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Private Bag X9165
CAPE TOWN
8000

TREASURY MUNICIPAL CIRCULAR MUN NO. 20/2020

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 THE DIRECTOR: SUPPORTING AND INTERLINKED FINANCIAL SYSTEMS (MR A MAZOMBA)

THE PROVINCIAL AUDITOR

MASTER RECORDS OFFICIAL: BUSINESS INFORMATION AND DATA MANAGEMENT

THE HEAD OF DEPARTMENT: LOCAL GOVERNMENT

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 THE CHIEF DIRECTOR: MFMA IMPLEMENTATION – NATIONAL TREASURY (MR TV PILLAY)

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MUNICIPAL BUDGET CIRCULAR FOR THE 2021/22 MEDIUM TERM REVENUE AND EXPENDITURE FRAMEWORK

1. PURPOSE

The purpose of this circular is to:

- provide the economic and fiscal context that should be considered by municipalities in compiling the 2021/22 Medium Term Revenue and Expenditure Framework (MTREF); and
- provide guidance to municipalities with the finalisation of the 2021/22 MTREF Budgets and accompanied budget documentation.

2. LEGISLATIVE CONTEXT

The Western Cape Provincial Government has institutionalised the Strategic Integrated Municipal Engagements (SIME; previously referred to as LGMTEC) process in fulfilment of its obligations under:

- Sections 5, 22 and 23 of the Local Government: Municipal Finance Management Act (MFMA), Act No. 56 of 2003;
- Chapter 5 of the Local Government: Municipal Systems Act (Act No. 32 of 2000) [MSA];
- Chapter 3 of the National Environmental Management Act (Act No. 107 of 1998) (NEMA); and
- Chapter 4 of the Spatial Planning and Land Use Management Act (Act No. 16 of 2013) (SPLUMA).

The 2021 SIME process will give effect to the “Integrated Work Plan” agreed to in 2017. It builds on the 2020 integrated municipal and provincial processes in order to strengthen alignment between municipal and provincial planning and budgeting and driving the theme of “**Integrated service delivery**”, specifically as municipalities are preparing for the final year of the current Integrated Development Planning Cycle.

3. STRATEGIC CONTEXT

3.1 Economic and Fiscal Environment

The 2021 SIME process will take place amid difficult domestic conditions. The National Treasury projects a real economic growth rate of 3.3 per cent in the country for 2021, subsequent to an estimated 7.8 per cent contraction in 2020. Strict lock down measures in the second quarter of 2020 resulted in a 17.1 per cent decline from the first quarter. All major sectors showed declines in output, except for agriculture. Growth is however expected to be positive, albeit sluggish over the medium term with 1.7 per cent growth estimated in 2022 and 1.5 per cent in 2023. With growth averaging 2.1 per cent from 2021 to 2023, GDP can only be expected to reach pre-pandemic levels by 2024.

The Western Cape economy mirrors the national trends. The Western Cape economy is expected to contract by a significant 6.9 per cent in 2020, and rebound by 3.8 per cent in 2021 based on a resurgence in the global and national economy after COVID-19. The main sectors driving growth in the Western Cape include agriculture, forestry and fishing, finance, insurance, real estate and business services and general government. The outlook for the tourism sector remains a concern as bans on travel, especially international travel existed for most of 2020.

The main risks to the economic-outlook include deterioration in the public finances and a failure to implement structural reforms, a resurgence in COVID-19 requiring economic restrictions, electricity and infrastructure constraints, as well as low business and consumer confidence.

Headline inflation is expected to fluctuate within the lower end of the 3 - 6 per cent band with 3.2 per cent estimated for 2020/21, 4.1 per cent for 2021/22, 4.4 per cent for 2022/23 and finally 4.5 per cent for 2023/24. A succession of rate cuts by the South African Reserve Bank (SARB) has brought interest rates to a record low of 7 per cent, which aims to boost spending and credit uptake.

Aside from the bleak macro-economic outlook, the Western Cape also faces challenges of poverty, inequality and unemployment, which have a negative impact on municipal revenue. Furthermore, accelerated Western Cape population growth of 1.8 per cent per annum from 2020 to 2024 (higher in urban areas such as the City of Cape Town due to in-migration) will place additional strain on already limited municipal resources.

