1. Introduction

All provisions of the Municipal Finance Management Act, Act 56 of 2003 (MFMA) relating to the budget process have been applicable to all municipalities with effect from the 2005/06 budget.

As indicated in MFMA Circular 10 issued on 8 October 2004, “the Integrated Development Plan (IDP) and budget process must be one process.” An effective budget process that incorporates the IDP review will:

- facilitate community input,
- encourage discussion,
- promote a better understanding of community needs,
- provide an opportunity for feedback. and
- improve accountability and responsiveness to the needs of the local communities.

This approach positions the municipality to represent the needs of the community and to provide useful inputs to the relevant provincial and national department strategies and budgets for the provision of services.

This module is not intended to provide a definitive guide on how to budget, it strives to set out the principles behind the preparation of the municipal budget from a strategic point of view incorporating National Treasury budget reforms, the content of the various MFMA circulars issued by National Treasury and providing some guidance on best practices in preparing a budget.

Furthermore, the module will not address the content and format of the budget. This subject is dealt with within the MFMA (section 17) and MFMA Circular 28 dated 12 December 2005. In addition, National Treasury has developed and circulated templates in this regard. Although not prescribed, details of the various budget documents and their formats are provided in MFMA Circular No. 28.

The module has been broken down into sections, namely:

- The strategic significance of the budget
- Legislative framework
- National Treasury's budget reforms
- The budget process
- Budget and budget related policies
- Funding of the budget
- Revision of the annual budget
- Community participation
- The Service Delivery and Budget Implementation Plan (SDBIP)

2. The strategic significance of the budget

Section 26(h) of the Municipal Systems Act, Act 32 of 2000 (MSA) indicates that "a financial plan, which must include a budget projection for at least the next three years" is a core component of the IDP. Hence, the link between the IDP and budget is established at a strategic level.

The failure to prepare and incorporate an appropriate financial plan in the IDP will result in ineffective and disjointed budgeting that does not align the strategic service delivery objectives of the municipality with the financial resources available to that municipality for service delivery purposes. In addition, revenue enhancement and the consideration of alternative sources of revenue to provide additional resources for service delivery will not be addressed at a strategic level, but rather haphazardly, on an annual basis when preparing the budget. Effectively, the financial plan referred to above provided the bridge between the municipality's strategic service delivery objectives and the annual budget. It also facilitates the development of the various budget related policies.

The preparation of a financial plan falls beyond the scope of this module.

If we consider the IDP as a municipality's strategic blueprint, the annual budget provides the mechanism for implementing the IDP. It is therefore imperative for municipalities to ensure that their annual budgets are output-driven, and that the intended outcomes are in line with the medium term service delivery objectives outlined in the IDP. The budget is the most important mechanism in giving effect to a municipality's service delivery strategies focusing on both the medium and short-term.

The IDP is also a co-ordinating tool that includes the needs of the community with respect to local services provided by all three spheres of government. It follows that the IDP of a municipality should differentiate between two sections – one part related to municipal functions and responsibilities and a second part relating to national and provincial responsibilities. The budget of the municipality can only fund the first part of the IDP related to municipal functions and services. The second part of the IDP requires the municipal manager to co-ordinate with national and provincial departments advocating on behalf of the local community.

By adopting three-year budgets (medium term) as part of each annual budget process, municipalities are compelled to take a medium-term view of their service delivery implementation targets, and are enabled to make more fully-informed decisions on whether their budgets are properly aligned with the IDP, whether their IDP is attainable, and whether revisions to key aspects of the IDP are dictated by unavoidable budgetary constraints. This focus on a three year-year period is necessary to align the Government's medium term expenditure framework (MTEF) with the medium term strategic objectives of the municipality.

One may there ask "what is the difference between the financial plan referred to above and a three-year budget?" One could argue that the answer lies in the purpose for which they are prepared and the level of detail included. A financial plan would contain *relatively* limited detail focusing on the alignment of the strategic service delivery objectives of the municipality with the financial resources available to that municipality for service delivery purposes, whereas a budget would contain a significantly greater level of detail focusing on the implementation of the service delivery objectives set out in the IDP in the medium to short term.

A sound budget is one which sensibly allocates realistically expected resources to the achievement of defined performance objectives identified as priorities in the approved IDP thereby ensuring that the municipality will be able to continue operating in a financially sustainable manner in the future.

3. Legislative framework

In order to avoid unnecessary duplication the legislative framework with respect to the budget has not been incorporated in this module. In order to obtain further details in respect of the legislation as it relates to budgeting you may refer to the following in the MFMA:

- Chapter 4 (sections 15 to 33) – Municipal budgets
- Chapter 5 (sections 35 to 44) – Co-operative government
- Chapter 7 (sections 53 and 54) – Responsibilities of mayors
- Chapter 8 (sections 68 to 73) – Responsibilities of municipal officials
- Chapter 9 (sections 80 to 83) – Municipal budget and treasury offices
- Chapter 10 (section 100 and 104) – Municipal entities

Your attention is also drawn to Attachment L – Compliance checklist which includes the various sections applicable to the budget.

One must always remember that in terms of MFMA section 15, Municipalities may incur expenses only in accordance with their approved annual budget (or adjustments budget), and within the limits of the amount appropriated for each vote in such budgets.

