MAKHADO
LOCAL MUNICIPALITY

FINAL BUDGET POLICY

(APPLICABLE FROM 1 JULY 2011)

INDEX

MAKHADO LOCAL MUNICIPALITY - BUDGET POLICY & GUIDELINES 2011/2012 TO 2013/2014 FINANCIAL YEARS

1 PURPOSE OF THE POLICY

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 document will serve as a guideline to all departments for the compilation of operational business plans and budgets.

2 LEGAL REQUIREMENTS

This policy has been compiled in accordance with the Local Government: Municipal Finance Management Act (MFMA), Act no 56 of 2003 and National Treasury Circulars set out below.

- MFMA Circular No 55 dated 08 March 2011 – The Municipal Budget Circular for 2011/2012 MTREF.
- MFMA Circular No 54 dated 10 December 2010 - The Municipal Budget Circular for 2011/2012 MTREF.
- MFMA Circular No 12 dated 31 Jan 05 – Definition of "Vote" in MFMA.
- MFMA Circular No 13 dated 31 Jan 05 – Service Delivery and Budget Implementation.
- The Division of Revenue Bill and Budgets Act 15 of 2010 dated December 2010
- MFMA Circular No 27 dated 18 Nov 05 – Medium Term Budget Policy Statement 2005.
- The Municipal Budget Regulation and Reporting
- The determination of the municipal tariff guideline and the revision of the municipal tariff benchmarks for the financial year 2011/2012

Where this policy is contrary to other legislation, such legislation will override this policy. It is an explicit responsibility of the Municipal Manager to bring such conflicts immediately to the attention of the Council once he/ she becomes aware of such conflicts and to propose changes to this Policy to eliminate such conflicts.

3 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, determines strategic budget objectives.

The challenges facing the municipality is to find the means to continue to deliver services to the community whilst also improving and expanding the current services to meet increasing needs. The solutions to this challenge from a management perspective are vested in:-

- Increasing productivity;
- Re-prioritising developmental projects and services; and

- Increasing revenue through, inter alia, innovative means of funding service delivery.

The Municipality must also 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 and honouring of development obligations.

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

The MFMA, inter alia, provides that the involvement of Councillors in the budgeting and financial management processes will be:-

- Continuous consultation with the 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;
- 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 reporting activities through annual reports 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 achievement of financial and non-financial objectives expressed in the budget and IDP.

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 should reflect the needs of the community. The goal is also to empower managers with timeous financial information throughout the year and for Council to take preventative action before a crisis arises.

A comprehensive discussion of the budget process can be read in Chapter 4 of the MFMA and National Treasury MFMA Circulars No 10 and 19. A summarised operational flow of the budget process, as per the notes on the Budget Reform Process, is attached hereto as Annexure A.

4 STRATEGIC FOCUS AREAS AND 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 top ten municipal strategic issues, identified at the strategic alignment workshop during October 2005, to be addressed during the 2006/2007 financial year are as follow:-

- Financially sustainable and viable municipality.
- Reduction in electricity losses.
- Water and sanitation problem in town and air force base.
- Increase debt collection by 10% and number of indigent registered by 20% by 2012.
- Compliance to policies and legislation.
- Development of personnel.
- More skilled personnel within the Technical Department.
- Develop a culture of payment within the communities.
- Inter-departmental communication and cooperation.
- Proper fleet management system, organisation and maintenance program and efficient security measures.

The above priorities are in addition to the departmental objectives presented during the strategic alignment workshop. It is recommended that the Council reconfirm these strategic municipal priority issues to guide the Municipal Manager and other Directors in compiling their respective operational plans and budgets. Council should also 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 can then be based on these outputs and outcomes.

5 OPERATIONAL PLANS

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 subject to Council clearly stating the priorities and targets to be achieved over the next three years to meet community needs. 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 with same. The functions should 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. 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 should cover at least the following:-

- Measurable objectives;
- Service delivery strategies;
- Key outputs; and
- Performance /service delivery indicators and targets.

Upon approval of the annual budget the Municipal Manager should ensure that Service Delivery and Budget Implementation Plans (SDBIP), in accordance with the MFMA and National Treasury MFMA Circular No 13, be compiled and submitted to the Mayor for approval before commencement of the new financial year. In accordance with the MFMA, these SDBIP's should also form part of the performance agreements of all managers appointed on contract in terms of Section 57 of the Municipal Systems Act (MSA).

6 GENERALLY RECOGNISED ACCOUNTING PRACTICES (GRAP)

The implementation of GRAP will play a significant role in the compilation of the Capital and Operating Budgets. The updating of Council's asset register, the financing of assets and the relocation of funds and reserves are some of the key issues that need to be addressed.