National Government will reduce transfers to local government by R17.7 billion, including R14.5 billion from the local government equitable share, R2.7 billion from the general fuel levy and R569 million in direct conditional grants over the 2021 MTEF period. The annual Division of Revenue Bill will be published in February 2021 with the Minister of Finance's budget speech. The Bill will specify grant allocations and municipalities must reconcile their budgets to the numbers published therein. Municipalities therefore have to address existing service delivery backlogs, keep pace with the demand for new basic services and maintain current service delivery standards, all while being faced with reductions in transfers to local government.

Role-players in the 2021 SIME process should make conscious efforts to maximize service delivery given these economic and fiscal challenges. Local government also has a vital role to play in the Province's Recovery Plan. Fiscal prudence in budgetary planning and preparation should be emphasized, improvement of governance and financial management to support service delivery and the implementation of the municipal standard chart of accounts are critical measures to respond to fiscal constraints.

3.2 Budgetary response to the Western Cape Recovery Plan

The current economic climate places greater demand on the Western Cape Government (WCG), with reduced funding to meet such demands. It therefore requires prioritisation of those key activities which will have the greatest impact in terms of the Western Cape's recovery. The Western Cape Government remains committed to the 2019-2024 Provincial Strategic Plan's vision of 'A safe Western Cape where everyone prospers', implemented through its five Vision Inspired Priorities. These will be used as the basis for the Western Cape Recovery Plan which will focus on creating **jobs**, making the province **safer** and promoting dignity and **wellbeing** for all our residents.

Given the current context of a substantial reduction in available resources, the WCG's budget policy response reflects a strong commitment to a holistic recovery through supporting the resumption of economic activity and social service delivery, maintaining fiscal sustainability and carefully managing persistent public health and service delivery risks. Fiscal sustainability requires a repositioning of public expenditures, through improved, more efficient and streamlined service delivery models.

The Western Cape's Medium Term Budget Policy Statement (WC MTBPS) of 2020, is a budget to bounce back in the Western Cape. The WCG is expected to spend R71.342 billion in 2021/22, R72.583 billion in 2022/23 and R73.051 billion in 2023/24 in the Western Cape. The 2020 MTBPS is available at: <https://www.westerncape.gov.za/provincial-treasury/files/atoms/files/Medium%20Term%20Budget%20Policy%20Statement%202020.pdf>.

The WCG has mobilised a combined R1.4 billion support package for "Jobs", "Safety" and "Wellbeing" in this financial year. These funds have been broken down as allocations for small business support, fencing of schools, the employ of safety ambassadors, improved data collection

at emergency centres and ECD support, amongst others. Additional National Government funding for the employ of education assistants, the supplementary funding of ECD staff and the provision of food relief will further drive the Western Cape Recovery Plan. Frontline departments such as the Department of Health and Transport and Public Works will also be provided with financial support to respond to the resurgence of the COVID-19 pandemic in the Western Cape.

The Western Cape's 2020/21 Second Adjustment Budget also serves to drive recovery. The objectives of the 2020 Second Adjustment Budget are to:

- Enable reprioritisation and additional funding to support the immediate financing requirements of the Western Cape Recovery Plan;
- Achieve fiscal sustainability in-year, while setting a base for fiscal consolidation over the 2021 MTEF, in the context of significant changes in national allocations; and
- Enable the WCG to continue to respond to COVID-19.

The 2020/21 Second Adjustment Budget makes provision for a net reduction for the 2020/21 financial year amounting to R1.239 billion, which is largely due to a significant reduction in compensation costs.

The Western Cape Government has as part of the 2020/21 Second Adjusted Budget also made changes to the local government grant allocation. These are reflected in the Western Cape Provincial Treasury: Division of Revenue Act (Act 4 of 2020): Additional and Amended Allocations to Municipalities available from: https://www.westerncape.gov.za/provincial-treasury/files/atoms/files/Prov-gaz-extra-2020-ag_8358-ex-ord-consolidated-2nd.pdf.