Furthermore, the following MFMA Circulars have relevance to the budgeting process:

- MFMA Circular 10 – Budget process 2005/06 dated 8 October 2004
- MFMA Circular 12 – Definition of "Vote" in MFMA dated 31 January 2005
- MFMA Circular 13 – Service Delivery and Budget Implementation Plan dated 31 January 2005
- MFMA Circular 14 – 2005 Division of Revenue Bill and Municipal Budgets dated 28 February 2005
- MFMA Circular 19 – Budget process 2006/07 dated 15 August 2005
- MFMA Circular 28 – Budget content and format – 2006/07 MTREF dated 12 December 2005
- MFMA Circular 31 – Budget tabling and adoption dated 10 March 2006
- MFMA Circular 41 – 2007/08 MTREF Budget update dated 31 January 2007
- MFMA Circular 42 – Funding a municipal budget dated 30 March 2007

4. The National Treasury's budget reforms

The budget reforms introduced by the National Treasury relate to mainly four aspects of the municipal budgeting process:

- a change in focus from annual budgeting to the preparation of medium-term budgets informed by and aligned with medium to long-term financial and development plans;
- a change in focus from mainly input-based budgets to budgets which realistically align credible budget inputs with clearly stated and measurable performance targets;
- the preparation and wide dissemination of a range of budget documents, including both user-friendly executive summaries of key budget data and full details of both budget inputs and envisaged outputs; and

- the standardisation of budget reporting formats, using international Government Financial Statistics (GFS) classifications.

MFMA circulars 10, 12, 13, 14, 19, 28, 31, 41 and 42 relate directly to the implementation of National Treasury's budget reforms. These circulars envisage the preparation of a proper timetable for the annual budget process and the inclusion of sufficient opportunities for meaningful consultation with the community and other stakeholders in the determination of budget inputs and intended deliverables.

An integral feature of the budget reforms – repeatedly and very necessarily stressed by the National Treasury in these circulars – is that municipal budgets must be **credible**: financially credible in the sense that realistically expected operating revenues and sources of capital finance will match realistically likely expenses, and strategically credible in the sense that the budget reflects the priorities and targets set in the municipality's IDP and reasonably accommodates the results of the consultation processes which precede the final approval of the budget.

The MFMA defines a vote as one of the main segments into which the budget is divided, which in practice will usually mean the departments or principal functional areas of the municipality. Your attention is drawn to MFMA Circular 12 where the question of the definition of "Vote" is explored extensively.

It should be noted at the outset that although the best budgetary practice is for the vote structure of a municipality to follow its organisational structure, the MFMA requires municipalities also to approve their budgets in the format prescribed by National Treasury. This format of the budget has not yet been prescribed, MFMA Circular 28 puts forward a format that is likely to be prescribed, for the purposes of this chapter it will be assumed that MFMA Circular 28 will be prescribed. The National Treasury format will not always correlate with the organisational structures of particular municipalities, which implies in turn that those municipalities where the organisational structure diverges materially from the prescribed format will have to apply themselves to finding a workable formula for apportioning their budgets in terms of the National Treasury requirements. Note again that where the municipality's own format differs from that of the National Treasury it must therefore approve part of the budget in two formats: its own and that required by the National Treasury.

It must therefore be clearly understood that there is likely to be a difference between the GFS vote classifications and those used in municipalities. Firstly, the GFS vote structure provides "a reasonably high level grouping of related service delivery activities", and, secondly, uses the same votes for both the capital and operating components of the budget.

Any expenditure incurred that is not in accordance with a vote (or exceeds the amount for a vote) is classified as unauthorised expenditure, which sets off corrective and disciplinary mechanisms against the accounting officer. Any movement of funds between "votes" or alteration of service delivery targets or performance indicators therefore requires an adjustment budget and a further council resolution. That is, a council resolution is required to deviate from the original council resolution that approved the budget. Keeping the "vote" at a high level allows senior managers to move expenditure and revenue as necessary within a "vote" without an adjustments budget provided the overall revenue, expenditure and performance objectives for that "vote" are not negatively affected.

The important consideration is that the municipality should not, if at all feasible, make it an impossibly cumbersome task for itself to "roll-up" its own votes into the relevant GFS classifications.

4.1 Format of Annual Budget

The MFMA section 17 prescribes the annual budget (section 17(1)) and supporting documents (section 17(3)). As previously mentioned, MFMA Circular 28 includes a yet to be prescribed format of the annual budget.

The prescribed budget includes four schedules, namely:

- Operating revenue by source;
- Capital revenue by source;
- Operating expenditure by vote; and
- Capital expenditure by vote.

4.2 *Documents which support the annual budget*

As previously indicated MFMA section 17(3) prescribes the documents that are required to support the annual budget. These are:

(a) Draft resolutions—
  (i) approving the budget of the municipality;
  (ii) imposing any municipal tax and setting any municipal tariffs as may be required for the budget year; and
  (iii) approving any other matter that may be prescribed;

(b) measurable performance objectives for revenue from each source and for each vote in the budget, taking into account the municipality's integrated development plan;

(c) a projection of cash flow for the budget year by revenue source, broken down per month;

(d) any proposed amendments to the municipality's integrated development plan following the annual review of the integrated development plan in terms of MSA section 34;

(e) any proposed amendments to the budget-related policies of the municipality;

(f) particulars of the municipality's investments;

(g) any prescribed budget information on municipal entities under the sole or shared control of the municipality;

(h) particulars of all proposed new municipal entities which the municipality intends to establish or in which the municipality intends to participate;

(i) particulars of any proposed service delivery agreements, including material amendments to existing service delivery agreements;

(j) particulars of any proposed allocations or grants by the municipality to—

- (i) other municipalities;
- (ii) any municipal entities and other external mechanisms assisting the municipality in the exercise of its functions or powers;
- (iii) any other organs of state;
- (iv) any organisations or bodies referred to in section 67(1);

(k) the proposed cost to the municipality for the budget year of the salary, allowances and benefits of—

- (i) each political office-bearer of the municipality;
- (ii) councillors of the municipality; and
- (iii) the municipal manager, the chief financial officer, each senior manager of the municipality and any other official of the municipality having a remuneration package greater than or equal to that of a senior manager;

(l) the proposed cost for the budget year to a municipal entity under the sole or shared control of the municipality of the salary, allowances and benefits of—

(i) each member of the entity's board of directors; and

(ii) the chief executive officer and each senior manager of the entity; and

(m) any other supporting documentation as may be prescribed.

Examples of selected of the foregoing documents are provided in MFMA Circular No. 28.

