DEPARTMENT of FINANCE
LEFAPHA LA DITSHELETE
UMNYANGO WEZEZIMALI
DEPARTEMENT van FINANSIES
Office of the Director General ● Kantoro ya Mokaedi Kakaretso
LHhovisi likaMqondisi Jikelele ● Kantoor van die Direkteur-generaal

✉ X115, PRETORIA, 0001

- Fax (012) 315 5045
- ☎ (012) 315 5154
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- ¡ T Pillay
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The Chief Executive Officer
District/Services Council

Sir/Madam

BUDGET: 2000/01 FINANCIAL YEAR

Our vision and our commitment are clear, to build a better life for all our people. This is our course. Sustainable growth and development call for on-going structural transformation of our economy so that we can take advantage of the untapped potential in our midst and the opportunities presented by globalisation. Sustainable growth and development also depend on our ability to overcome the scourge of poverty and the deep inequalities that we inherited.

Minister Trevor Manuel
2000 Budget Speech

SUMMARY

After providing some *background*, this circular:

- Provides guidelines for preparing municipal budgets and financial statements in the light of *demarcation*.

- notifies you of the Minister of Finance’s determination under section 10 of the Local Government Transition Act of *maximum expenditure increases* of 5% for each of the capital, special & trust funds, and operating budgets;

- provides an update on the implementation of *GAMAP*.

- encloses and explains the form that should be used for your *return to the Department of Finance* to record your budgeting decisions (as required in section 10 of the Local Government Transition Act) by <u>31 May 2000</u>;

- provides some *general guidelines* for councils to follow in formulating their budgets; and

- notes some *up-coming changes and legislation*.

BACKGROUND

1. The process of transformation and change, as outlined in the White Paper on Local Government, is rapidly unfolding. This will affect all residents, impact on the places where they live and the services they have access to. Local governments should not lose sight of their pivotal role to provide for basic and effective delivery of services to communities across the country. It is essential that individual municipality's finances are sound at all times to be in a position to discharge this mandate. As part of its responsibility in maintaining macro-economic and fiscal stability, the Department of Finance annually determines aggregate guidelines with regard to the capital and operating expenditure of municipalities.

2. During the 1999/2000 financial year, municipal budgeted expenditure increased by 5,5% representing R58,1 billion (1998/99 R54,9 billion). The budgeted capital expenditure remained unchanged at R13,7 billion while the operating expenditure increased by 8% to R44,4 billion. The 1999/2000 municipal budgets amounted to 10% of GDP. Municipal finances therefore have a significant effect on the national economy.

3. Certain negative trends identified during 1998/99 continued during the 1999/2000 financial year in many municipalities. These included significant increases in administrative and personnel expenditure components, the lack of fiscal and financial discipline and the lack of regular internal reporting on actual financial position. Municipal salaries, wages and allowances still absorb a high percentage of total operating budgets.

4. The Municipal Demarcation Board will be announcing new municipal boundaries, with MEC's allocating the powers and functions to Category B and C municipalities and issuing establishment notices in terms of section 12 of the Municipal Structures Act, 1998 shortly. For many municipalities, implementing the new boundaries and adjusting to the changes to powers and functions will impact on the preparation of budgets and financial statements. They will also have to hold Council elections mid-way through the financial year. This circular provides guidance for preparing budgets and financial statements in light of demarcation and elections.

DEMARCATION

5. Municipalities should prepare their 1999/2000 financial statements for existing structures, timeously ensuring that all assets and liabilities are clearly listed in the accounting records and registers. All outstanding financial statements should be finalised before the municipal elections. The registers should be updated monthly thereafter to ensure all necessary information will be available for demarcation implementation later in the year.

6. Municipalities should prepare their 2000/2001 budget based on the 12 months to 30 June 2001 and on existing municipal boundaries. Whenever possible, this budget should be compiled in a format that will facilitate the transition to the newly demarcated municipalities and thereafter, the consolidation of figures. Thus a "holding" budget approach is recommended.

7. Unless your municipality is unlikely to be affected by demarcation, your 2000/2001 budget should primarily be a maintenance budget with no major commitments to new programmes, capital projects or debt obligations. Major new initiatives should be left to the new Councils, which will be elected later in the year.

8. For those municipalities that have already made substantial progress towards amalgamation and institutional reforms, a longer-term focus may be taken in preparing budgets and Councils may also plan to make major revisions to the 2000/2001 budget around January/February 2001 after the new Councils take office.