The Premier signed the Western Cape Second Adjustments Appropriation Act (Act 5 of 2020) on 10 December through which additional revenues were allocated or transferred to municipalities. It was published in the Provincial Gazette (Provincial Notice 137 of 2020: Publication of the Western Cape Second Adjustments Appropriation Act, 2020, in the Provincial Gazette Extraordinary 8368, dated 14 December 2020.) In terms of regulation 23(3) of the Municipal Budget and Reporting Regulations (MBRR), the mayor of a municipality must at the next available council meeting, but within 60 days of the approval of the relevant national or provincial adjustment budget referred to in section 28(2)(b) of the MFMA, appropriate the additional revenues.

4. NATIONAL TREASURY AND PROVINCIAL TREASURY GUIDELINES

4.1 Context

- Municipalities are advised to consult the latest Budget Circular, MFMA Circular 107 released on 4 December 2020.
- Municipalities MUST include the National and Provincial Treasury Budget Circulars as part of the source documents consulted in the preparation of the 2021/22 MTREF Budget documents and to table it as part of the budget documentation in the Municipal Council.
- The Western Cape Provincial Treasury will in due course issue a follow-up circular in which the budget process, submission, assessments and SIME engagements will be outlined.

4.2 Ensuring Municipal Sustainability through a funded budget

In the current economic and fiscal environment, where demand for basic and free basic services rises, household incomes falls impacting on consumer's ability to pay their municipal bills, and transfers from national government rise at a slow pace, it is evident that municipalities are more likely to face financial strain.

As per section 18 of the MFMA, municipalities should nevertheless ensure that their budget is funded from realistically anticipated revenue to be collected, cash backed accumulated funds from the previous year as well as borrowed funds to be utilised for capital projects.

In order to ensure financial sustainability each Municipality must consider the following when compiling their 2021/22 MTREF budgets:

- Improving the effectiveness of revenue management processes and procedures;
- Cost containment measures to, amongst other things, control unnecessary spending on nice-to-have items and non-essential activities as highlighted in the Municipal Cost Containment Regulations read with MFMA Circular No. 82;
- Ensuring value for money through the procurement process;
- The affordability of providing free basic services to all households;
- Not taking on unfunded mandates;
- Curbing the consumption of water and electricity by the indigents to ensure that they do not exceed their allocation;
- Budget adequately to support the servicing of debt obligations; and
- Maintain collection rates of at least 95 per cent and ensure that arrear debt is collected.

The following sections contain additional guidelines regarding revenue and expenditure in an effort to ensure credible and sustainable budgeting.

4.2.1 Revenue

- a) Municipalities should comply with Section 74(2) of the MSA by setting cost-reflective tariffs. This ensures that municipalities set tariffs that enable the recovery of the full cost of providing the service. Municipalities are encouraged to utilise the tariff setting tool referenced in MFMA Circular 98, item 4.2. Municipalities should also maintain tariff increases at levels that reflect an appropriate balance between the affordability to poorer households and other customers while ensuring the financial sustainability of the municipality. The inflation rates have been provided in section 3.1. Municipalities must justify any increases in excess of the projected inflation rate for 2021/22 and include a detail of their revenue growth assumptions for the different service charges within the 2021/22 budget narrative.
- b) In March 2020, the National Energy Regulator of South Africa (NERSA) approved a municipal tariff increase of 6.9 per cent effective 1 July 2020 (1.2 per cent lower than the tariff increase in Multi-Year Price Determination (MYPD) 4 period due to differences in municipal and national financial years). Municipalities are advised to use the tariff increases previously approved by NERSA of 5.2 per cent for 2021/22, 8.9 per cent for 2022/23 and 8.9 per cent for 2023/24.

- c) Municipalities should comply with Section 18 of the MFMA by ensuring that the 2021/22 MTREF budget is funded from realistically anticipated revenues. Some municipalities struggle to attain desired collection rates. While this may be due to governance matters or consumer's inability to pay their municipal bills, a fundamental reason for this has been identified as an inability to set realistic and attainable collection rates. It is therefore essential that municipalities pay attention to reconciling the valuation roll data to that of the billing system to ensure that revenue anticipated from property rates are accurate. See MFMA Circular 93, 98 and 107 for guidance in this regard. Note that Municipalities are requested to submit the reconciliation of the valuation roll to the financial system to the National Treasury by no later than 05 February 2021 via email to linda.kruger@treasury.gov.za or upload to the LG Upload Portal at: <https://lguploadportal.treasury.gov.za/>. Municipalities must also account for the impact of COVID-19 and the subsequent economic decline on their collection rates. Each municipality should assess the likely impact of this for the 2021/22 MTREF period based on the impact observed in the first two quarters of the 2020/21 municipal financial year.
- d) Municipalities must refrain from budgeting for indirect grant allocations as this results in revenue being overstated. Ensure that the Municipality only budgets for the allocations that are directly allocated and transferred to it.