In addition to the budget documents prescribed by the Act, the National Treasury requires municipalities to prepare and submit to National Treasury the following documents, examples of most of which are also provided in MFMA Circular 28:

- the mayoral budget speech;
- an executive summary of the budget;
- budget-related charts and explanatory notes;
- budget process overview, referring to the consultation process and its outcomes;
- the assumptions according to which the budget was compiled;
- the funding of the budget, comprising the actual sources of funding of both the capital and operating budget components and a fiscal overview consisting of a review of past and current financial performance and an updated projection of the long-term financial outlook;
- a disclosure on the extent to which the municipality has implemented and intends to implement the MFMA and other relevant legislation;
- a summary of the municipality's departmental/functional budgets and SDBIPs;
- a summary of the budgets and SDBIPs of the municipality's entities and other external service delivery mechanisms;
- a summary of the detailed capital plan; and

- the budget financial statements of the municipality and each of its entities, separately and in consolidated format (statement of financial position; statement of financial performance; statement of changes in net assets; cash flow statement).

5. The budget process

National Treasury envisages (MFMA Circular 10) a six step process to the preparation of a budget as detailed below. We have added a seventh step, reporting, to the process to illustrate the linkage between the budget processes until approval to the implementation of the budget. It is critical to note that consultation on the budget occurs throughout the budget process.

	Step	**Process**
1	Planning	• Review previous budget processes – provide information about what worked well, what didn't, where to improve and issues to address for legislative compliance. The budget process makes provision for various engagements and for appropriate reviews to assess progress in implementation. Lessons learnt should then be factored into the next planning and budgeting cycle. • Schedule key dates • Establish consultation forums **Key responsibilities of the Mayor** **Mayor** is responsible to co-ordinate the process (MFMA section 21) and the **accounting officer** (Municipal Manager) assists in developing and implementing the budgetary process (MFMA section 68). The **mayor** must provide political guidance, and must monitor and oversee the responsibilities assigned to the **accounting officer** (Municipal Manager) and the **chief financial officer**, but may not interfere in the exercise of those responsibilities.

	Step	Process
		The **mayor** must take all reasonable steps to ensure that the municipality performs its constitutional and statutory functions within the limits of its approved budget. **Entities and the budget process** Municipalities with entities must ensure that the municipal budget process includes the budget process for each of its entities. The entity budget processes must be shaped by, and be within the framework of, the municipality's budget process. In particular, it will be necessary to ensure that the entities strategic plan and budget is consistent with the direction of the parent municipality's IDP and budget. The mayor of the parent municipality must therefore coordinate the overall budget process including that of its entities.
2	Strategising	• Review IDP - one process, together with the process for approving taxes, levies, user charges and budget related policies. This will ensure credible plans and budgets that are realistic and able to be implemented. Furthermore, the IDP should be an input into the entire budget, not just the capital budget, which has traditionally been the case. • Set service delivery and objectives for next 3 years • Consult on tariffs, indigent, credit control, free basic services

	Step	Process
		• Consider local, provincial and national issues, previous years performance and current economic and demographic trends • Consider national policy priorities and the fiscal framework including growth parameters. The Budget process is consultative and the collective product of all within a municipality. If treated as an accounting exercise only, the **mayor** and **accounting officer** (Municipal Manager) will have failed in their obligations to the municipality and the community. The budget process must involve all the **senior managers** and, importantly, it must be guided by the strategic priorities of the municipality. The budget process should be preceded by a number of strategic and consultation processes within the municipality, involving the **mayoral/executive committee and councillors**. These processes are not legislated and are left to the discretion of each municipality. The **first** external consultation process is informal, and open-ended that includes the following: • Public meetings with residents and small businesses in local communities - to

	Step	Process
		identify and prioritise the greatest local needs and to obtain the views of the community the council should consider the use of ward committees to gain an understanding of the issues in each ward; • Meetings with key stakeholders to identify community and business needs and concerns, including the level of municipal tariffs and charges. • Consultations between the municipality and the relevant district municipality all other municipalities within the area of the district, the relevant provincial treasury and local government departments, National Treasury, provincial and national sector departments and providers of bulk resources. This first phase of informal or open-ended consultations ends when the **mayor** tables the budget and revisions to the IDP. The **second** external consultation process is more formal and takes place after the tabling of the draft budget, when the council convenes hearings on the draft budget and revisions to the IDP. The municipality must invite the public and stakeholder organisations to submit comments and submissions in response to the draft budget and revised IDP. Since specific proposals are

	Step	Process
		contained in the draft budget and revised IDP the public comments and responses tend to be more directed to these proposals.
3	Preparing	• Prepare budget, revenue and expenditure projections • Draft budget policies • Consult and consider local, provincial and national priorities Budget preparation includes the following processes: • Winning support for the priorities that will shape the way budget allocations will be • determined • Integration of strategic objectives with budget allocations • Appropriate planning and improved project management • Assessing affordability of rates and service charges, and identifying poor households • unable to afford such rates and charges; • Accurate in the estimation of revenue and expenditure projections • Consultation and review of national, provincial and local priorities • Assessment of previous year performance and corrective action to be incorporated in the next budget

	Step	Process
		Throughout the budget process consideration should be given to the effect that previous performance will have on the medium term plan and the current and forthcoming budgets. This should include past year and current year information.
4	Tabling	• Table draft budget, revised IDP, draft resolutions and budget related policies before council no later than 1 April each year. • Call for public submissions • Host public hearings • Consult and consider formal community, local, provincial and national inputs or responses Reference should be made to MFMA Circular 31 dated 10 March 2008 which serves to reminder municipalities of the requirements of the MFMA relating to the tabling and adoption of budgets.
5	Approving	• Council approves budget and related policies Failure to approve the budget before the start of the budget year will have serious operational consequences for the municipality (as no payments can be made without an approved budget) and could result in a section 139 constitutional intervention in terms of sections 25 and 26 of the MFMA. Should the municipality fail to approve the budget before the start of the

