

**Policy Title**

**BUDGET POLICY**

**Policy Version**

**Role & Process**

**Responsible  
Individual**

**Name and/or Date**

**Responsibility Accepted**

**Signature**

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## 1. POLICY PURPOSE

The purpose of this policy is to inform Council on the strategy to be followed with the compilation of annual budgets, including the three-year budgets for both operating and capital expenditure. The strategy and process mapped out in this policy will serve as a guideline to all departments for the compilation of operational business plans and budgets.

## 2. POLICY DEFINITIONS

**Adjustments budget** – Prescribed in section 28 of the MFMA. The formal means by which a municipality may revise its annual budget during the year.

**Allocations** – Money received from Provincial or National Government or other municipalities.

**Budget** – The financial plan of the Municipality.

**Budget related policy** – Policy of a municipality affecting or affected by the budget, examples include tariff policy, rates policy, credit control and debt collection policy.

**Capital expenditure** - Spending on assets such as land, buildings and machinery. Any capital expenditure must be reflected as an asset on the Municipality's balance sheet.

**Cash flow statement** – A statement showing when actual cash will be received and spent by the Municipality.

**DORA** – Division of Revenue Act. Annual legislation that shows the total allocations made by national to provincial and local government.

**Equitable share** – A general grant paid to municipalities. It is predominantly targeted to help with free basic services.

**Fruitless and wasteful expenditure** – Expenditure that was made in vain and would have been avoided had reasonable care been exercised.

**GRAP** – Generally Recognised Accounting Practice. The new standard for municipal accounting.

**IDP** – Integrated Development Plan. The main strategic planning document of the Municipality

**MBRR** – Local Government: Municipal Finance Management Act (56/2003): Municipal budget and reporting regulations.

**MFMA** – Local Government: Municipal Finance Management Act (56/2003). The principle piece of legislation relating to municipal financial management. Sometimes referred to as the Act.

**MTREF** – Medium Term Revenue and Expenditure Framework. A medium term financial plan, usually 3 years, based on a fixed first year and indicative further two years budget allocations. Also includes details of the previous and current years' financial position.

**Operating expenditure** – Spending on the day to day expenses of the Municipality such as salaries and wages.

**Rates** – Local Government tax based on the assessed value of a property. To determine the rates payable, the assessed rateable value is multiplied by the rate in the rand.

**SDBIP** – Service Delivery and Budget Implementation Plan. A detailed plan comprising quarterly performance targets and monthly budget estimates.

**Strategic objectives** – The main priorities of the Municipality as set out in the IDP. Budgeted spending must contribute towards the achievement of the strategic objectives.

**Unauthorised expenditure** – Generally, is spending without, or in excess of, an approved budget.

**Virement** – A transfer of budget.

**Virement policy** - The policy that sets out the rules for budget transfers. Virements are normally allowed within a vote. Transfers between votes must be agreed by Council through an Adjustments Budget.

**Vote** – 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 that is appropriated for the purposes of the department or functional area concerned. In Emalahleni Municipality this means votes such as Executive & Council, Financial Services, Corporate Services, and Public Safety etc.

### 3. LEGISLATIVE FRAMEWORK

This policy is established within the framework of the following legislation and policies:

- **Municipal Systems Act** 32 of 2000
- **MBRR – Local Government:** Municipal Finance Management Act (56/2003): Municipal budget and reporting regulations.
- **MFMA – Local Government:** Municipal Finance Management Act (56/2003). The principal piece of legislation relating to municipal financial management.
- **GRAP-** Generally Accepted Municipal Accounting Practices
- **DORA-**Division of Revenue Bill-National Treasury

### 4. BACKGROUND

As budgeting is central to the process of prioritisation for service delivery and the management of functions within the Municipality, it is eminent that Council in conjunction with management must determine strategic budget objectives.

The challenges facing municipalities in South Africa is finding the means to continue to deliver services to the community while also improving and expanding the services to meet increasing needs.

The solutions to this challenge from a management perspective lie in:

- Increasing productivity;
- Increasing revenue through, among other things, innovative means of funding service delivery, optimising grants received;
- Re-prioritising developmental projects and services; and
- Support to local municipalities and obtain the funding in this regard.

The budget process is a continuous cycle of planning, implementing, monitoring and reporting.

The Municipality must maintain its assets to ensure viable and sustainable service delivery. Similarly, it must maintain its financial capacity and resources to enable the delivery of services honouring of development obligations. Improved financial management leads to improved service delivery.

The budget process must involve activities relating to at least three budget years simultaneously. The process involves simultaneously assessing how the Municipality is managing the closure of the previous financial year budget, the monitoring of the current year budget and the planning for the next three years' budgets, linked with the Integrated Development Plan (IDP).

The Municipal Finance Management Act provides that the involvement of Councillors in the budgeting and financial management processes must be:

- Continuous consultation with the local municipalities, community and other stakeholders in the planning of services and reviewing of performance;
- Ensuring that the budget allocates resources in line with the Council's policy objectives and priorities and the needs of the community and local municipalities;
- Ensuring that the budget is realistic and financially sound before approving the budget and any adjustments;
- Evaluating periodic reports on performance of the budget related to developmental and service delivery plans; and
- Formal annual reporting activities through annual reports, reports from stakeholders and audited financial statements.

By focusing on these critical aspects, Councillors will be able to provide appropriate political leadership and direction to the Municipality's operations, oversee the preparation of budgets and oversee the achievement of financial and non-financial objectives expressed in the budget and IDP.

The Council further faces the challenges of guiding, combining, integrating, co-ordinating policies and planning of budgeting processes. Through the joint efforts of politicians, ward committees, citizens and officials, budgets must reflect the needs of the community. The

goal is also to empower managers with regular in-year information and for Council to take preventative action before a crisis arises.

## **5. STRATEGIC FOCUS AREAS AND STRATEGIC MUNICIPAL PRIORITY ISSUES**

Municipal budgets must reflect policy priorities determined by Councillors who are elected representatives of the community.

It is essential that the Municipality by means of the IDP planning process identify the strategic focus areas and prioritise strategic issues.

