addresses sector-by-sector.

Engagement between various spheres on alignment of functions is key to improve institutional coherence.

Thank you