4.2.2 Expenditure

- a) The Municipality's expenditure budget should be adequate to deliver quality services in a sustainable manner at the lowest possible cost.
- b) Municipalities are encouraged to budget for bulk services and honour their current account payments (inclusive of Eskom) religiously to avoid stringent application of the bulk suppliers' credit control policy. Note that Eskom's payment terms have been extended to 30 days and the interest on overdue accounts is set at 2.5 per cent plus prime.
- c) Municipalities are encouraged to clear the control accounts on a monthly basis and to allocate trade and other receivable payments in these suspense accounts to the relevant debtor accounts regularly before the monthly submissions as required by the MFMA.
- d) Given the current economic condition, municipalities are urged to consider projecting increases to wages that would reflect their affordability in 2021/22. The costs of remuneration of councillors as approved within the Government Gazette on the Remuneration of Public Office Bearers Act: Determination of Upper Limits of Salaries, Allowances and Benefits should be considered in the 2021/22 MTREF. Should any negotiated increase in remuneration for employees or councillors be above the level of the Municipality's affordability the Municipality is advised exercise the option for exemption as provided by the South African Local Government Bargaining Council. Given the uncertainty on outcomes of the wage negotiations, municipalities may want to consider budgeting for an affordable level of total compensation of employee spending and noting that if higher salary increases are agreed to, then the number of employees may have to be reduced (through attrition and other measures).

4.2.3 Addressing Unfunded Budgets

- a) Municipalities are reminded to develop a credible funding plan in cases where the budget is unfunded. This plan must be tabled and adopted by Council with the 2021/22 MTREF budget and be submitted to National and Provincial Treasury when it is tabled and adopted budget in terms of Section 22(b)(i) and 24 (3) of the MFMA. The Provincial Treasury is available to review and provide guidance on the credibility of draft Budget Funding Plans. Failure to approve a credible plan may result in the invoking of Section 216(2) of the Constitution to withhold equitable share transfers.

- b) Where municipalities have adopted an unfunded budget without a credible funding plan, they will be required to correct the budget and go back to the Municipal Council to ensure they adopt and implement a funded budget as required in terms of Section 18 of the MFMA.

4.3 Municipal Standard Chart of Accounts

4.3.1 Release of Version 6.5 of the chart

On an annual basis, the Municipal Standard Chart of Accounts (mSCOA) chart is reviewed to address implementation challenges and correct chart related errors. To this end, Version 6.5 was released with MFMA Circular No. 107. The main budget, adjustments budget and Section 71 monthly reporting schedules that have been regulated in terms of the MBRR have been aligned to the mSCOA chart version 6.5 changes.

Version 6.5 of the chart must be used to compile the 2021/22 MTREF budget. As per the mSCOA regulations, manual population of the A1 schedule version 6.5 is not allowed and should be generated directly from the Municipality's financial system. The National Treasury will no longer gather supporting data from the MBRR A1 Schedules but will expect each municipality to submit the prescribed supporting data strings containing the required data using the LG Upload Portal.

4.3.2 Budgeting and Reporting through MSCOA

- a) As per the Annexure to MFMA Circular No. 99, mSCOA Circular No. 9, and GRAP 12, municipalities were advised to record and ring-fence all funding and expenditure pertaining to the COVID-19 pandemic for the 2020/21 MTREF when budgeting and transacting; and to budget and account for all bulk water purchases as inventory. This has not been adhered to by all municipalities. It is hereby reiterated that municipalities must budget for water as inventory and appropriately record COVID-19 expenditure in the 2021/22 MTREF as well as the main adjustments budget process in February 2021.
- b) Municipalities must implement the new property categorisation framework as revised through the Local Government Municipal Property Rates Amendment Act, 2014 by no later than July 2021. The mSCOA chart Version 6.5 makes provision for the new and the old framework. The Municipalities are advised to use the new framework since the old framework will be retired in the next version of the chart.
- c) Section 164(1)(c) of the MFMA stipulates that a municipality may not make loans to councillors or officials of the municipality; directors or officials of the entity; or members of the public. Therefore, municipalities are advised not to use these items in the Item Assets segment of the mSCOA chart when budgeting. National Treasury may retire these items in the next version of the chart.
- d) The population of the cash flow reconciliation in tables A7, B7 and C7 of the MBRR formats using mSCOA data strings has been a challenge in previous financial years. It is critical that municipalities undertake balance sheet and cash flow budgeting to provide accurate cash flow information. National Treasury has provided guidance in this regard in MFMA Circular No. 98 and mSCOA Circular No. 10 and 11 and have also corrected the errors in the linkages of the MBRR cash flow tables to the mSCOA data strings.