	Step	Process
		budget year, the **mayor** must inform the MEC for Finance that the budget has not been approved.
6	Finalising	• Publish the budget and approval of the SDBIP and annual performance agreements and indicators for the **municipal manager and senior managers**. • The **accounting officer** (municipal manager) is responsible for implementing the annual budget.
7	Reporting	Within thirty days after the end of each quarter, the **mayor** must submit a report to the council on the implementation of the budget, and on the financial state of affairs of the municipality. The **accounting officer** (Municipal Manager) must take all reasonable steps to ensure that all expenses are incurred in accordance with the budget, that expenses are reduced as necessary when expected or actual revenues are less than projected in the budget and service delivery and budget implementation plan, and that revenues and expenses are properly monitored. The **accounting officer** (Municipal Manager) must further report in writing to the council if there are any impending shortfalls in budgeted

	Step	Process
		revenues, or any impending overspending of the budget, and must indicate the steps taken or to be taken to rectify such shortfalls or overspending. The **accounting officer** (Municipal Manager) must further notify National Treasury if the municipality's bank account(s) is overdrawn for a period exceeding the prescribed period. Very importantly, the **accounting officer** (Municipal Manager) must, not later than ten working days after the end of each calendar month, submit to the mayor and to the Provincial Treasury a statement in the prescribed format setting out the state of the municipality's budget for the month concerned and for the financial year to date. Such statement must reflect: • actual revenues collected, by source; • actual borrowings; • actual expenses incurred by vote; • amount of allocations received; • actual expenses incurred against such allocations (but excluding expenses incurred against the equitable share); • explanations of material variances from projections of revenues and expenses; • explanations of material variances from

	Step	Process
		service delivery and budget implementation plan; • remedial steps taken or recommended; • projection of revenues and expenses for remainder of budget year, revised as necessary; and • comparisons between all actual amounts provided and corresponding amounts in approved budget. The **mayor** may, in an emergency or other exceptional circumstances, authorise unforeseen and unavoidable expenses not approved in the annual budget, provided such expenses: • are in accordance with a prescribed framework; • do not exceed a prescribed percentage of the approved budget; • are reported by the mayor to the next council meeting; and • are appropriated in an adjustments budget, and such adjustments budget is passed within 60 days after the expenses were incurred. The MFMA provides (limited) scope for moving budget appropriations between capital votes forming part of multi-year budgets, but such

	Step	Process
		movement will require the prior written approval of the **mayor**.

6. Budget policy and budget related policies

A budget related policy is defined in section 1 of the MFMA as being: "a policy of a municipality affecting or affected by the annual budget of the municipality, including:" the tariffs policy [MSA section 74]; the rates policy [Municipal Property Rates Act, Act 6 of 2004, section3] or the credit control and debt collection policy [MSA section 96].

The key terms here are "affecting or affected by". This implies that budget related policies are those that have a direct relationship with the budget. The budget related policies should be prepared before and budget policy to ensure consistent application and alignment to the service delivery objective embodied in the IDP. The budget policy should support the preparation of the budget and focus on matters that extend beyond the various budget related policies, for example the application of the municipality's accounting policies (these are determined in terms of the relevant accounting standards, either Generally Recognised Accounting Practice (GRAP) of General Accepted Municipal Accounting Practice (GAMAP)).

MFMA Circular 10 indicates that budget related policies include but are not limited to policies on: tariff setting; credit control / debt collection; indigents; cost recovery; investment; borrowing; cash management; spending delegations or authorisations; other supply chain considerations such as purchasing limits for sole supplier versus quote or tender; and so on. Some of these are required to be passed as a by-law and may require significant planning before changes can be made.

One would, therefore, correctly expect the budget policy adopted by the municipality to set out at least the budgeting principles which the municipality will apply in preparing each annual budget.

6.1 Illustrative budgeting principles to be incorporated in the budget policy

The following are examples of illustrative paragraphs that might be included in a municipal budget policy that must be taken into account in preparing the budget. Our comments are included in *italics* after the illustrative paragraph where appropriate.

6.1.1 Cross-subsidisation between votes

Electricity services tariffs are required to include a 10 percent administration charge payable to rate and general services for management services. *[Services that cross-subsidise rate and general services should be fully ring fenced in order to determine the true cost of services rendered by rate and general to the services. These costs should form the basis for the charge from rate and general services. The methodology used to determine the charge should ideally include activity based budgeting studies. This process will enable the municipality to determine more realistic tariffs for other services such as refuse removal.]*

6.1.2 Debt ratios

A debt ratio of 2:1 is to be maintained when determining funding sources in respect of capital projects to be included in the capital budget. *[This paragraph assists the municipality in determining the source of funding to be used to fund capital projects. The financial statements will reflect the actual funding utilized whereas the budget will reflect planned funding sources. The budget should be prepared reflecting the planned funding sources based on the above paragraph although this might differ from actual funding sources.]*

6.1.3 Local economic development (LED) incentives and initiatives

The expected local economic development benefit should be identified and quantified (if possible) is respect of all projects included in the capital budget. *[This is a budgeting issue which requires the municipality to include LED strategies and initiatives in the budgeting process. It does not refer to specific LED projects but requires the municipality to address LED initiatives in capital projects undertaken, for example, the employment of local labour.]*

6.1.4 Maintenance policies

The maintenance line item in each vote is to comprise a minimum of 5% to the total expenditure budget of that vote. *[This is a budgeting issue – it reflects the importance that a municipality places on the maintenance of its assets to ensure the sustainability of service delivery. Frequently maintenance budgets are "cut" as this type of cost is seen as non-essential. This is obviously not the case as the sustainability of service delivery becomes impaired.]*

6.1.5 Capital Component of Annual Budget

Except in so far as capital projects represent a contractual commitment to the municipality extending over more than one financial year, the annual capital budget shall be prepared from a zero base. *[This is a budgeting issue – it reflects the method by which a municipality is required to prepare its capital budgets.]*

The capital budget component of the annual or adjustments budget shall only be approved by the council if it has been properly funded, that is, if the sources of finance which are realistically envisaged to fund the budget equal the proposed capital expenses. *[This is a budgeting issue – it reflects a parameter placed on the preparation of a municipality's capital budgets.]*

The council may establish a capital replacement reserve for the purpose of financing capital projects and the acquisition of capital assets. Such reserve may only be established from the following sources of revenue:

- unappropriated cash-backed accumulated surpluses to the extent that such surpluses are not required for operational purposes;
- interest on the investments of the capital replacement reserve, appropriated in terms of the cash management and investments policy; and
- net gains on the sale of fixed assets in terms of the fixed asset management policy.