The Council must reconfirm these strategic municipal priority issues in order to guide the Municipal Manager, the Chief Financial Officer and other Directors in compiling their respective operational plans and budgets.

In addition, Council must place emphasis on the strategic focus areas and objectives through clear and measurable outputs and derived outcomes that will give clear guidelines to the administration on what has to be achieved. The budget allocations must then be based on these outputs and outcomes.

## **6. OPERATIONAL PLANS**

Departments must align their operational plans with the strategic municipal priority issues and identified outcomes and targets of Council. The strategic municipal priority issues will facilitate the evaluation of existing operations so that Council may determine, if necessary, to continue with all existing functions of a department and to what extent the Municipality desires to continue the services.

After Council has confirmed its strategic municipal priorities, issues and determined the outcomes and service targets to be achieved, Directors must prepare and submit operational plans to Council for consideration and approval.

These plans must cover a three-year period and include the following:

- Measurable objectives;
- Functions/activities;

- Outputs and targets; and
- Income and expenditure projected over three years.

The absence of detailed operational plans with measurable objectives and outputs results in a budget that simply allocates funds based on previous year's allocations.

The preparation of operational plans is dependant on the Council clearly stating the priorities and targets to be achieved over the next three years to meet community needs.

The functions/activities must also be listed in order of priority to enable Council to consider, where necessary, which functions/activities to increase, scale down and/or abolish. Detailed operational plans will assist Management with the compilation of the Capital and Operating Budget.

## **7. GENERALLY ACCEPTED MUNICIPAL ACCOUNTING PRACTICES (GRAP)**

The circular from National Treasury, dated 12 April 2002, indicated that all Municipalities are expected to implement plans adopted by Councils for the implementation of GRAP. The Municipality must prepare the budget and financial statements in compliance with these standards.

## **8. BUDGETS**

The annual budget must be approved by Council and must contain the following:

- A balanced operating budget containing expenditure details and realistically anticipated revenue; (actual revenue collected matches actual expenditure incurred)
- A balanced budget for capital expenditure that is within what funding can realistically be available, together with the projected financial implications of that capital expenditure;
- Details of borrowing intentions and other liabilities that will increase the Municipality's debt;
- Audited actual results for the 3 previous years;
- Projected budget outcomes for the current financial year, next year's budget and the outer two years.



The budget of the Council consists of the operational budget (revenue and operational expenditure), the capital budget and the cash flow budget. The budget must, within the available resources, reflect the Council's IDP and how it will be funded. National Treasury requested that Councils provide at least a three-year operating and capital budget.

## 9. BUDGET POLICIES

### Policy No 1 - Budget Sustainability

#### Background

Sustainability is the notion that current economic and consumption patterns should not reduce opportunities for future generations by depleting or impairing resources. The driving force behind sustainability is the recognition that, our communities' natural capital is limited. Sustainability demands balance among economy, environment, and community. Emphasizing any one of these factors over the others causes an imbalance in future equity and undermines the ability to support current business practices over the long term. Many businesses worldwide have demonstrated that they can operate profitably while employing sustainable practices.

Similarly, many governments have adopted and implemented sustainable policies and business practices. Through the power of example, the public sector must continue to lead the way toward a sustainable future. Standing at the vortex of the policymaking process, government has an important role to play in this critical effort.

That the issue of sustainability is considered a core value in setting organizational policy and establishing business practices in all areas of public finance. Accordingly, Emalahleni Municipality must adopt the following actions:

#### A. *Public Policy:*

- Incorporate a commitment to sustainability into mission and value statements;
- Develop organizational goals that reflect sustainability principles at the departmental levels;
- Encourage policy development that supports the environmental sustainability of the Municipality;
- Implement policies encouraging or requiring the use of products certified as sustainable and/or environmentally friendly;

- Evaluate how the Municipality tax structure affects its goals for a healthy economy, a healthy environment, and social fairness; and
- Form partnerships with other government agencies and with the private and not-for-profit sectors that promote sustainability.

**B. *Budget and Management:***

- Develop budget processes that reflect sustainability goals and objectives, measure government performance in realizing those goals and objectives, and benchmark such performance against comparable Municipalities and/or accepted standards; and
- Consider financing and capital planning processes that systematically identify future costs and allocate those costs equitably across generations. The use of life-cycle costing and similar analytical tools is advised.

**C. *Sustainable Business Practices:***

- Implement purchasing practices that support the procurement of sustainable and recycled goods and services consistent with the Municipality financial plans and resources;
- Promote the use of products certified by reputable third-party organizations;
- Develop sustainability principles and guidelines for facility and infrastructure development. Adopt green building standards, for construction projects;
- Adopt policies that promote sustainable business practices in governmental operations, such as fleet management, building maintenance, and parks and green space. Consider adopting guidelines established by independent organizations;
- Implement practices and procedures that reduce waste, carbon dioxide emissions, and reliance on non-renewable resources; promote recycling and reuse; and minimize employee exposure to hazardous materials;
- Educate and inform employees of the importance of sustainable practices and offer suggestions they can employ in the workplace;
- Report on sustainable business practices and goals in annual reports, budget documents, and other core communications; and

- Include sustainability in job descriptions and performance reviews.

## Policy No 2 – Financial Planning Policies

### Background

The development and adoption of Financial Policies form the framework for the preparation of Operating and Capital Budgets that encompasses the broad scope of governmental planning and decision-making with regard to the use of resources. The policies included are those considered fundamental to the budget process and the long-term financial sustainability of Emalahleni.

The Municipality's adopted financial policies should be used to frame major policy initiatives and be summarized in the budget document.

It is further recommended that these policies, along with any others that may be adopted, be reviewed during the budget process. Finance staff should review the policies to ensure continued relevance and to identify any gaps that should be addressed with new policies. The results of the review should be shared with the Council during the review of the proposed budget.

These policies address both the need for a long-term view and the fundamental principle of a balanced budget. At a minimum, the Municipality should adopt policies that support:

#### **A. *Balanced Budget:***

That Emalahleni Municipality adopt the policy of commitment to a balanced operating and capital budget under normal circumstances, and provides for disclosure when a deviation from a balanced budget is planned or when it occurs.