9. For practical and accountability purposes, as soon as the new Council is elected later in the year, the new Council should consider and approve the existing budgets with minor changes. This will give municipalities sufficient time to begin preparation of the 2001/2002 budgets, taking into account the new Councils' plans and priorities.

10. Municipalities should take advantage of the current information available on demarcation to begin negotiations and consolidation plans with neighbouring municipalities they may amalgamate with. This will assist them to obtain the necessary resources and achieve the necessary consensus with regard to, for example, the allocation of assets and liabilities. Special preparations will be necessary when a municipal area is divided into two or more separate new municipalities.

11. The 2000/2001 financial statements should be prepared on a similar basis as the budget. That is for the full financial year based on existing boundaries, and consolidated thereafter into the newly demarcated structure. For accountability purposes the individual financial statements will be subject to audit by the Auditor-General. A clear audit trail should be documented for the consolidation. The chief executive officer/municipal manager as at 30 June 2001 will remain responsible for timeously obtaining the individual financial statements to be consolidated. The compilation of individual financial statements and the consolidation thereof should be properly planned beforehand as to not cause undue delays. For purposes of the disclosure in the consolidated income statements, a consolidated budget document, which includes the amendments made by the new Council, should be compiled and linked to the individual approved budgets and amendments in a clear manner.

12. On a cautionary note, salary scale increases, promotions, filling of vacant posts and councillor allowance increases should be cautiously undertaken, if at all, during the period leading up to the elections, with due consideration of budgetary constraints and affordability for the newly demarcated municipalities. Higher increases than the announced 5% in these components will be viewed in a serious light and will be understood to mean that communities serviced by the municipality have access to adequate infrastructure. The Auditor-General will be requested to report on any misuse of funds in this regard.

GAMAP IMPLEMENTATION

13. As most municipalities are aware, a new accounting standard, Generally Accepted Municipal Accounting Practice has been developed for South African local governments. The Department or the to be established Accounting Standards Board will soon set guidelines for GAMAP implementation. Once the guidelines have been established, the Auditor- General will prescribe a new format for financial statements. Our goal is to assist municipalities with full implementation of GAMAP beginning with the 2001/2002 financial year.

14. A number of municipalities have prematurely begun to implement GAMAP, and some have proposed taking advantage of GAMAP to inflate surpluses due to the write-down in statutory fund balances and reversal of excessive provisions. It should be noted that when GAMAP is introduced, there may need to be possible write-offs of irrecoverable debtors' balances and other costs. It is planned that the write-down in statutory fund balances and the reversal of excessive provisions will be used to offset these costs.

15. Therefore, the Department recommends that, although municipalities should prepare for implementing GAMAP, they should continue to prepare financial statements in the currently prescribed formats. Complete asset registers, for example, should be prepared in advance of the implementation of GAMAP.

MAXIMUM EXPENDITURE LIMITS

16. Under section 10(G)(4)(b) of the Local Government Transition Act, Act no 209 of 1993, the Minister of Finance may determine maximum expenditure limits for the budgets or components of such budgets of municipalities for a financial year.

17. In order to maintain macro-economic stability, the Minister of Finance has set the guideline growth rate increases for local government for the 2000/2001 financial year at 5%.

18. It must be emphasised that the Minister of Finance determines overall maximum expenditure limits for local governments in order to fulfil his task of managing the economy and maintaining fiscal stability. Local governments should operate within these limits.

19. Local governments that can succeed in limiting their expenditure to a level less than the prescribed guidelines should not refrain from doing so out of fear that it will impede their growth in the 2001/2002 financial year. Under appropriate circumstances, and considering the impact of the new structures, the levels of expenditure calculated on the guideline growth rates for 2000/2001 will be used as a base to determine the limits for the 2001/2002 financial year.

20. Under exceptional circumstances an increase above 5% may be considered, provided that –

    (a) reasons for the excesses are advanced, fully explaining and motivating the request;

(b) the continuation and expansion of essential services on a sustainable basis are thereby promoted; and

(c) an unreasonable financial burden is not placed on the inhabitants.

21. Projects intended for the improvement of previously disadvantaged areas, the creation of infrastructure for the provision of essential services, the urbanisation process, housing development and the provision of facilities to provide for community and welfare needs, will be considered.