[This is a budgeting issue – it reflects a method by which a municipality sets aside funds for future capital expenditure. Caution should be exercised when incorporating such a paragraph in a municipality's budget policy to ensure that cognisance is taken of the relevant accounting standards as such a provision might require the reconciliation of the municipal budget with the results reflected in the statement of financial performance included in the financial statements.]

6.1.6 Operating Deficits and Surpluses

Each annual and adjustments budget shall reflect a realistic excess, however nominal, of current revenues over expenses. *[Whilst there might be valid reasons for a municipality budgeting for an operating deficit a Council might choose to specify in its budget policy that its budget may not reflect an operating deficit.]*

Any unappropriated surplus from previous financial years, even if fully cash-backed, shall not be used to balance any annual or adjustments budget, but shall be appropriated, as far as it is not required to finance the payment of operating creditors or for other operational purposes, to the municipality's capital replacement reserve. *[This is may be included in a municipality's budget policy at the option of Council. Where such a paragraph is included in a budget policy the effect thereof must be included in the municipal budget.]*

An impending operating deficit shall be made good in an adjustments budget, but if an operating deficit arises at the end of a financial year, notwithstanding the precautionary measures adopted by the council, such deficit shall immediately be made good in the annual budget for the ensuing financial year, and shall not be offset against any unappropriated surplus carried forward from preceding financial years. *[This is may be included in a municipality's budget policy at the option of Council. Where such a paragraph is included in a budget policy the effect thereof must be included in the municipal budget.]*

6.1.7 Provisions

The municipality shall establish and maintain a provision for bad debts in accordance with its rates and tariffs policies, and shall budget appropriately for contributions to such provision in each annual and adjustments budget. *[This item might be significantly affected by the application of the relevant accounting standards – the budget policy should not contradict the content of the municipality's approved accounting policies and the application of the relevant accounting standards dealing with the impairment of assets and financial instruments.]*

The municipality shall establish and maintain a provision for the obsolescence and deterioration of stock in accordance with its stores management policy, and shall budget appropriately for contributions to such provision in each annual and adjustments budget. . *[This item might be significantly effected by the application of the relevant accounting standards – the budget policy should not contradict the content of the municipality's approved accounting policies and the application of the relevant accounting standards dealing with inventory and the impairment of assets.]*

6.1.8 Finance Charges, Depreciation and Interest Earned

All expenses, including depreciation, shall be cash-funded. The cash received in respect of depreciation on assets financed from external borrowings shall be transferred to the investments created to redeem such borrowings. *[This item might be significantly affected by the application of the relevant accounting standards – the budget policy should not contradict the content of the* *municipality's approved accounting policies and the application of the relevant accounting standards.]*

Finance charges payable by the municipality shall be apportioned between votes on the basis of the proportion at the last balance sheet date of the carrying value of the fixed assets belonging to such vote to the aggregate carrying value of all fixed assets in the municipality. However, where it is the council's policy to raise external loans only for the financing of fixed assets in specified council services, finance charges shall be charged to or apportioned only between the votes relating to such services. *[This paragraph merely relates to the allocation of expenses to votes within the statement of financial performance – it does not reflect a deviation from an accounting standard unless a municipality has adopted an accounting policy that requires the capitalization of borrowing costs.]*

Depreciation and finance charges together ought to not exceed 20% of the aggregate expenses budgeted for in the operating budget component of each annual or adjustments budget. *[This is a budgeting issue – it reflects a parameter within which a municipality is to prepare it budgets.]*

The allocation of interest earned on the municipality's investments shall be budgeted for in terms of the banking and investment policy. . *[This item might be significantly affected by the application of the relevant accounting standards – neither the budget policy nor the cash management and investments policy should contradict the content of the municipality's approved accounting policies and the application of the relevant accounting standards.]*

6.1.9 Other Principles Relevant to Operating Component of Annual Budget

The municipality shall adequately provide in each annual and adjustments budget for the maintenance of its fixed assets in accordance with its fixed assets management policy. At least 10% of the operating budget component of each annual and adjustments budget ought to be set aside for such maintenance costs.

[This is a budgeting issue – it reflects a parameter placed on the determination of amounts to be included in a municipality's budget.]

The amount budgeted for salaries, allowances and salaries-related benefits shall be separately determined, and ought to not exceed 40% of the aggregate operating budget component of the annual or adjustments budget. For purposes of applying this principle, the remuneration of political office bearers and other councillors are to be included in this limit. *[This is a budgeting issue – it reflects a parameter placed on the determination of amounts to be included in a municipality's budget.]*

In preparing its revenue budget, the municipality shall strive to maintain the aggregate net revenues from property rates at not less than 25% of the aggregate net revenues budgeted for. *[This is a budgeting issue – it reflects a parameter placed on the determination of amounts to be included in a municipality's budget.]*

When considering the draft annual budget, the council shall consider the impact which the proposed increases in rates and service tariffs will have on the monthly municipal accounts of households in the municipal area. The impact of such increases shall be assessed on the basis of a fair sample of randomly selected accounts. Because households have no mechanism for passing on such increases to other parties, but must fully absorb the increases concerned, the council shall ensure that the average additional impact of such increases is not more than the relevant increase in the consumer price index (CPIX). *[This is a budgeting issue – it reflects a parameter placed on the determination of amounts to be included in a municipality's budget.]*

6.2 Budget related policies

In addition to the matters set out in the budget policy itself the municipality must apply various principles espoused in its budget-related polices. The impact of the most important of these principles on the budget is discussed below.