In this regard, National Treasury introduced the Financial Management Grant (FMG) to promote and support reforms to municipal financial management practises, including the modernisation of budgeting, financial management, accounting, monitoring systems in municipalities and implementation of the MFMA.

The allocation of funds is targeted at pilot municipalities in all categories to implement the financial reforms. In this regard, the Makhado Municipality became a beneficiary of the programme with an allocation of ***R750 000*** and ***R 1,250,000.00*** for ***2010/2011*** and ***2011/2012*** respectively.

7 GENERAL NOTES ON ANNUAL BUDGETS

The annual budget approved by Council must at least 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 realistic funding already secured, together with the projected future financial implications of such capital expenditure;
- Details of borrowing intentions and other liabilities that will increase the Municipality's debt;
- Audited actual results for the previous year; and
- Projected budget outcomes for the current financial year, next year's budget and the outer two years.

In layman's terms, the budget of the Council consists of the operational budget (revenue and expenditure) and the capital budget. The budget must, within the available resources, reflect the Council's IDP and how it will be funded. The MFMA requires Council to approve at least a three-year operating and capital budget.

National Treasury MFMA Circulars no 14 and 27 also emphasized the following guidelines:-

- Municipalities must aim to ensure that revenue projections are accurate, realistic and collectable.
- The guideline growth limits are only for self-generated revenue sources. It excludes the increased national allocations provided for the purposes of expanding infrastructure and providing basic services to more households.
- Municipalities are requested to ensure that tariff increases remain within the inflation band of between 3 and 6 percent. Any increases in municipal rates and tariffs above the guideline growth limits must be fully motivated and explained to the local and business communities.
- Municipalities are obliged to ensure that their budgets are balanced and all expenditure is fully funded.
- Municipalities must ensure that the IDP is revised and linked to resource allocations in the budget.
- To achieve national objectives, municipalities should also strive to alter the composition of their budgets by spending more on capital and basic services and less on personnel and administration and improve the quality of spending. Municipalities are expected to maintain a clear focus on expanding infrastructure investments to encourage economic growth potential, adding impetus to the national priorities for improved spending in this area.
- On the operating side, it is important to continue to strive to achieve efficiency and productivity gains whilst being mindful of the implication that rapid growth in salaries & allowances will mean for service delivery.

- When preparing the annual budget, the Mayor must take into account the national budget, the relevant provincial budget, the national governments fiscal and macro economic policy, the annual Division of Revenue Act and any agreements reached in the Budget Forum. This is in addition to consultation with the community and other stakeholders, including district and all local municipalities within the district.

To ensure that a credible budget is compiled it is important to note the following extract from National Treasury MFMA Circular no 28:-

"Amongst other things, a credible budget is a budget that:
- Funds only activities consistent with the revised IDP and vice versa ensuring the IDP is realistically achievable given the financial constraints of the municipality;
- Is achievable in terms of agreed service delivery and performance targets;
- Contains revenue and expenditure projections that are consistent with current and past performance and supported by documented evidence of future assumptions;
- Does not jeopardise the financial viability of the municipality (ensures that the financial position is maintained within generally accepted prudential limits and that obligations can be met in the short, medium and long term); and
- Provides managers with appropriate levels of delegation sufficient to meet their financial management responsibilities.

A budget sets out certain service delivery levels and associated financial implications. Therefore the community should realistically expect to receive these promised service delivery levels and understand the associated financial implications. Major under spending due to under collection of revenue or poor planning is a clear example of a budget that is not credible and unrealistic. Furthermore, budgets tabled for consultation at least 90 days prior to the start of the budget year should already be credible and fairly close to the final approved budget."

8 ANNUAL OPERATING AND CAPITAL BUDGET

The operational budget is the financial plan, which the Council uses to effect sustainable service delivery within the guidelines of the Council and in terms of affordability. The operational budget also 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. The development of the budget will be undertaken using the following divisions:-

- Departments;
- Revenue and Expenditure categories; and
- Revenue and Expenditure line items.

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

The incremental budgeting technique is generally accepted as the basis of cost-orientated budgeting. However, it is of utmost importance that Council ensures an in-depth reviewing of its revenue budget and the goals for each category on an annual basis.

It is also important that the level of spending always be limited by the availability of revenue. Therefore, when the expenditure budget is compiled, the ability of the consumers to pay must always be taken into consideration. New operations and expansion of operations on the operating budget should therefore be motivated to Council before inclusion in the operating budget. Such operations must be included in departmental operational plans.