#### **B. *Long-Range Planning:***

That Emalahleni Municipality adopt a policy(s) that supports a financial planning process that assesses the long-term financial implications of current and proposed operating and capital budgets. This requires that the long-term financial impact of all

budget decisions be included in the budgets including maintenance cost of new infrastructure.

**C. *Asset Management:***

That Emalahleni Municipality adopt a policy that assess the condition of all major capital assets and plan for the ongoing financial commitments required to maximize the public's benefit and in accordance with GAMAP policy.

**D. *Linkage of the IDP and Capital Budget:***

That Emalahleni Municipality adopt a policy whereby only projects identified in the IDP be included in the Capital Budget

**E. *Separate Multi-year Capital Budget:***

That Emalahleni adopt a policy of preparing a separate 3 year Capital budget that includes financing plans to ensure a balanced Capital Budget.

**F. *Total cost of Capital Projects:***

That Emalahleni Municipality adopt a policy where Council must consider the total cost covering all financial years until the project is operational and must consider the impact of future costs and revenues on the operational budget.

**Policy No.3 – Budget Policy**

**Background**

The Adoption of Budget Policies forms the framework upon which the Revenues and Expenditures of the Operating and Capital Budgets are constructed. This framework ensures the budgets are compiled using realistic assumptions. They also ensure that the budget estimates are sustainable in future years.

**A. *Revenue Policies:***

That Emalahleni Municipality adopt the policy of budgeting for revenue projections that can realistically be collected and are sustainable. Understanding the revenue stream is essential to prudent planning. This policy seeks stability to avoid potential service

disruptions caused by revenue shortfalls. At a minimum Emalahleni should have policies that address:

- **Revenue Diversification** - That Emalahleni adopt a policy that encourages a diversity of revenue sources in order to improve the ability to handle fluctuations in individual sources.
- **Tariffs** – That Emalahleni adopt a policy that identify the manner in which tariffs are set and the extent to which they cover the cost of the service provided.
- **Use of One-time Revenues** – That Emalahleni adopt a policy of discouraging the use of one-time revenues for ongoing expenditures and that all one time revenues are used to fund one-time expenditures, eg. Grants from DBSA for capacity building and development of policies.
- **Use of Unpredictable Revenues** – That Emalahleni adopt a policy where on the collection of major revenue sources it considers unpredictable, a corresponding allowance for non-collection be included in the Budget.
- **Revenue Management** – That Emalahleni municipality adopt a policy that the approved credit control policy will be enforced to ensure a high rate of collection of the revenues owing to the Municipality.

**B. *Expenditure Policies:***

The expenditures of the Municipality define the ongoing public service commitment. Prudent expenditure planning and accountability will ensure fiscal stability. At a minimum Emalahleni should have policies that address:

- **Appropriation of funds for expenditure** – That Emalahleni Municipality adopt a policy by which it incurs only those expenditures that are approved in the Budget and within the limits of the amounts appropriated for different votes in the approved Budget.
- **Debt Capacity, Issuance, and Management** – That Emalahleni Municipality adopt a policy that specifies appropriate uses for debt and identifies the maximum amount of debt and debt service be no greater than 35% of Gross Operating Expenditure.
- **Reserve or Stabilization Accounts** - That Emalahleni adopt a policy to maintain a prudent level of financial resources to protect against the need to reduce service levels or raise taxes and fees due to temporary revenue shortfalls or unpredicted

one-time expenditures. That this Reserve be capped at a maximum of 20% of Gross Operating Expenditures and be funded from any cash surpluses generated.

- **Operating/Capital Expenditure Accountability** - That Emalahleni adopt a policy to compare actual expenditures to budget on a monthly basis and that staff be required to recommend actions that will bring into balance, if necessary.
- **Salary and Allowance costs** – That Emalahleni adopt a policy whereby the cost of salaries and allowances do not exceed 35 % of Gross operating costs and that this policy be phased in over the next three years.

## 10. OPERATING BUDGET

The operational budget is the financial plan, which the Council must use to effect sustainable service delivery within the guidelines of the Council and in terms of affordability.

The macro-economic indicators, which will have an impact on the Budget, are set out below:

- Economic growth, or the lack thereof, in the area;
- The Consumer Price Index (inflation); and
- The maximum growth rate allowed by National Treasury. National Treasury usually issues guidelines, which limits the percentage of growth in the budgets of the municipalities. The Council must follow the incremental budgeting technique and ensure an in-depth reviewing of its revenue budget and the goals for each category on an annual basis. The incremental budgeting technique is generally accepted as the basis of cost-orientated budgeting. The format divides the budget into:
  - Departments;
  - Eight expenditure categories; and
  - Expenditure items.

The purpose of this type of budgeting is to facilitate control over revenue and expenditure.

The zero-based budgeting technique is applied to certain categories of expenditure (e.g. salaries, repairs and maintenance) to ensure that an in-depth review of revenue, expenditure and the targets for each category is undertaken during this budget process.

This will result in a credible three-year budget, not merely based on an incremental approach, which will ensure continuity within medium-term budgeting where the outer years will become the starting point for the next budget process.

The operational budget serves as a comprehensive, detailed statement in which the municipality shows how much it intends to spend on the rendering of each service during a particular financial year.

New issues and expansion of issues on the operating budget should be motivated to Council before inclusion in the operating budget.

#### **10.1 Revenue Budget**

The Council must determine what the total realistic income for the Council will be. This calculation must be based on realistic and affordable tariff increases.

It must show the various sources from which the expenditure will be financed.

The Council must indicate the target level with which tariffs should increase. As a general guideline a general tariff increase equal to the consumer price index should be approved.

It is important that the level of spending be limited by the availability of revenue. Therefore, when the expenditure budget is compiled, the ability of the consumers to pay, must be taken into consideration.

It is policy of the Council to avoid major price increases for services as it has a negative impact of removing a portion of the consumers' disposable income. However, to be able to provide services and fulfil its responsibilities, the Municipality will have to obtain additional revenue from tariff increases on the various services provided.