6.2.1 Rates Policy

The determination of the rate in the rand is directly impacted upon by the level of expenditure budgeted for by a municipality. Whilst legislation specifies how rates revenue is to be determined, Council may vary certain aspects, such as the granting of rebates, of the determination of rates payable in respect of categories of properties and owners of properties. These variations must be taken into consideration when budgeting for rates revenue in addition to the concept of affordability and the Governments MTEF parameters.

In principle, given an unchanged municipal valuation and an absence of additional sources of revenue, the greater the level of expenditure, the greater the required rate in the rand required to generate sufficient rates revenue to fund such expenditure.

6.2.2 Tariffs Policy

The determination of tariffs has a direct impact upon the budget, both from a revenue budget point of view and an expenditure budget point of view. Where there the principle of cost recovery is not embodied in the determination of tariffs one must always consider the source funds, for example grants, rates revenue or interest earned, that are to be applied in funding such expenditure and whether or not such services and or funding sources are sustainable.

The content of this policy should always be applied in determining the revenue budget, however, where tariffs are based upon the cost of providing a service (for example, electricity, water, sewerage, and refuse removal) it is essential that an expenditure budget is prepared first specifying not only the cost of providing such services but also the standard of service to be provided and the quantity of the particular service used or consumed. Numerous factors might impact upon the determination of a tariff, for example, tariffs applicable elsewhere in the economic region and the impact of tariffs on local economic development. Irrespective of the factors involved the tariff should always be determined in terms of the tariff policy and included in the operating budget.

The municipality might specify in its tariff policy that the tariffs levied in respect of the water and electricity services further generate an operating surplus each financial year of 10% or such lesser percentage as the Council of the municipality may determine at the time that the annual operating budget is approved. Whilst this has an impact on the budget through the determination of the revenue from tariffs, it has no impact on the financial performance of a municipality. Such a surplus would be included in the accumulated surpluses of the municipality until appropriated in terms of a future municipal budget. However, caution should be exercised in adopting such a policy as such surpluses might be viewed as a concealed tax.

The municipality should annually review its indigent support programme for the municipal area. This programme should set out clearly the municipality's cost recovery policy in respect of the tariffs which it levies on registered indigents, and the implications of such policy for the tariffs which it imposes on other users and consumers in the municipal region. It is essential that these are reflected in the budget to provide for a full understanding of the cost of the indigent support programme and the source of funding thereof.

In line with the principles embodied in the Constitution and in other legislation pertaining to local government, the municipality may differentiate between various categories of users and consumers in regard to the tariffs which it levies, but such differentiation shall, however, at all times be reasonable and fully disclosed in each annual budget.

A common principle adopted by municipalities is that all minor tariffs are standardised within the municipal region and all such tariffs over which the municipality has full control are annually adjusted in line with the prevailing consumer price index, unless there are compelling reasons why such an adjustment should not be effected. This should always be taken into consideration when preparing a budget.

6.2.3 Cash management and investment policy

This policy will deal with interest earned on investments, and may state, for example, that the interest accrued on all the municipality's investments, shall, in compliance with the requirements of GRAP/GAMAP, be recorded in the municipality's operating account, and thereafter be appropriated to the reserve or account in respect of which such investment was made. In this instance the requirements of the relevant accounting standards (GAMAP 9) have been considered and interest revenue would be correctly reflected in the statement of financial performance as revenue. Budgeting for the appropriation to a reserve or account would be considered in the municipality's statement of net assets.

6.2.4 Fixed Asset Management Policy

This is a prime example of a budget related policy as it should contain a number of aspects that directly relate to the preparation of a budget, these aspects include:

- Capitalisation criteria: material value;
- Capitalisation criteria: intangible items;
- Capitalisation criteria: reinstatement, maintenance and other expenses;
- Maintenance plans;
- Deferred maintenance
- General maintenance of fixed assets;
- Creation of non-distributable reserves (reserves for future depreciation);
- Replacement norms; and

- Insurance of fixed assets.

The fixed asset management policy should also establish the responsibility for determining and complying with the relevant accounting standards relating to fixed assets. The accounting policies adopted by a municipally relating to fixed assets, such as property, plant and equipment, investment properties, and intangible assets, have a significant impact upon the preparation of the budget. Accordingly the following will need to be considered in the budget preparation process:

- Depreciation of fixed assets, including the rate of depreciation and the method of depreciation;
- Amendment of asset lives and diminution in the value of fixed assets; and
- Revaluation of fixed assets.

6.2.5 Other Policies

The National Treasury has recommended that the following policies should also be treated as budget-related policies:

- indigent management policy (if not already covered in the rates and tariffs policies);
- policy on free basic services (if not already covered in the tariffs policy);
- supply chain management policy;
- human resources policy (working of overtime, filling of vacancies, payment of allowances).

It is of critical importance that the municipal budget is reconciled to the municipality's statement of financial performance at the close of each year. This reconciliation will reflect how the short term financial plan (the budget) of the municipality has been implemented and the effect thereof on the financial performance and financial position of the municipality. It provides for the reconciliation of what a municipality "wishes to happen" against what really has happened from a financial point of view.

7. Funding the budget

Specific reference should be made to MFMA Circular 42 issued on 30 March 2007 when considering the funding of a municipal budget. A practical example is included in Annexure A to the circular clarifying the reforms and intent of the MFMA including the following aspects:

- The move to accrual based financial management - implications for funding a budget. MFMA Circular 28 contains guidance in respect of accrual based financial management.
- The distinction between “a balanced budget” and “a funded budget”
- Full disclosure of revenue and cash
- Clarity on “realistically anticipated revenues to be collected” (MFMA section 18)
- Clarity on “funds not committed for any other purpose” (MFMA sections 18 and 19)
- Realistic estimation of expenditure - implications for funding a budget
- Clarity on the concept of a “credible budget” (MFMA section 21)

7.1 Credible Budget

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.