8.1 Operating Revenue Budget

The Council must determine what the total realistic revenue for the Municipality in the new financial year will be. Using actual levied revenue for the first six months of the current financial year and projecting these figures up to the end of the current financial year will determine such possible revenue. This calculation must further be based on realistic and affordable tariff increases.

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 as well as assessment rates.

The Council must therefore indicate the target level with which tariffs should increase. It is proposed that a general tariff increase within the target range for the consumer price index be approved. In this regard, it is also important to note that the tariff increases for water supply and sewerage services must be determined by the Vhembe District Municipality as these services are currently only rendered by Makhado Municipality on an agency basis.

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

Employee remuneration and related employee cost forms a significant portion of the total operational expenditure budget. It is therefore of utmost importance that the South African Local Government Bargaining Council (SALGBC) agreement on salary increases and its impact on the remuneration budget is taken into account before final tariff increases are determined.

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

8.1.1 Grants and Subsidies

This item consists of subsidies for clinic and health services, percentage of motor license fees as well as inter-governmental contributions in the form of equitable share contributions, finance manage grant, municipal systems improvement grant and others as may be determined from time-to-time.

8.1.2 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 far reaching implications on the assessment rate tariff. Due to the time consuming nature of the compilation of a new valuation roll to conform to the guidelines of the Property Rates Act, it is proposed that only the new valuations of the formally established urban areas be taken into account during the 2006/07 budget process. The valuations of the rural and informal areas will be phased in as from the 2007/08 financial year.

8.1.3 Consumer Revenue

Consumer revenue consists of income generated from the sale of electricity and water (trading services) and from amounts levied for sewerage and refuse removal (economical services).

With reference to each of the services the following increments for 2011/2012 to 2013/2014 financial years should be noted:

Service	2010/2011	2012/2012	2013/2014
Refuse Removal services	4.8%	5.3%	5.5%
Water	4.8%	5.3%	5.5%
Sewer	4.8%	5.3%	5.5%
Sundry Tariffs	4.8%	5.3%	5.5%

- The above increases were guided by the Headline CPI Inflation rate. *Source: Budget Review 2011* as reflected in the National Treasury MFMA Circular no 55(Municipal Budget Circular for 2011/2012 MTREF) pages 3 of 20 paragraph no 2.
- An increase of ***20.38%*** will be affected on electricity sales as approved for the 2011/2012 during municipal tariff review process by the National Energy Regulator of South Africa.
- The budgeted increase of ***26.71%*** on electricity bulk purchases by Eskom is also considered when determining the bulk purchase costs for 2011/2012 financial year.

8.1.4 Other Revenue

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

8.2 Operating Expenditure Budget

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

Where possible, the zero-based budgeting technique is applied to categories of expenditure. This will ensure that an in-depth review of revenue, expenditure and the targets for each category is undertaken during the budget process, resulting in a credible three-year budget, not merely based on an incremental approach. The zero-based type of analysis where all activities are open to review at budget time also allows an opportunity to reallocate resources and avoid continuous growth in budgeted expenditure.

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

- Employee remuneration and related employee cost projections;
- Repairs and maintenance;
- Interest and redemption requirements to service borrowings;
- 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 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 required to be reduced rather than to receive an increased allocation of funds.

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

8.2.1 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. 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.

It does not include costs of training courses (shown under General Expenses) and costs of contractors. The remuneration of Councillors, including possible full-time Councillors, is also not included in this category as they are not employees of the Municipality. 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 such as all managers appointed on contract in terms of Section 57 of the MSA.

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.

8.2.2 General Expenses

This section must include all expenses that will be necessary for the Municipality to carry out operations or activities that are not classified under one of the other expenditure groups. Set out below are some of the common general expenditure items:-

- Councillor Allowances: 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.

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

- Working Capital Reserve: This is the value of monies unable to be recovered. Each year an estimate should be made of the expected write-off value to be included in this item of the budget. Actual debt written off is an expense to the municipality. Working capital reserve relates to revenue, which is levied, but not paid and cannot be recovered through legal avenues or where costs of recovery might greatly exceed the revenue recoverable. The quantum of this item would relate directly to the revenue collection ratio. For example, if the municipality expects that it will only be able to collect 90 percent of all revenue raised it will include an amount under this item equal to 10 percent of the total revenue raised.

- 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 not debited to the customer. This item also includes discounts allowed for prompt payment of accounts.

- Depreciation (GRAP): The full implementation of GRAP is dependent on the identification and recording of assets and their current values. In terms of GRAP, 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.