In determining the level of revenue and possible changes to tariffs, the amount of possible bad debt must also be determined.

The revenue of the Council is derived from several sources. For budgeting purposes the revenue from the various sources is set out below:

#### **10.1.1 Inter-Government Transfers (IGT's)**

IGT's include the following:

- Operating subsidies, capital grants, specific agency service payments and municipal service transfers; and
- Funds received from the Municipal Infrastructure grant (MIG).

#### **10.1.2 Assessment Rates**

An assessment rate element is levied on the land value of property in the municipal area, based on a predetermined percentage. The Local Government Property Rates Act has certain implications on the assessment rate tariff and budgeted income. Care must be taken to keep the increase on assessment rates as low as possible. Should the percentage surplus with regard to other services be reduced, the loss will have to be funded through assessment rates.

#### **10.1.3 Consumer Revenue**

Consumer revenue consists of income generated from the sale of electricity and water and from amounts levied for sewerage and refuse removal. With reference to each of the services please note the following:

- The guideline of a 5% surplus on turnover by the National Electricity Regulator (NER) on electricity must also be taken into account when the percentage increase in electricity tariffs is considered.
- Water services, a trading service, are delivered by the municipality as an agency services on behalf of Chris Hani District Municipality and therefore must break even.
- Refuse removal is an economic service and should therefore break even.
- Sewerage service is also an economic service and should therefore break even.



#### **10.1.4 Other Revenue**

Departments that provide services other than consumer services listed above, must recover the costs and may generate a surplus. The services include building plan fees, water and electricity connection fees, fines, driver's licenses, transport fees, dumping fees etc.

#### **10.2 Expenditure Budget**

The expenditure framework must be based on the strategic plans/IDP, the functional operational plans and the revenue framework.

The following elements have a major impact on the formulation of the expenditure budget:

- Employee remuneration and related employee cost projections;
- Remuneration to Councillors
- Repairs and maintenance;
- Interest to service borrowings;
- Depreciation on assets;
- Contributions from the operating budget for capital expenditure; and
- Provision for long-term liabilities and other commitments.

A factor that must be included in the preparation of the operational plans is motivations in cases where ongoing commitments and planned work exist.

The zero-based type of analysis where all activities are open to review at budget time allows an opportunity to reallocate resources and avoid continuous growth in budgeted expenditure.

The Council therefore requires that all activities be continuously justified in terms of their outcomes and whether they still meet the Council's strategic priority issues as well as past performance.

In other words, an activity that is not performing may be scaled down or terminated by Council rather than to receive an increased allocation of funds annually.

The expenditure budget sets out the operating expenses and cash outflows to both internal and external sources. The total expenditure should be reconciled with the cash flow budget.

The expenditure budget consists of operating service delivery items and provides inter alia for the following:

#### **10.2.1 Salaries And Wages – Employee Related Costs**

Salaries and wages consist of all remuneration in cash and in kind to employees in return for work performed. This includes allowances and other benefits paid as part of conditions of employment, except social contributions. It does not include costs of training courses (shown under General Expenses) and costs of contractors. However, the costs relating to contractors who are engaged under the municipality's basic conditions of service are included – these are essentially employees on fixed term contracts.

Social contributions are payments, actual or imputed, made to social insurance schemes to obtain entitlement to social benefits for employees. Employer contributions into a pension fund are an example of a social contribution. Another example is contributions to a medical aid scheme.

The amount to be budgeted in the capital budget for employee costs must also be reflected and deducted from salaries and wages. It is shown as a contra entry under salaries to avoid double counting operating expenses in Contribution from Operating – Capital Outlays. All capitalised expenditure will be included in the capital budget and therefore any operating expenses such as salaries and wages that are capitalised (thus being part of the capital budget) should be deducted from operating expenses in the operating statement.

#### **10.2.2 Remuneration of Councillors**

All the costs associated with the remuneration of Councillors, including their allowances and any other benefits paid, must be showed in this section as a separate expense.

#### **10.2.3 Collection Costs**

This item reflects all costs directly incurred in the recovery of revenue that will not be paid in accordance with an invoice or consumer account and in terms of Council Policies. These costs include commissions and fees charged by debt collection agencies, and all costs for

legal actions taken to recover debts. This item also includes discounts allowed for prompt payment of accounts.

#### **10.2.4 Depreciation**

The full implementation of GAMAP is dependent on the identification and recording of assets and their current values. In terms of GAMAP, depreciation will be charged as an expense on all fixed assets. As this is not a cash transaction, it has the effect of creating a provision/reserve by reducing the amount in the surplus available for distribution. Accumulated depreciation indicates how much of the assets have been expensed.

#### **10.2.5 Repairs And Maintenance**

This item must include all labour and material costs for the repair and maintenance of the assets of the municipality. It must include both contracted services and services performed by employees. The total cost of asset maintenance is disclosed in this item to enable an evaluation of asset performance.

Expenditure that maintains an asset in good working order, to ensure asset performance and the useful life originally expected, is not capital and must be shown under this item. "Total Asset Management" requires that a schedule of programmed maintenance should be developed for all assets of the municipality. This ensures that the asset maintains optimal performance and the municipality obtains maximum flow of economic benefits from employment of the asset over its optimum life.

The deferral of maintenance expenditure on assets has the effect of increasing future maintenance costs and also has potential for reducing the economic life of the asset and hence the flow of economic benefits. Deferrals should be indicated clearly in the operational plans.

In determining the estimates under this section, the following should also be provided for:

- New assets to be produced/acquired in the course of the budget year and which would require repairs.
- Capital assets to be sold or disposed of in the course of the year and which would not require further maintenance.

### **10.2.6 Interest Expense – External Borrowings**

This section must include the following:

- Interest expenses on external borrowings include the interest component of external loan repayments. It includes borrowings from government agencies, for example Development Bank loans.

With the implementation of GAMAP, redemption payments (or loan principle payments) are a repayment of capital. For annuity loans, loan repayments need to be split into interest and principal components. The total cash outflow will be recorded in the cash flow statement. The interest component will still be shown as an expense while the principle component will be reflected in the balance sheet as a reduction in borrowings.