7.2 Balanced budget v funded budget

In the past, municipal budgets have been concerned with demonstrating that a budget is balanced from a funds perspective. That is, funds going out were balanced with funds coming in, plus any funds already held in reserve from previous years. The guidance presented in MFMA Circular 42 requires that the budget should be managed in a full accrual manner reflecting a transparent budget and accounting system approach. The MFMA through section 18 requires that the budget can only be funded by realistically anticipated revenue to be collected and cash-backed accumulated funds from previous years, not committed for other purposes. The use of cash-backed accumulated funds from previous years, not committed for other purposes to financing the budget (although allowed by the Act) is not recommended best practice.

If such accumulated surpluses are used, it means that the current budget becomes uneconomic, because current revenues (raised in terms of current rates and service charges) are not sufficient to cover current expenses. Best practice therefore requires municipalities to ensure at all times that expected cash operating expenses will equal or be less than expected cash operating revenues from current rates and tariffs and other sources.

The capital budget may be funded by cash-backed current year surplus in the Financial Performance budget (operating budget), including capital grants and other contributions, cash-backed accumulated funds from previous years not committed for other purposes, and borrowing.

7.3 Full disclosure of revenue and cash

The intent of the MFMA is for the budget to reflect the full amount of revenue budgeted to be billed, accrued or otherwise levied or revenue directly received (e.g. bus fares and recreation facility admission fees), to ensure that the municipality and other readers of the budget are fully aware of the total revenue contributions by its community and revenue from other sources. Therefore, revenue shown in the Financial Performance budget (operating budget) must be the full amount of revenue to be "raised" or "billed", accrued or otherwise directly received.

Realistically anticipated amounts for the provision for doubtful and bad debts (amounts billed that are not expected to be collected) must be budgeted separately under "expenditure" and not netted out from the "revenue" line. A municipality's revenue policy should provide guidance on the methodology for determining the doubtful/bad debt provision taking into consideration recent collection trends.

For effective budgeting and management of revenues, municipalities must also ensure that the number of consumer accounts is reconciled with property records and metering information to ensure that all consumers are billed appropriately. Full disclosure will enhance policy development, regular financial performance monitoring and improved service delivery.

7.4 Not committed for any other purpose

"Committed for other purposes" implies that there has been a council resolution to allocate the funds for a specific purpose, to be used for a fixed contractual obligation, whether as part of a medium term revenue and expenditure framework or by reserving the accumulated surplus.

Future commitments must be analysed as part of the preparation of the Cash Flow budget to ensure that an accumulated surplus is genuinely cash-backed. The process of determining which part of the accumulated surplus is cash-backed is achieved by analysing the cash resources available to a municipality and the commitment requirements to ensure that sufficient cash and investments are provided as shown in the example contained in MFMA Circular 42 Annexure A.

8. Revision of annual budget

A municipality may revise its approved annual budget through an adjustments budget. Such adjustments budget must adjust the estimates of revenues and expenses downwards if a material under-collection of revenues occurs or is foreseen. An adjustments budget may also appropriate additional revenues which have become available in order to revise or accelerate spending programmes already budgeted for.

An adjustments budget may:

- authorise unforeseen and unavoidable expenses as recommended by the mayor (provided that the budget must be passed within sixty days after the expenses were incurred);
- authorise the transfer of projected savings on one or more votes towards spending on one or more other votes;

- authorise the spending of funds unspent at the end of the previous budget year, but subject to certain conditions; and
- correct any errors in the approved budget.

The MFMA stipulates that an adjustments budget may not increase the property rates, levies or service charges and tariffs imposed in terms of the originally approved annual budget.

The accounting officer must prepare an adjustments budget whenever necessary. However, the Act indicates that adjustments budgets may be tabled only in accordance with prescribed limitations as to timing and frequency.

The accounting officer must submit the prepared adjustments budget to the mayor, who must then consider it, and table it in the council. Only the mayor may table an adjustments budget in the council.

When the adjustments budget has been tabled, the mayor must provide an explanation to the council of how the adjustments budget affects the approved annual budget, the motivations for material changes to the annual budget, and an explanation of the impact of any increases in expenses on the annual budget and on the budgets for the next two budget years.

Although the MFMA allows municipalities to table adjustments budgets when necessary (within prescribed limitations), provision is also made for a compulsory mid-year assessment of the budget.

By 25 January the accounting officer must assess the municipality's performance for the preceding half of the budget year, taking into consideration the monthly statements on the budget, the service delivery performance, service delivery targets and performance indicators set in the service delivery and budget implementation plan, and the previous year's annual report and progress made in resolving the problems identified in such report.

By 25 January the accounting officer must also submit this assessment report to the mayor, the National Treasury and the Provincial Treasury, and must make recommendations on whether an adjustments budget is necessary, and on what revised projections for revenues and expenses are recommended.

On receipt of the assessment report, the mayor must consider the report, check whether the approved budget is being implemented in accordance with the service delivery and budget implementation plans, make the necessary revisions to the service delivery and budget implementation plan, identify actual, impending or emerging financial problems facing the municipality, and submit the report to the council by 31 January.

If the municipality faces serious financial problems, the mayor must promptly respond to and initiate the remedial steps recommended by the accounting officer in the assessment report, including the tabling of an adjustments budget, and alerting the council and the MEC for Local Government to the problems concerned.

9. Community participation

In terms of Chapter 4 of the MSA municipalities are encouraged, and must create conditions for, the local community to participate in the affairs of the municipality, including specifically the preparation of its budget.

For this purpose the municipality is obliged to contribute towards the building of capacity in the local community to enable it to participate in the affairs of the municipality (including, presumably, the annual budget process). To achieve this goal, the municipality must use its resources and annually allocate funds in its budget to the extent appropriate for achieving and implementing the required community participation.

Part of the general community consultation process (not specifically limited to the annual budget) is the requirement that the municipality must provide for:

- the receipt, processing and consideration of petitions and complaints lodged by members of the local community;
- notification and public comment procedures;
- public meetings and hearings by the municipal council and other political structures and political office bearers;
- consultative sessions with locally recognised community organisations and traditional authorities; and
- report back to the local community.