- Contracted Services: This expenditure relates to payments for services provided by external entities. These services may also be referred to as "outsourced services". Entities rendering these services are not Council owned entities or municipal entities but are independent businesses. The two main types are set out below.
  - Services provided to external parties – where the Municipality contracts out the rendering of services such as refuse removal or electricity supply; 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. An example of shared service providers could be where an in-house section collects household refuse while a contractor services residential and business customers. Another example could be where a refuse collection service involves an in-house administrative section with a contractor carrying out actual collections.

- Deficit on sale of assets (GRAP): In terms of GRAP, 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.

8.2.3 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 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.

8.2.4 Capital Charges

This section must include the following:-

- Interest on internal loans paid by a functional unit or entity to the financing arm of the Municipality for loans that have been obtained for the capital employed in that function of the organisation. The expenditure for internal interest should be offset by the total income.
- Redemption on internal loans in respect of amounts transferred in redemption of internal loans. The expenditure for internal redemption should be offset by the total income.
- Interest expenses on external borrowings include the interest component of external loan repayments. It also includes borrowings from government agencies, i.e. Development Bank loans.
- Redemption payments on external borrowings include the redemption of the principle component of external loans raised by the Municipality.
- With the implementation of GRAP, redemption payments (or loan principle payments) are a repayment of capital. For annuity loans, loan repayments need to be split into interest and principle components. The total cash outflow will be recorded in the cashflow 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.

8.2.5 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. All capital expenditure, with a value of more than R1 000 but less than R20 000, should be financed from operating income (contribution to capital outlay).

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.
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”.

In terms of GRAP, capital expenditure will be allocated to the value of the asset recorded in the balance sheet. Currently, all capital expenditure with a value of more than R1 000 will be recorded in the asset register.

8.2.6 Contributions towards Funds

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. Currently, the Council contributes towards the following funds:-

- Provision for Bad Debts;
- Bursary Fund;
- Leave Reserve Fund; and
- Insurance Fund.

8.2.7 Summary of Operating Budget

Refer to 9.1.4 and 9.2 below for the detailed summary of the operational budget for 2011/2012 to 2013/2014 financial years including the current year original and adjustment budget and prior year actual from 2007/2008 financial years.

8.3 Capital Budget

The driving force behind the implementation of the Council's strategies is the IDP. In terms of the Local Government: Municipal Systems Amendment Act, 2003, Act No. 44 of 2003, the IDP process has to 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.

8.3.1 Categories

Council should divide the capital budget between contractually committed projects, continually compelled projects and new projects.

- **Contractually Committed (Type A Projects)**

Contractually committed projects are those for which formal arrangements already exist.

- **Continually Compelled (Type B Projects)**

The main focus areas of the continually compelled projects are the strengthening and expansion of networks and the replacement or reconstruction of existing infrastructure. The Technical Department identify type B projects and the main focus is on the protection of the Municipality's assets. Examples of Type B projects are the replacement of worn out water and sewer networks and the replacement of dangerous electricity networks. Any expenditure that simply ensures that the asset remains in good working order, retain its original characteristics of performance and useful life will be expensed in the operating budget. Type B projects represent projects that are necessary and executed to extend the life span of assets.

- **New Projects (Type C Projects)**

This category comprises of new projects of a capital nature for which the need has been identified through the IDP process.

9 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 includes revenue strategies, operational expenditure strategies and capital financing strategies.

9.1 Revenue Strategies

The needs of the community, the ability of the community to pay for the services provided to them and the growth rate allowed by National Treasury should be taken into account when Council considers the annual increase in tariffs and the average effect thereof on consumer accounts.

In line with MFMA Circular No 27, it is proposed that one of the Council's guidelines when drafting the ***2011/2012*** operational budget should be that the increase in consumer tariffs should be between the inflation target ranges of ***4.8%*** and ***6.8%.*** It is recommended, however, that when drafting the ***2011/2012*** to ***2013/2014*** income budgets the following be taken into account:-

- The actual income and expenditure for the 2007/2008 to 2009/2010 financial year.
- The estimated actual income for the 2010/2011 financial year (based on the July to November income figures).
- An increase of 4.8% on average in tariffs.
- Tariffs in 2012/2013 to 2013/2014 were increased by 5.3% and 5.5% respectively.

Cross subsidisation and profit guidelines will be contained in the Tariff Policy. It should be noted that these surpluses are used to subsidise assessment rates. Affordable accounts will go a long way in assisting that debt does not escalate further. Special attention should therefore be paid to the indigent and pensioners.