Municipal bonds will be treated similarly with interest reflected as an expense and any repayment shown as a reduction in debt and a cash outflow.

### **10.2.7 Bulk Purchases**

The expenditure for the bulk purchase of water and electricity and the departmental usage of municipal services must be included under this heading.

### **10.2.8 Contracted Services**

This expenditure relates to payments for services provided by external entities. These services may also be referred to as “outsourced services”. The entities rendering these services are not Council owned entities or municipal entities but are independent businesses.

There are two main types of these services –

- Services provided to external parties – where the municipality contracts out the rendering of services such as; and
- Services provided for the internal functioning of the council, i.e., corporate services such as internal audit or information technology. The services may be wholly or partly provided by the external entity.

### **10.2.9 Deficit on sale of assets**

Deficit on sale of assets (GAMAP): In terms of GAMAP, the sale of assets will generate either a surplus or a deficit. If the proceeds received on disposal of an asset are greater than the book value of the asset, then a surplus is realised. If the proceeds received are less than the book value, then a deficit will be realised:

- A surplus on a sale will be recorded as income/revenue.
- A deficit on a sale will be recorded as an expense.

### **10.2.10 Contributions To Capital Outlay**

This item shows the value of appropriations transferred out of the Operating Sections into the Capital Sections for use in capital expenditure. The details of the application of the funds will be in the capital budget and supporting documents.

The classification of expenditure as "capital" should be based on the definitions contained in guidelines on the budget process. Expenditure is only capitalised if it is for the purposes of acquiring a new or replacement asset, changes the nature of an asset, extends the life of an asset, or increases the performance potential of the asset.

In terms of GAMAP, capital expenditure will be allocated to the value of the asset recorded in the balance sheet.

Expenditure that maintains the asset in good working order at the level of performance or useful life originally expected is not capital and is shown under the appropriate section for "Repairs and Maintenance".

### **10.2.11 Contributions Towards Funds, Reserves and Provisions**

This expenditure group must contain all expenditure items involved in the instances where the Council makes contributions from operating income to certain funds, reserves or provisions. Only contributions determined by legislation and/or Council policy should be included in this section.

## **11 CAPITAL BUDGET**

The driving force behind the implementation of the Council's strategies is the IDP. In terms of the Municipal Systems Act (Act No. 32 of 2000) the IDP process must inform the municipal budget and the preparation of the capital budget is based on the capital development priorities approved in the IDP.

The capital budget consists of the non-operational needs of the community. The procurement of assets, with a life span of more than one year can be classified as capital expenditure.

## **12 FINANCIAL STRATEGY**

The purpose of the financial strategy is to identify and recognise the financial resources (revenue envelope) available for capital and operational expenditure and must include revenue strategies, operational expenditure strategies and capital financing strategies.

Points to consider when preparing a financial strategy:

- **Remuneration**

The National Treasury circular dated 12 April 2002 cautioned "that the creation of new organisational structures, filling of vacant posts and councillor allowances increases should only be undertaken with due consideration of budget constraints, affordability to its citizens and impact on the local economy".

It is recommended that the Municipality's Human Resources Strategy should be informed by and take into consideration the National Treasury circular dated 12 April 2002 in terms of managing remuneration expenditure.

- **Repairs and Maintenance**

Departments must indicate their needs to maintain the assets of the Municipality in the repairs and maintenance master plans. Departments must also indicate in their operational plans their annual requirements and the deferred maintenance needs.

It is recommended that Departments indicate in their operational plans their annual and deferred repair and maintenance requirements.

- **GAMAP**

The implementation of GAMAP will affect the compilation of the capital and operating budget. The updating of the Municipality's asset registers, the financing of assets and the reallocation of funds and reserves are some of the key issues that need to be addressed on a constant basis.

- **Budget Guidelines**

All role-players concerned with the compilation of the budget must be supplied with budget guidelines and should therefore make meaningful contributions towards the drafting of the budget consistent with the Municipality's requirements and policy priorities.

The purpose of these guidelines will be to ensure that there is effective alignment between the Municipality's vision, mission, strategic focus areas, priority issues, policy priorities and budgetary allocations.

It is recommended that the Chief Financial Officer prepare budget guidelines before the end of March each year and supply it to all role players in the budget compilation process.

### **13. OPERATIONAL FLOW OF BUDGET PROCESS FOR YEAR 01/02 TO YEAR 03/04**

The flowchart attached as APPENDIX A can be explained as follows:

#### **13.1 NEEDS IDENTIFICATION**

##### **13.1.1 Community Input**

The needs of the community will be mostly forthcoming from the IDP and any public participation programmes initiated by Council. In the absence of a formal participation policy it will suffice to accept the IDP representative forum with a direct invitation to interested stakeholders to participate with this forum on budgetary issues.

##### **13.1.2 Input from the District Municipality**

Section 21(ii) of the Municipal Finance Management Act forces that consultation takes place with the Municipalities in the District. The form of how consultation is to be conducted is not prescribed.

### **13.1.3 Input from National and Provincial Government**

Input must be received from National and Provincial Government to determine which grants and subsidies might be available that could have an impact on the budget.

### **13.1.4 Input From The Administration**

Needs will be identified by the Administration through a process that takes into consideration the departmental status quo as well as new issues identified through their operations.

### **13.1.5 Needs Analysis**

Through the processes applied in the Integrated Development Plan, a process of needs analysis will have to be followed. The specific procedure will be outlined in the IDP process and will forward issues to the following step in the process for consideration.

### **13.1.6 Identify Issues**

All the needs/issues identified by the community and Administration must be processed for possible inclusion in the IDP submitted to the Council for approval. The approved IDP will form an integral part of the Municipality's Strategic Plan.

## **13.2 MUNICIPALITY'S STRATEGIC PLAN**

The Municipality's Strategic Plan must be formulated taking into consideration all of the following factors:

### **13.2.1 Political Inputs**

Politicians will be required to submit any aspects for inclusion in the Municipality's Strategic Plan and departmental business plans.