Moreover, the municipality is obliged to establish mechanisms, processes and procedures for community participation (in the municipality's affairs generally, but certainly by clear implication also in the annual budget process) to take into account the special needs of people who cannot read or write; people with disabilities; women; and other disadvantaged groups.

In communicating information about any consultative processes the municipality must also take into account language preferences and usage in the municipal area.

All meetings of the municipal council and its committees must be open to the public, including the media, when such meeting entails consideration of or voting on (among other matters) a budget tabled in the council.

When the municipality notifies anything through the media to the local community it must do so in a local newspaper or newspapers in its area; in a newspaper or newspaper circulating in its area and determined by the council as a newspaper of record; or by means of radio broadcasts covering the area of the municipality. Such notices must be in the official languages determined by the council, having regard to language preferences and usage within the municipal area.

Although this is not a specified legal requirement, municipalities with ward committee structures or sub-council structures would presumably avail themselves of these political committees to facilitate the broad consultative processes surrounding each annual budget.

By the same token, municipalities with partially decentralised regional administrations could use these structures for effective communication to and feedback from the community. This could either be done in conjunction with the political structures or as an ancillary exercise.

10. The service delivery and budget implementation plan (SDBIP)

Whilst the preparation, approval and implementation of SDBIP's falls beyond the scope of this module it is essential that the reader understands its purpose and role within the overall budget cycle. . The SDBIP is discussed in detail in MFMA Circular 13 dated 31 January 2005.

The SDBIP is the quintessential budget management tool in that it measures both compliance with the intended utilisation of allocated budgetary resources and the extent to which performance targets for each vote are achieved by the managers responsible for these votes

The MFMA indicates that an SDBIP entails a detailed plan approved by the mayor of the municipality for implementing the municipality's delivery of municipal services and its annual budget. This plan must indicate:

- projections for each month of revenues to be collected, by source, and operational and capital expenses, by vote; and
- service delivery targets and performance indicators for each quarter.

The MFMA further provides that the accounting officer (municipal manager) must no later than 14 days after the approval of the annual budget submit to the mayor a draft SDBIP for the budget year, and drafts of the annual performance agreements as required in terms of the MSA for the municipal manager and all senior managers. The mayor must then approve the SDBIP within 28 days after the approval of the budget, and must ensure that the annual performance agreements comply with the requirements of the MFMA in order to promote sound financial management, and are linked to the measurable performance objectives approved with the budget and to the SDBIP.

As most of the information required to compile the SDBIP is prepared as part of the process of drafting each annual budget – cash flows, KPIs and performance targets – municipalities should be able to finalise their SDBIPs simultaneously with or immediately after the approval of the budget. If this is done, the municipality can commence with the implementation of its budget immediately at the beginning of the new budget year. An important input into the SDBIP is the performance agreements of the municipal manager and the senior management team.

MFMA Circular 13 provides useful guidelines on the preparation and format of SDBIPs. This circular interestingly describes the SDBIP as a "contract between the (municipal) administration, council, and community expressing the goals and objectives set by the council as quantifiable outcomes that can be implemented by the administration over the next twelve months."

Finally, the aforementioned Circular 13 sensibly stresses the need for ward-based information in the SDBIP. Although the circular refers specifically to information on capital works and service delivery on a ward basis, and on such operating expenditure (including the cost of free basic services and other indigent relief) as can be meaningfully allocated to individual wards, it may also prove useful to have the information on revenue collection (payment levels specifically) available by ward. This could help to mobilise ward councillors and ward committees to assist the municipality in attaining its credit control targets.

NOTE: DATES IN BRACKETS ARE PUTATIVE

FINAL DATE	ACTION BY MUNICIPALITY	ACTION BY MUNICIPAL ENTITY
31 August	Table in council timetable for preparation of coming year's annual budget	-
20 January	-	Assess current year's budget performance and submit report to board of directors and municipality
25 January	Assess current year's budget performance	-
31 January	Table assessment report in council	-
31 January or earlier	-	Submit proposed budget for coming year to municipality
(31 January)	Consider municipal entity's proposed budget for coming year and make recommendations	-
(31 January or earlier)	Table municipal entity's adjustments budget for coming year	Submit adjustments budget for current year to municipality and make budget public
(Between 31 January and 31 March)	Table municipality's adjustments budget for current year and changes to service delivery targets and KPIs	-
(Between 31 January and 31 March)	Make public (adjustments budget and) revisions to service delivery and budget implementation plan for current year	-
Mid-March	-	Submit revised budget for coming year to municipality

FINAL DATE	ACTION BY MUNICIPALITY	ACTION BY MUNICIPAL ENTITY
31 March	Table municipality's draft budget for coming year	-
31 March	Table municipal entity's revised budget for coming year	-
Immediately after 31 March	Make public draft budget for coming year and invite submissions from community, provincial treasury and others	-
Before 31 May	Respond to submissions and revise draft budget for coming year	-
31 May	Consider approval of budget for coming year and attendant resolutions	Approve revised budget for coming year and make budget public
30 June	Budget for coming year and attendant resolutions must be approved by 30 June. Approved budget of entity must be tabled.	-
Early June to early July: immediately after budget approved	Submit budget to national treasury and provincial treasury	-
Early June to early July: immediately after approval dates	Place on website annual budgets and all budget-related documents	-
Mid June to mid July: 14 days after budget approved	Finalise draft service delivery and budget implementation plan and draft performance agreements	-
Late June to late July: 28	Approve service delivery and budget implementation plan	-

FINAL DATE	ACTION BY MUNICIPALITY	ACTION BY MUNICIPAL ENTITY
days after budget approved		
Late June to late July: 28 days after budget approved	Conclude performance agreements	-
Mid July to mid August: 14 days after service delivery and budget implementation plan approved	Make public projections of revenues and expenses for each month of coming year, service delivery targets for each quarter, and performance agreements	-