The revenue estimates should be realistic because the operating expenditure budget will be based on the total revenue budget. 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 as well as assessment rates.

Although an overall tariff increase of ***4.8%*** will be used when drafting the guidelines for the ***2011/2012 to 2013/2014*** financial years, it must be noted that a different percentage increase may be considered for each service, as long as it results in an overall income increase of ***4.8%*** for the Municipality. This will assist in determining the most acceptable and affordable scenario for the residents and ratepayers of the Municipality.

9.1.1 Assessment Rates

The Local Government Property Rates Act will have certain implications on the future assessment rate tariff and budgeted income. Care should be taken to keep the increase on assessment rates as low as possible. However, should the percentage surplus on turnover with regard to other services be reduced, the loss will have to be funded through assessment rates.

The compilation of a valuation roll that will include the rural areas is of utmost importance. The valuation process and implementation of a new valuation roll is a time consuming process. It is therefore advisable not to budget on the implementation of the complete valuation roll, but rather to focus on implementing the new valuation roll for the formal urban areas and attempt to implement the valuation roll for the rural areas.

Determination of Assessment Rates Tariffs should be considered taking into account the guidelines from MFMA Circular No 14 from National Treasury, set out below.

- "The new property rates legislation should not be seen as an opportunity to significantly increase the rates-burden on ratepayers. Municipalities should adjust their rates lower to take account of higher property values.
- Municipalities should be mindful of the overall tax burden and are cautioned against extending property taxes in a manner that may impact negatively on residential, business, agricultural, mining and industrial sectors.
- An assessment of the impact of the new property rates legislation on public infrastructure and state-owned properties, particularly those offering local services such as schools, police stations, magistrate's courts and public medical facilities will be undertaken. Municipalities are encouraged to be mindful of the broader implications when imposing taxes on public infrastructure, as such action may lead to perverse outcomes that may prove to be more detrimental to the long-term interests of the municipality."

9.1.2 Electricity

The guideline of a ***20.38%*** surplus on turnover by the National Electricity Regulator (NER) on electricity should always be taken into account when the percentage increase in electricity tariffs is considered. Electricity is the only trading service that can generate income to support income from assessment rates. It is therefore of utmost importance that measures are put into place to ensure that the budgeted surplus is realised.

9.1.3 Waste Removal

Waste removal is an economic service and should therefore break even. As a first step towards a balanced account, the level of tariffs needs to be investigated continuously.

9.1.4 Framework for the Revenue Budget

The framework for the Draft Revenue Budgets for the ***2011/2012 to 2013/2014*** financial years, based on the above-mentioned increases and growth rates, will be as follow:-

Description	2007/8	2008/9	2009/10	Current Year 2010/11				2011/12 Medium Term Revenue & Expenditure Framework		
R thousand	Audited Outcome	Audited Outcome	Audited Outcome	Original Budget	Adjusted Budget	Full Year Forecast	Pre-audit outcome	Budget Year 2011/12	Budget Year +1 2012/13	Budget Year +2 2013/14
Revenue By Source										
Property rates	9,096	24,754	16,831	25,676	23,674	20,939	17,458	24,819	26,134	27,571
Property rates - penalties	–	–	–	–	–	–	–	–	–	–
Service charges - electricity revenue	84,386	120,280	152,912	227,829	174,786	152,436	126,850	207,973	218,995	231,040
Service charges - water revenue	15,048	17,678	14,782	23,825	13,975	11,885	9,827	14,644	15,421	16,269
Service charges - sanitation revenue	6,045	–	5,517	12,062	7,427	6,120	5,100	7,783	8,196	8,646
Service charges - refuse revenue	5,538	10,939	6,695	6,570	7,317	6,404	5,335	7,668	8,074	8,518
Service charges - other	–	–	–	1	–	–	–	–	–	–
Rental of facilities and equipment	246	388	220	1,326	357	276	232	375	395	416
Interest earned - external investments	3,065	5,230	2,942	3,473	3,444	2,582	2,152	3,609	3,801	4,010
Interest earned - outstanding debtors	365	3,034	9,586	11,992	11,992	7,851	6,537	12,568	13,234	13,962
Dividends received	–	–	–	–	–	–	–	–	–	–
Fines	2,125	2,773	2,797	172	1,973	1,557	1,325	2,065	2,174	2,294
Licences and permits	3,851	11,314	9,766	18,329	10,159	9,723	8,180	10,648	11,212	11,829
Agency services	–	–	–	–	–	–	–	–	–	–
Transfers recognised - operational	125,927	166,875	180,769	243,149	249,659	223,205	186,005	274,487	304,610	323,746
Other revenue	11,056	11,210	7,860	97,029	105,133	12,574	10,481	131,092	38,040	40,132
Gains on disposal of PPE	–	–	–	–	–	–	–	–	–	–
Total Revenue	**266,747**	**374,475**	**410,678**	**671,432**	**609,896**	**455,552**	**379,481**	**697,731**	**650,285**	**688,433**