### **13.2.2 National Priorities And Target Groups**

All the requirements from the National Treasury and other Target Groups must be considered when the Municipality's Strategic Plan is compiled. The strategy will have to be continuously aligned to incorporate these priorities.



### **13.2.3 Source Documentation**

A wide range of approved policies, guidelines and processes influencing the budgeting process must form the source documentation for the Municipality's Strategic Plan. These will include, inter alia, the following:

- Integrated Development Plan,
- Division of Revenue Act,
- Performance Management Systems,
- Strategic Focus Areas,
- Operational Plans,
- Revised current year's budget, and
- Closed off previous year's budget.

The outcome of the determination of the Municipality's Strategic Plan must entail that Strategic Focus Areas must be identified and approved by Council.

### **13.2.4 MUNICIPAL PRIORITY ISSUES**

The municipal priority issues will be formulated from the Municipality's Strategic Plan and forwarded to the Finance Department for inclusion in the Budget Framework/Financial Strategy. One of the outcomes of the determination of the municipal priority issues is that the capital projects linked to these issues, will by then be sorted or separated from all needs identified in the initial steps.

## **13.3 FINANCIAL STRATEGY / BUDGET FRAMEWORK**

The Financial Strategy is compiled by the Finance Department and submitted to Council for approval. The following represent, inter alia, aspects that will form part of the financial strategy:

### **13.3.1 Revenue Envelope**

Limitations and expectations affecting the level of revenue that the Council can collect will be included in formulating the strategy.

### **13.3.2 Expenditure Envelope**

Limitations and expectations affecting the level of expenditure that the Council can afford will be included in formulating the strategy.

### **13.3.3 Prioritisation Process**

Input from the prioritisation of capital projects will be incorporated into the financial strategy.

### **13.4 BUDGET POLICIES**

After approval of the financial strategy, the Finance Department will compile budget policies that must be distributed to all the departments. The purpose of distributing budget policy guidelines is to supply guidelines to all those concerned with the compilation of the budgets. The guidelines will enable them to make their contributions towards the draft budget with confidence, knowing that they are consistently executing the Council's requirements.

In compiling the budget policy guidelines, the Chief Financial Officer must acknowledge and take the vision, mission, objectives and action plans of the Municipality into consideration.

The purpose of these policy guidelines is to prevent important activities from being omitted, or duplicated when compiling the budget.

### **13.5 OPERATIONAL STRATEGY**

With all the information obtained from the processes leading up to this point, the departments can now compile operational plans for submission to the Finance Department.

The operational process consists of the following steps:

#### **13.5.1 Operational Plans**

Departments must align their operational plans to the strategic municipal priority issues and identified outcomes and targets of the Council. This will facilitate the evaluation of existing operations so that the Council may determine if it is necessary to continue with all existing functions of a department and to what extent the Council desires to continue.

From the operational plans the following steps will emanate:

#### **13.5.2 Draft Three Year Capital Budget**

From the operational plans and accompanying templates submitted to the finance department, the first draft 3-year capital budget will be compiled by the Finance Department.

### **13.5.3 Draft Three Year Operating Budget:**

From the operational plans and accompanying templates submitted to the Finance Department, the first draft 3-year operating budget will be compiled by the Finance Department. A continuous alignment will take place with the draft capital budget and the prioritisation process, the reason being that amendments to the capital budget will have an influence on the operating budget, as capital charges, for example, might vary.

### **13.6 DRAFT OPERATING AND CAPITAL BUDGETS**

The draft operating and capital budgets must be circulated to the role players for perusal and deliberation at the budget conferences.

### **13.7 BUDGET CONFERENCES**

Formal budget conferences must take place with all role players to deliberate on the draft budgets. Alterations must be referred back in the process to enable the drafts to be amended continuously.

### **13.8 FINAL OPERATIONAL PLANS**

With all the amendments from the budget conferences incorporated and noted, the departments are now in a position to compile their final operational plans. These plans will form an integral part of the final operating and capital budgets.

### **13.9 FINAL OPERATING AND CAPITAL BUDGETS**

Final operating and capital budgets must be prepared and submitted to Council for approval.

### **13.10 COUNCIL APPROVAL**

Council must meet to approve the budgets no later than 30 days before the start of the budget year unless indicated otherwise by National Treasury.

### **13.11 SUBMISSION TO NATIONAL TREASURY**

The final approved budgets, accompanied by the relevant budget reform schedules must be submitted to National and Provincial Treasury for approval within 5 working days after approval, or before the 7<sup>th</sup> of July.

## **14 SERVICE LEVEL ARRANGEMENTS**

The key objectives of service level agreements are to:

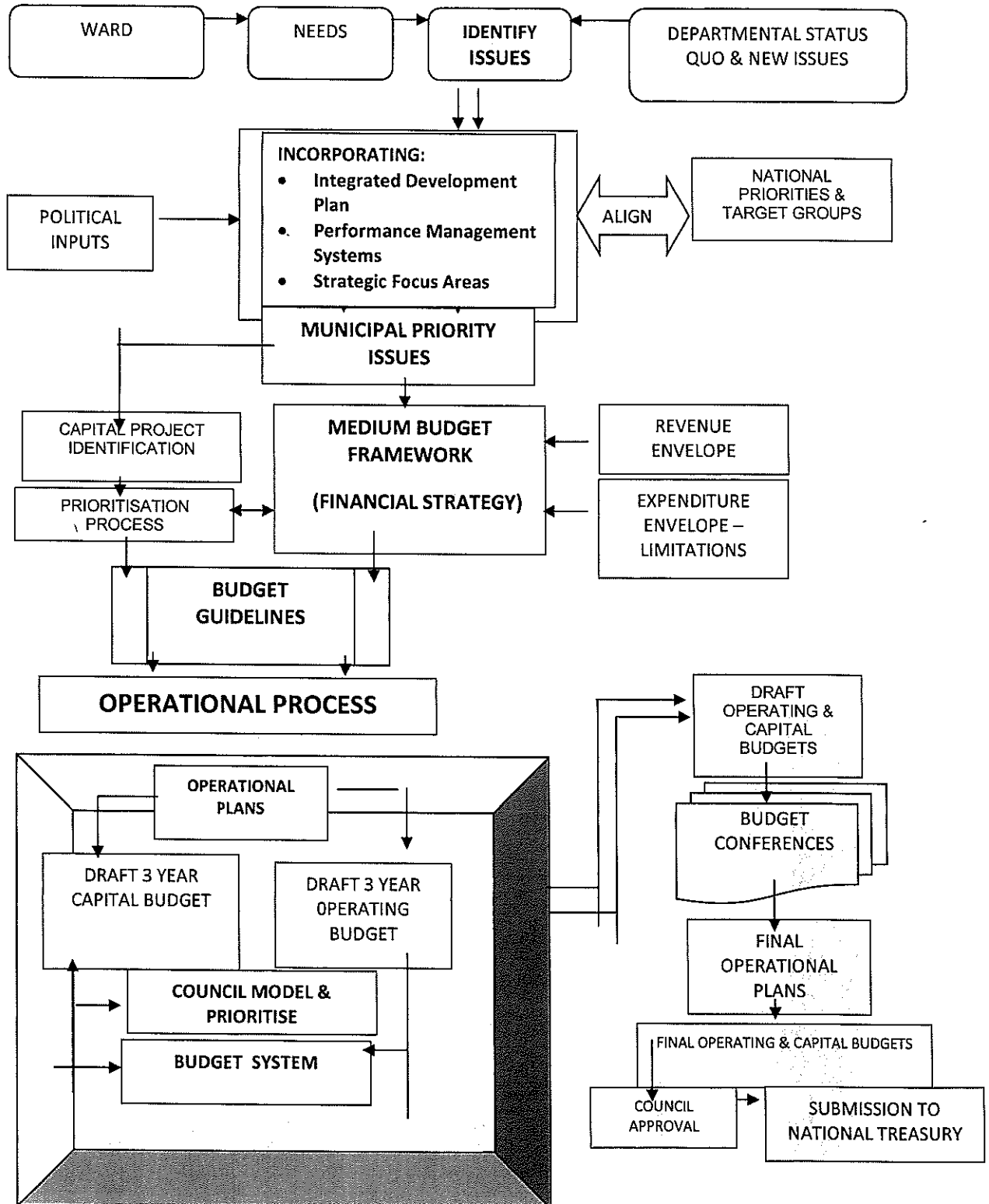
- Improve the method of budgeting and accounting for internal cost recovery;
- Introduce Service Level Arrangements between internal service providers and the recipients of those services; and
- Set standards and benchmarks for performance management.

## **15 CONCLUSION**

A balanced three-year budget, which reflects the needs of the community, must be a high priority. The financial strategy will be a necessary tool in achieving this goal. The budget must be monitored from month to month by comparing the actual financial position to the budgeted position.

## ANNEXURE A

### OPERATIONAL FLOW OF BUDGET PROCESS



| ACTIVITIES RELATING TO NEW BUDGET   |  | INTEGRATED DEVELOPMENT PLAN FOR NEXT YEAR   |  | ACTIVITIES FOR THE DEPARTMENTS |  | COMPLETION DATE |
|---|--|---|--|--------------------------------|--|-----------------|
| JUNE  |  | JUNE  |  | JUNE                           |  |                 |
| <p>Review the IDP and Budget processes undertaken for the next budget preparation, and adapt the processes to address deficiencies, develop improvements and ensure integration of processes for the next three budgets.</p> <p>Document the updated process and circulate to Councillors and Management for adoption.</p> <p>Establish the schedules for the next cycle.</p>   |  | <p>Analysis and review of IDP process and development of improvements for next cycle</p>  |  |                                |  |                 |
| JULY  |  | JULY  |  | JULY                           |  |                 |
| <p>Advertise the budget process and schedules – no later than 31 August.</p> <p>Establish forums for consultation on budget and IDP preparation.</p> <p>Establish budget committees and teams.</p> <p>Ensure technical systems, procedure and standardized documentation are in place.</p> <p>Align consultations on budget with consultations on IDP.</p> <p>Review external mechanisms for possible changes to agreements impacting on next budget.</p> |  | <p>Council approves the revised process.</p> <p>Advertise new process, and schedules for consultations and meetings of forums and committees – no later than 31 August.</p> <p>Align consultations on IDP with consultations on budget.</p> |  |                                |  |                 |
| AUGUST  |  | AUGUST  |  | AUGUST                         |  |                 |
| <p>Initiate the strategic planning, IDP and budget consultations with community to update community needs analysis and obtain feedback on results of the previous budget year – outputs, outcomes and evaluation of performance.</p>  |  | <p>Review IDP performance over past year and consult with community on performance and changes to needs.</p>  |  |                                |  |                 |

|  |                         |                         |  |
|--|-------------------------|-------------------------|--|
| <p>Consult with community on any proposed new or changes to external mechanisms for service delivery.</p> <p>Prepare internal analysis of financial and non-financial performance of previous financial year incorporating community feedback.</p> <p>Analyze gaps between actual and planned performance and assess the impacts on next three-year plans.</p> <p>Based on financial statements the previous financial year and performance review, determine the financial position of the municipality and assess its financial capacity and potential impacts on future strategies and budgets.</p>   | <p><b>SEPTEMBER</b></p> | <p><b>SEPTEMBER</b></p> |  |
| <p>In consultation with the Executive Committee, establish the future directions and priority areas for the municipality to guide the budget allocations and IDP plans.</p> <p>Confirm existing and set new policy priorities for next three years.</p> <p>The Executive Committee adopts policy directions and priority areas.</p> <p><b>Identify all factors that impact on future budgets and determine broad financial parameters.</b></p> <p>Determine the funding/revenue envelope potentially available for next three years.</p> <p>Determine the most likely financial outlook and identify need for changes to fiscal strategies.</p> <p>Refine funding policies including tariff structures.</p> <p>Prepare initial allocations based on financial capacity and future outlook.</p> | <p><b>SEPTEMBER</b></p> | <p><b>SEPTEMBER</b></p> | <p>In consultation with the Executive Committee, update future directions, strategies and priorities for next 3-5 years. {Incorporate feedback from community}</p> |