- e) In terms of performance reporting on conditional grants, municipalities and Transferring Officers are urged to pay attention to the contents of money spent against conditional grants. Most municipalities in the country are still not reporting on conditional grants as per the mSCOA requirements. The mSCOA data strings will be the main source of data that will be used to monitor the performance against grants and to inform decisions on the stopping and reallocation of conditional grants funding in the 2021/22 MTREF. The credibility of the mSCOA data strings reporting on grants will therefore be closely monitored going forward.

4.3.3 Municipal Financial Systems

- a) National Treasury and the Western Cape Provincial Treasury held extensive engagements with key system providers during which the municipal financial system functionalities were demonstrated. The engagements provided these departments with an understanding of what functionality is available on each system and what the key system related challenges are. Municipalities should address the challenges and include the cost thereof in the 2021/22 MTREF budgets. As part of the key objectives of the mSCOA reform we want to ensure that municipalities are budgeting, transacting and reporting directly via integrated ERP systems to have one version of the truth in terms of the reported financial performance. Hence, the manual correction of data strings by municipal officials or system vendors are not allowed in terms of the mSCOA Regulations.
- b) All municipalities and municipal entities had to comply with the mSCOA Regulations by 1 July 2017. The National Treasury will therefore conduct independent audits on all municipal financial systems in 2021 (postponed from 2020 due to travel bans) to determine to what extent the financial systems that are currently being used by municipalities comply with the minimum business processes and system specifications required in terms of mSCOA. The results of the audits will inform the new transversal tender for the procurement of municipal financial and internal control systems in 2022. Until these audits have been concluded, and the results have been released, municipalities should exercise caution when changing their financial system to avoid purchasing a system that does not comply with the necessary mSCOA functionality requirements. However, should a municipality need to procure a new financial system, they must follow the processes set out in the MFMA read together with the Municipal Supply Chain Management Regulations and MFMA Budget Circulars No. 93, 98 and mSCOA Circulars No 5 and 6.
- c) It is important to note that once the service level agreement (SLA) for the support and maintenance of the financial system has expired, it cannot be extended, and the municipality will have to embark on a new procurement process. Therefore, it is advised that at least six months prior to the expiry of the SLA, the municipality should either extend the existing SLA or approach the market to procure the service. Also, when the contract for the support and maintenance of the financial system comes to an end, the municipal need not procure a new financial system, but only the support and maintenance services for the financial system.

4.3.4 Non-compliance with MSCOA Requirements

National Treasury and the Western Cape Provincial Treasury will analyse the credibility of the data string submissions. If your municipality has not yet achieved the required level of mSCOA implementation, then it must provide a detailed action plan (road map) to the National and the Western Cape Provincial Treasury to indicate how the municipality will fast track the implementation of mSCOA. The action plan must be drafted by the municipality and not the system vendor and the progress against it should be carefully monitored by the municipality's mSCOA Project Steering Committee (chaired by the Accounting Officer). Municipalities must present progress against the action plan at the 2020/21 Mid-Year Budget and Performance visits and the SIME engagement. The

Municipality should consult MFMA Circular No. 107 for further detail regarding what should be included in the action plan.