Operating Budget (Maximum 5% Increase)

22. The *relevant* operating budget consists of all operating expenditure.

23. The relevant operating expenditure limit for 1999/2000 and the realistically projected income receivable will be used as the basis for the determination of the 5% expenditure limit for 2000/2001. In other words, the relevant operating budget for 2000/2001 should not be more than 5% above the expenditure limit for 1999/2000 taking cognisance of the income collected by council during this period. It is appreciated that extraordinary rapid development will result in greater demands, but resolute steps should be taken to accommodate the operating commitments within the parameters of the 5% limit.

RETURN TO THE DEPARTMENT OF FINANCE

24. According to section 10(G)(4)(c) of the Local Government Transition Act, No 209 of 1993, a council's budget shall be submitted to the Minister of Finance within 14 days from the adoption thereof by the Council for the purpose of monitoring whether the maximum expenditure limits have been complied with.

25. As described below, the return should be submitted to the Department of Finance before 31 May 2000. Since the Department is not empowered to grant extensions, should it prove to be impossible to meet this deadline, please notify the Department and advise when the submission can be expected. This should be as soon as possible after 31 May. Please notify the Department immediately if your planned timetable changes and will delay the preparation of the budget.

26. The attached schedule must be completed as fully and as accurately as possible as part of the return and sent to the Department of Finance, together with one copy of your Council's budget. You are also requested to submit a copy of your Council's budget to the provincial department responsible for local government for information purposes.

27. All expenditure to be incurred during the 2000/2001 financial year should be included in the return, *irrespective of the source of finance or whether it has been included in a previous budget*. Expenditure financed by grants/contributions received from other government departments, town developers and members of the public, must therefore also be included in the budgets. Funds for capital expenditure received from the above sources should be reflected under the capital budget and not as income under the operating budget.

28. To expedite the evaluation and finalisation of the budget, care must be taken to ensure that the return form is completed in full and where required, is supplemented by explanations and such additional information as may be of assistance. The motivation should include specific projects that provide evidence of re-prioritisation.

29. Section 10D(1)(b)(i) of the Local Government Transition Act, No 209 of 1993, states that the Province must provide sufficient funding in cases where the Province devolves functions, therefore, written consent should be obtained before any functions are accepted.

30. It will be appreciated if you indicate briefly the reasons for increases and decreases in the 2000/01 expenditure and revenue headings compared with the budget for 1999/2000 as determined by the Department of Finance.

REGIONAL FUNCTIONS (section 12(6)(a))

31. Kindly ensure that the expenditure (and income) shown under section 12(6)(a) refer to functions that have been entrusted to the Council by the Premier in terms of **section 3(1)(b) of the Regional Services Councils Act, 1985**.

32. Contra entries for bulk services must be excluded for budget purposes. Should there be a need for this information it can be disclosed by way of a note to the financial statements.

33. Regional functions classified as trade - or economic services should, as far as possible, be operated in such a way that the costs thereof are recovered in full by means of tariffs. With regard to other regional functions, cost reflective tariffs should be introduced in the delivery of these functions. Councils must also consider the option of PPP’s in the provision of services.

LOCAL BODIES (section 12(6)(b))

34. The maximum expenditure limits is not directed towards capital infrastructure where the greatest need exist.

35. You are requested to submit a detailed progress report on all projects carried forward from previous years. Reasons must also be provided why projects that were not started by 31 March 2000 are carried forward.

36. In determining priorities, the focus must be towards capital infrastructure development projects where the greatest need exist.

37. The following important issues should also be considered in determining priorities:

    - Affordability: The effect that increases in tariffs will have on industry, commerce in general and the residents within the municipal boundaries.

    - Sustainability: The Council must ensure that mechanisms will be in place which results in effective metering, billing, cost recovery and credit control.

38. Details of allocations to local bodies must be submitted together with the budget. A total amount will, however, be evaluated for section 12(6)(b) expenditures and your Council may effect changes, in accordance with regulation 7(1) of the Financial Regulations, during the financial year at its own discretion, provided that the maximum amount is not exceeded.

39. It is essential that the assets of municipalities be adequately maintained, since the neglect of assets leads to further capital spending on upgrading and replacement. Councils can make an important contribution to ensure that assets are maintained to the benefit of the community concerned. An appeal is again made to your Council to pay special attention to the maintenance of infrastructure in underdeveloped areas when funds are apportioned.

ADMINISTRATION (section 12(6)(c))

40. The Council should take active steps to restrict to a minimum the costs resulting from the collection of the levies and the administration of the Act. Council's should also exercise strict financial discipline in respect of its own operating transactions and **<u>will be limited to the growth rate of their levy income with a maximum growth of 5%</u>**. This restriction is in accordance with the fiscal strategy of the Government to contain recurrent expenditure. However, this rate is not directed towards expenditure items such as capital costs on project loans and contributions to reserve funds, which have been separated from the normal operating expenditure in part D of the return.