| OCTOBER   | OCTOBER   | OCTOBER  | OCTOBER  |
|---|---|----------|----------|
| Executive Committee articulates outcomes, objectives, priorities and outputs desired for next 3 years.  | Executive Committee articulate outcomes, objectives, priorities and outputs desired for next 3 years. |          |          |
| <p>National Regulators (e.g. NER, DWAF, F&amp;FC) and External Mechanism entities review and update pricing strategies for next three years.</p> <p>Consultations with Municipality on pricing regime.</p> <p>Municipalities negotiate on proposed price changes for next three years under external mechanisms agreements.</p> <p>National Government determines co-ordinated pricing regime for next three years.</p> <p>Municipalities receive other inputs from National and Provincial Government and other bodies on factors influencing the budget.</p> <p>Prepare drafts for IDP and the capital and operational plans with cost and revenue estimates.</p> | <p>Prepare draft updates to IDP plans, services and projects with updated financial impacts.</p>      |          |          |
| NOVEMBER  | NOVEMBER  | NOVEMBER | NOVEMBER |
| <p>Prepare estimates of preliminary functional allocations based on projections on past performance and adjusted for known factors, known commitments (e.g. backlogs) and asset maintenance requirements.</p> <p>Optional Consultation with community on developments of the budget and IDP and issues arising during preparations.</p> <p>Adjust plans to align with resources available and policy priorities.</p>  | <p>Integration of the IDP including updates and the budget framework.</p>                             |          |          |



|  |   |          |          |
|--|---|----------|----------|
| Finalize preliminary options for IDP and budget for next three years.<br><br>Assess impacts on tariffs and user charges.<br><br>Consolidate draft municipal entity business plans and budgets with municipality plans and budget.<br><br>Municipal Manager informs the Executive Committee of budget and IDP options on medium term (3 year) proposals.<br><br>Consultations with Executive Committee on preliminary budget and IDP medium term proposals.<br><br>Executive Committee discusses preliminary budget and IDP proposals with priorities and objectives set out in the medium term proposals.  |   |          |          |
|  | DECEMBER  | DECEMBER | DECEMBER |
| .  |   |          |          |
|  | JANUARY   | JANUARY  | JANUARY  |
| Executive Committee determines strategic choices on outcomes and broad financial allocations across functions. This undertaken using a strategic planning model that informs the executive of financial impacts of various choices and planning scenarios.<br><br>Continue finalization of detailed operational plans and budgets.<br><br>National and Provincial accounting officers finalize any adjustments to projected allocations for next three years no later than in their budgets.<br><br>Assess mid year review of 2008/2009 budget for impacts on budgets for next three years. Also incorporate any changes from National and Provincial governments on three-year allocations. | Executive Committee determines strategic choices on outcomes and broad financial allocations across functions. This is undertaken using a strategic planning model that informs the Executive Committee of financial impacts of various choices and planning scenarios.<br><br>Continue finalization of detailed plans. |          |          |

|   |                        |   |                        |  |                        |  |  |  |
|---|------------------------|---|------------------------|--|------------------------|--|--|--|
| <p>Review tariffs and charges and develop options for changes to be included in draft budget.</p> <p>Incorporate changes in preliminary budget and IDP proposals to take account of assessment from mid-year review and consultations on tariffs.</p> | <p><b>FEBRUARY</b></p> | <p>Finalize detailed draft budget in uniform formats.</p> <p>Executive Committee receives budget and IDP updates.</p> <p>Optional consultation on tariff changes in proposed budget.</p> <p>Municipality notifies details of any transfers to other municipalities no later than 1 March.</p> | <p><b>FEBRUARY</b></p> | <p>Finalize detailed updates to IDP plans and align with budget.</p> <p>Executive Committee receives budget and IDP updates.</p> <p>Optional consultation on changes to IDP.</p> | <p><b>FEBRUARY</b></p> |  |  |  |
|---|------------------------|---|------------------------|--|------------------------|--|--|--|

| MARCH  | MARCH   | MARCH | MARCH |
|--|---|-------|-------|
| <p>Consolidate the municipal plans and budget with business plans of municipal entities.</p> <p>Forward copy of budget and updates to IDP to National and Provincial Governments for review.</p> <p>Integrate and align the draft budget and IDP documentation.</p> <p>Finalize budget for next three years in prescribed formats.</p> <p>Executive Committee adopts budget.</p> <p>Mayor tables the budget in Council by 31 March.</p> <p>Council debates budget and updated IDP.</p> | <p>Integrate and align the budget and IDP documentation.</p> <p>Finalize updated IDP for next three years.</p> <p>Executive Committee adopts budget.</p> <p>Mayor tables the budget in Council by 31 March.</p> |       |       |

| APRIL   | APRIL   | APRIL |
|---|---|-------|
| Undertake community consultation on budget and updated IDP.   | Council debates budget and updated IDP.                     |       |
| Receive and analyze additional inputs from community and National and Provincial Governments  | Undertake community consultation on budget and updated IDP. |       |
| Incorporate feedback from community and National and Provincial Government and if required revise the budget and IDP updates tabled in Council.   |   |       |
| MAY   | MAY   | MAY   |
| Mayor tables revised new budget and IDP incorporating community input in Council – no later than 31 May.  | Municipal Council approves budget and IDP by 31 May         |       |
| Municipal Council approves budget and IDP by 31 May.  |   |       |
| JUNE  | JUNE  | JUNE  |
| Publish tariffs for next year in Provincial Gazette.  |   |       |
| Publish budget and IDP and forward copy of approved budget to National and Provincial Government.   |   |       |
| Establish and complete performance contracts for executive responsible for functional outcomes linked to the operational plans for the functions. |   |       |
| JULY  | JULY  | JULY  |
| Implement the budget.   |   |       |
| Start of preparation of the next budget.  |   |       |

**16 DATE ADOPTED**

\_\_\_\_\_

**17 DATE REVISED**

\_\_\_\_\_

**18 EFFECTIVE DATE**

\_\_\_\_\_