5. 2021 LOCAL GOVERNMENT ELECTIONS AND THE BUDGET PROCESS

The Local government elections are scheduled to take place in 2021, although the proposed date is yet to be determined. Municipalities are urged to do the following to ensure that the elections do not hamper the budget process:

- a) If elections take place after the start of the financial year, the outgoing council will be responsible for approving tariffs for the 2021/22 MTREF and the newly elected council for the implementation thereof, since section 28(6) of the MFMA does not allow the increase of tariffs during the financial year;
- b) If elections take place after the start of the financial year, the outgoing council must ensure that they comply with the timeframes for approval of the budget;
- c) Municipalities must ensure that public and stakeholder consultation processes are adhered to as required by the legislative framework provided by section 23 of the MFMA and Chapter 4 of the MSA, and that these are not neglected or used to serve the interest of political parties;
- d) Employ sound municipal decision-making so that the long-term sustainability of municipal finances and service delivery is achieved beyond the election period;
- e) Consider the regulatory framework set out in the Municipal Cost Containment Regulations insofar as it relates to the use of municipal funds to fund election campaigns and other non-priority issues, which may further impact the financial sustainability of municipalities;
- f) Councils are advised to prioritise expenditure appropriations aligned to the policy intent as described in the IDP;
- g) The outgoing council is advised to critically consider the financial implications before entering into new long-term contracts that are not of priority to the municipality and avoid if possible, committing the incoming council to any non-priority long-term contracts;
- h) The Mayor and municipal manager of the municipality should ensure the seamless preparation of the IDP and 2021/22 budget as these processes cannot be delayed in anticipation of the announcement of an election date;
- i) As is the norm, the newly elected council should implement the last adopted IDP during their first year of office, and adopt a new IDP in its second year of office, after thorough interrogation and extensive consultation with the citizens of the municipality; and

In the absence of detailed information on the 2021 Local Government Elections, National Treasury and the Western Cape Provincial Treasury will provide further guidance in the follow-up MFMA Budget Circular to be issued in March 2021.

6. KEY DATES OF THE 2021/22 INTEGRATED PLANNING AND BUDGETING PROCESS

Municipalities are urged to consult MFMA Circular 107 for information regarding the budget process and submissions. The Western Cape Provincial Treasury will issue a follow-up circular in which the budgeting process and submission, as well as the LGMTEC assessments and SIME engagements will be outlined.

The following key dates should be considered by the Municipality in the 2021/22 Integrated Development Planning and budgeting process.

Dates	Budget Process
January 2021	Mid-year Budget and Performance Assessment
February 2021	Municipal Main Adjustments Budget
February 2021	National Budget Day
March 2021	Provincial Budget Day
Latest 31 March 2020	Municipal Draft Budget Tabling Day
Provisionally 26 April – 12 May 2021	SIME Engagements

If municipalities require advice with the compilation of their respective budgets, specifically the budget documents or Schedule A1, they should direct their enquiries to the following WC Provincial Treasury officials:

Directorate	Official	Tel. No.	Email
Public Finance	Chris Mapeyi	021 483 6100	Christopher.Mapeyi@westerncape.gov.za
	Elizabeth de Lange	021 483 4540	Elizabeth.deLange@westerncape.gov.za
Budget Office	Malcolm Booysen	021 483 3386	Malcolm.Booyesen@westerncape.gov.za
	Nadia Rinqest	021 483 8692	Nadia.Rinqest@westerncape.gov.za
	Kim Engel	021 483 8459	Kim.Engel@westerncape.gov.za
Fiscal Policy	Dr Ndodana Nleya	021 483 6707	Ndodana.Nleya@westerncape.gov.za

Municipalities may also contact the following officials at National Treasury:

	Responsible official	Tel. No.	Email
Cape Town	Kgomotso Baloyi	(021) 315 5866	Kgomotso.Baloyi@treasury.gov.za
George	Willem Voigt	(012) 315 5830	WillemCordes.Voigt@treasury.gov.za
	Mandla Gilimani	(012) 315 5807	Mandla.Gilimani@treasury.gov.za
Technical issues with Excel formats	Elsabe Rossouw	(012) 315 5534	lgdataqueries@treasury.gov.za

7. CONCLUSION

Municipalities are encouraged to take into account and apply the contents on this budget circular in the 2021/22 planning and budgeting process.

Please direct any queries regarding this circular to: Malcolm Booysen at Malcolm.Booyesen@westerncape.gov.za



MALCOLM BOOYSEN
 pp HEAD OFFICIAL: PROVINCIAL TREASURY
 DATE: 18 December 2020