COMMUTER TRANSPORT (section 12(6)(d))

41. Expenditure relating to the transport of commuters should be allocated in terms of section 12(6)(d) of the Regional Services Councils Act, irrespective of whether this function has been entrusted to your Council. Such expenditure includes allocations to local bodies for the financing of taxi stands and bus termini for example.

OTHER (section 12(6)(e))

42. Other expenditure to be incurred in terms of section 12(6)(e) and which the Minister must consider, after consultation with the Premier, should be motivated in full. All factual information in respect of section 12(6)(e) allocations, together with reasons for the Council's decision to give preference to the appropriation of funds for other purposes than those provided for in paragraphs (a) to (d) of subsection (6), should be furnished.

TARIFFS AND BREAKDOWN OF RECOVERABLE COST

43. Full details regarding the following should also be submitted:

- The tariff structure charged to business, commerce, industry and householders, as well as a breakdown of recoverable cost relating to economic services (where the tariffs are fixed in such a way that the full cost of providing the service may be recovered without a profit or loss), trading services (where the tariffs are fixed in such a way that the provision of the service should yield a trading profit) and general services.

- The number of staff in each cost centre and the related cost.

GENERAL GUIDELINES

44. The following important issues should also be taken into consideration when compiling the budget:

    - Affordability: The effect that increases in tariffs will have on industry, commerce in general and the residents within the municipal boundaries.
    - The effect of non-payment on potential income: Despite notice of this matter in previous communications, many municipalities still maintain that 100% of income will be realised. It is suggested that this assumption be reconsidered in the light of trends experienced in the previous year. The Council must ensure that mechanisms are in place that will result in effective metering, billing, cost recovery and credit control.

45. Councils are strongly advised to secure the necessary sources of funding before finalising their budgets.

46. In order to assist municipalities in addressing the backlog in service delivery, given the financial constraints, Councils should seriously review their activities in terms of their core areas of competency and encourage the involvement of the private sector in performing certain functions.

47. Local Government in general must improve the system of regular internal and external reporting. In order to properly account for its responsibilities to the community, audited financial statements should be presented timeously. The introduction of benchmarks, to compare the outputs of one municipality against another should be undertaken. Improvements in the level of services that lead to improved economies of scales and generally benefit the public must be vigorously pursued. It is also important that Councils regularly inform their communities on progress.

48. Disturbing trends have been noted in the previous financial year regarding increases in general administration and salary components. It is advised that Councils exercise extreme caution when these components are considered so as not to hinder development and prejudice the financial viability and sustainability of local government.

UP-COMING CHANGES AND LEGISLATION

49. The Local Government Finance Management Bill is now in the final drafting stage. Current plans are to publish the Bill in April/May and then hold several workshops for stakeholder input. The overall approach of the Bill is to enable managers to better manage their jurisdictions by requiring standard accounting practices, a clear and transparent multi-year budget process, and simplified reports (requiring only information they should already be using to manage their organisations).

50. The National Government's 2000 Budget provides for two new conditional grants. A restructuring grant will assist eligible municipalities whose financial status are of such a scale that they pose a significant threat to national economic development. The grant will be funded from the additional local government allocation in the 2000/01 Budget framework. The total envelope for the restructuring grant will be R300 million in 2000/01, R350 million in 2001/02 and R400 million in 2002/03.

51. The other new grant is for financial management capacity. The first stage of this programme will focus on building the financial management capacity of the metros and district councils, as well as the implementation of impending budget reforms. In the second stage of the grant programme, planning and performance management capabilities will be built upon the financial management capacity developed in stage one. The proposed allocation is R50 million for 2000/01, R60 million for 2001/02 and R70 million for 2002/03. Conditions for eligibility can be extracted from the Division of Revenue Bill 2000. More details regarding these and other grants will be provided in a separate circular soon.

CONCLUSION

52. In conclusion, I wish to emphasise that the information called for is required to enable the Department of Finance to perform its responsibilities with regard to the co-ordination and maintenance of macro-economic stability in the country. It remains the responsibility of each Council to determine its priorities and to pro-actively manage its funds throughout the fiscal year, provided that the limits, as determined, are not exceeded.

53. This circular must be brought to the attention of your Council.

Yours faithfully

DEPUTY DIRECTOR-GENERAL: BUDGET OFFICE