The municipality anticipated the borrowing of ***R 100,000,000.00*** million to upgrade the substations in ***2011/2012*** budget which is included in the operating revenue budget. The total budgeted revenue for ***2011/2012*** financial year excluding loan amounts to ***R 597,731,000.00***

The current service level agreement between the Makhado Municipality and Vhembe Municipality on the provision of water and sanitation services provides for an administration fee to be paid to Makhado Municipality for the services rendered. This has been provided under Sundry Revenue from the ***2011/2012*** financial year.

9.2 Expenditure Strategies

The Municipality should adopt an expenditure strategy that sets out how it intends to apply revenue collected/received. To ensure that the Municipality spends revenue efficiently, effectively and within the Municipality's priorities, the Head of the Finance Department should always determine targets for the six expenditure categories (Remuneration, General Expenses, Repairs & Maintenance, Capital Charges, Contribution towards Capital and Contribution towards Funds). The current structure of the budget is summarised below:-

Description	2007/8	2008/9	2009/10	Current Year 2010/11				2011/12 Medium Term Revenue & Expenditure Framework		
R thousand	Audited Outcome	Audited Outcome	Audited Outcome	Original Budget	Adjusted Budget	Full Year Forecast	Pre-audit outcome	Budget Year 2011/12	Budget Year +1 2012/13	Budget Year +2 2013/14
Expenditure By Type										
Employee related costs	100,153	117,647	150,864	235,412	185,147	159,191	132,659	193,283	203,527	214,721
Remuneration of councillors	13,022	14,444	15,600	19,946	16,436	14,594	12,162	17,225	18,138	19,136
Debt impairment	9,035	10,832	19,218	11,582	11,582	–	–	10,800	11,372	11,998
Depreciation & asset impairment	10,097	48,805	46,026	60,000	60,000	–	–	62,000	65,286	68,877
Finance charges	1,164	1,327	1,602	3,695	2,495	1,422	1,185	2,618	2,757	2,908
Bulk purchases	46,639	75,935	87,672	100,061	105,691	87,749	73,618	116,342	122,509	129,247
Other materials	–	–	–	–	–	–	–	–	–	–
Contracted services	924	–	1,598	1,650	2,165	1,361	1,134	2,220	2,338	2,467
Transfers and grants	100	–	–	120	–	–	–	–	–	–
Other expenditure	64,441	74,257	113,075	216,874	286,838	71,549	60,320	354,413	289,358	305,273
Loss on disposal of PPE	–	–	–	–	–	–	–	–	–	–
Total Expenditure	**245,575**	**343,247**	**435,655**	**649,342**	**670,355**	**335,867**	**281,078**	**758,902**	**715,285**	**754,626**
Surplus/(Deficit)	**21,172**	**31,228**	**(24,977)**	**22,090**	**(60,459)**	**119,685**	**98,403**	**(61,171)**	**(65,000)**	**(66,193)**
Surplus/(Deficit)	**21,172**	**31,228**	**(24,977)**	**22,090**	**(60,459)**	**119,685**	**98,403**	**(61,171)**	**(65,000)**	**(66,193)**
Taxation	–	–	–	–	–	–	–	–	–	–
Surplus/(Deficit) after taxation	**21,172**	**31,228**	**(24,977)**	**22,090**	**(60,459)**	**119,685**	**98,403**	**(61,171)**	**(65,000)**	**(66,193)**
Attributable to minorities	–	–	–	–	–	–	–	–	–	–
Surplus/(Deficit) attributable to municipality	**21,172**	**31,228**	**(24,977)**	**22,090**	**(60,459)**	**119,685**	**98,403**	**(61,171)**	**(65,000)**	**(66,193)**
Share of surplus/ (deficit) of associate	–	–	–	–	–	–	–	–	–	–
Surplus/(Deficit) for the year	**21,172**	**31,228**	**(24,977)**	**22,090**	**(60,459)**	**119,685**	**98,403**	**(61,171)**	**(65,000)**	**(66,193)**

The operating budget must always be balanced, to ensure that operating expenditure does not exceed realistically anticipated revenue. To avoid a shortfall Council should ensure the following:

- The percentage of the budgeted total salaries (including councillor's remuneration) to the total expenditure budget for ***2011/2012*** financial year is ***26%.*** The percentage is considered reasonable as is below the acceptable norm of ***35%*** by National Treasury.
- The total salary budget was calculated considering the intention to fill critical vacant positions to ensure improved service delivery levels.
- The increase of travelling allowances for identified positions to accommodate the enlarged municipal boundaries and the latest fuel increases.
- The identification of non-core functions and the possibility of phasing them out should be considered on a continuous basis.

- The full implementation of GRAP 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.

10 IMPORTANT FINANCIAL RATIOS

As discussed above, Council's decision on the correct combination of funding sources for capital expenditure such as, capital from income, lease agreements and long-term loans for infrastructure will be guided by certain important financial ratios. For purposes of this report the ratios of total debt versus annual income and net debtors versus annual income will be discussed.

Information in determining these ratios was taken from the ***financial statements for the year ended 30 June 2010***. Although this information might have changed during the course of the current financial year it is still deemed to be appropriate for purposes of the discussion.

10.1 Total Debt / Annual Income

Objective

Indicates the extent of long and short-term liabilities in relation to income. The purpose of the ratio is to provide assurance that sufficient income will be generated to repay liabilities.

Formula

The formula for calculating this ratio is: -

[Total Debt ÷ Total Income] × 100%

Definitions

Total Debt	Aggregate of long-term liabilities, short-term liabilities including bank overdrafts, hire purchase liabilities and finance lease liabilities but excluding trade creditors, consumer deposits, payments in advance from consumers and provisions.
Total Income	Income from all sources that will be credited to the income statement for financial statement purposes in accordance with prescribed financial statement formats.

Calculation of current ratio

COMPONENT	SOURCE	AMOUNT
Long-term loans	Annual financial statements	12 872 256
Short-term loans	Annual financial statements	1 446 185
Bank overdrafts	Annual financial statements	0
Total debt		**14,318,441**
Total Income		**412 919 975**
Current ratio	[14,318,441 ÷ 412,919,975] × 100	**3.5%**

Explanation of trend conditionality

The target ratio is 35%, as this will limit the exposure to loans and interest volatility. The ratio as calculated of 3.5% indicates that the municipality is not more dependent on loans for operation.

10.2 Net Debtors to Annual Income

Objective

This ratio focuses on the period that it takes to recover payment in respect of those amounts that are deemed to be recoverable. It therefore only takes into account the major income sources that give rise to consumer and other current debtors, excluding bad debts provisions. The ratio will indicate the effectiveness of credit control procedures as well as enable a realistic assessment to be made of the provision for bad debts.

Formula

The formula for calculating this ratio is: -

[Net Current Debtors ÷ Total Income] × 100

Definitions

Net Current Debtors	Is the balance of debtors that are classified as current for financial statement purposes, but excluding the short-term portion of long-term debtors' balances.
Provision for bad debts	Is the amount set aside as a provision in the accounting records to take into account the possible non-payment of certain debtors.
Total Income	Income from all sources that will be credited to the income statement for financial statement purposes in accordance with prescribed financial formats.

Calculation of current ratio

COMPONENT	SOURCE	AMOUNT
Current debtors	Annual financial statements	103 970 966
Provision for bad debts	Annual financial statements	19 217 656
Net Current debtors		**84,753,310**
Total Income	Annual financial statements	**412 919 975**
Current ratio	[84 753 310 ÷ 412 919 975] × 100	**20.5%**

Explanation of trend conditionality

An ideal target is 8.3%. However, there are significant arrears debtors' balances and debtors are increasing on a monthly basis by approximately R1 million. This situation will make it more difficult to fund significant capital projects from income in future. Failure to collect revenue due to the municipality will merely result in approved capital projects not being executed due to cash flow problems.

11 OPERATIONAL FLOW OF BUDGET PROCESS FOR 2011/2012 TO 2013/2014.

The operational flow of the budget process is attached as Annexure A to this document.

12 SERVICE LEVEL ARRANGEMENTS

Service level arrangements between Departments within Makhado Municipality should be considered during the 2011/2012 financial year. The key objectives of these service level arrangements are to:-

- Improve the method of budgeting and accounting for internal cost recovery; and
- Set standards and benchmarks for performance management.

Costs of internal support services should only be charged out to other departments to:-

- Ensure that the true full costs of trading departments is identified and reported; and
- Ensure that departments providing internal/external services could recover their costs from other departments.

13 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.

14 RECOMMENDATIONS

It is recommended to Council:

1. That the Budget Policy and Guidelines be approved as the basis for compilation of the ***201/2012*** to ***2013/2014*** Operational and Capital Budgets.
2. That new operations and the expansion of existing operations on the operating budget be motivated to Council before inclusion in the operating budget.
3. That Council makes provision for an average increase in tariffs for services of not more than the consumer price index as detailed in ***8.1.3*** above when drafting the ***2011/2012*** to ***2013/2014*** Budgets.
4. That the guideline of ***20.38%*** surplus on turnover by the National Electricity Regulator (NER) will be used to determine the increment on electricity charges.
5. That the refuse removal tariffs are determined in such a way that it results in a budgeted break-even situation.
6. That the proposed targets for the expenditure categories be approved.

7 That Council takes cognisance of the SALGBC agreement on salary increases and its impact on the remuneration budget.

8. That Departments indicate in their operational plans, their annual and deferred repair and maintenance requirements.

9. That the Director Finance ensures that GRAP is implemented is fully implemented by 30 June 2012.

10. That the Municipal Manager be requested to establish a committee representative from the rural area to consider the process of implementation of assessment rates in the rural areas.

12. That Heads of Departments submit operational plans in line with the budget reform process as part of the budget process for the 2011/2012 financial year.

13. That in terms of section 17(1)(e) of the MFMA this policy be reviewed on annual basis and the reviewed policy tabled to Council for approval as part of the budget process.

OPERATIONAL FLOW OF BUDGET PROCESS FOR 2011/2012 TO 2013/2014

The operational flowchart is part of the guidelines that was issued by National Treasury as part of the budget reform process. The flowchart, attached as Appendix A, is discussed below:

1 NEEDS IDENTIFICATION

1.1 Community Input

The needs of the community will be forthcoming from the various ward committees chaired by the Ward Councillor. This will ensure that the needs from the grassroots level are considered from the outset.

1.2 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.

1.3 Needs Analysis

Through the processes applied in the Integrated Development Plan (IDP), a process of needs analysis will 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.

1.4 Identify Issues

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

2 MUNICIPAL STRATEGIC PLAN

The Municipal Strategic Plan will be formulated taking into consideration all of the following factors:

2.1 Political Inputs

Politicians will be required to submit any aspects for inclusion in the Municipal Strategic Plan.

2.2 National Priorities and Target Groups

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

2.3 Source Documentation

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

- Integrated Development Plan.
- Operational Plans.
- Performance Management Systems.
- Strategic Focus Areas, etc.

The outcome of the determination of the Municipal Strategic Plan will entail that Strategic Focus Areas will be identified and approved by Council.

3 MUNICIPAL PRIORITY ISSUES

The municipal priority issues will be formulated from the Municipal 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.

4 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:

4.1 Revenue Envelope

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

4.2 Expenditure Envelope

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

4.3 Prioritisation Process

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

5 BUDGET GUIDELINES

After approval of the financial strategy, the Finance Department will compile budget guidelines to be distributed to the departments.

The purpose of distributing budget policy guidelines is to ensure 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 incorporating the Council's requirements.

In compiling the budget policy guidelines, the Manager of the Finance Department 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.

6. 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:

6.1 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:

6.2 Draft Three-Year Capital Budget

From the operational plans and accompanying templates submitted to the Finance Department, the Finance Department will compile the first draft 3-year capital budget.

A continuous alignment will take place with the draft operating 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.

6.3 Draft Three-Year Operating Budget

From the operational plans and accompanying templates submitted to the Finance Department, the Finance Department will compile the first draft 3-year operating budget.

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.

6.4 Council Model

The Council Model represents a process where all the proposed changes will be captured, modelled and refined until the preferred result can be captured into the budget system.

6.5 Budget System

The final draft three-year capital and operating budgets will be captured in the budget system (IT program).

7. DRAFT OPERATING AND CAPITAL BUDGETS

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

8. BUDGET CONFERENCES

Formal budget conferences will take place with all role players to deliberate on the draft budgets.

Alterations will be referred back in the process to enable the drafts to be amended continuously.

9. 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.

10. FINAL OPERATING AND CAPITAL BUDGETS

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

11. COUNCIL APPROVAL

Council will meet to approve the final capital and operating budgets for the 2006/2007 to 2008/2009 financial years during May 2006.

12. SUBMISSION TO NATIONAL TREASURY

The final approved budgets, accompanied by the relevant budget reform schedules must be submitted to National Treasury for approval.

OPERATIONAL FLOW OF BUDGET PROCESS