national treasury
Department:
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REPUBLIC OF SOUTH AFRICA

# GUIDELINES FOR COSTING AND BUDGETING FOR COMPENSATION OF EMPLOYEES

FOR THE PREPARATION OF EXPENDITURE ESTIMATES FOR THE 2015 MEDIUM TERM EXPENDITURE FRAMEWORK (MTEF)

National Treasury

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# 1 INTRODUCTION

1.1 The purpose of these guidelines is to provide guidance to institutions on costing and budgeting for compensation of employees (COE).

1.2 The 2012 wage agreement is coming to an end in 2014/15 financial year. Negotiations for a new wage agreement are expected to commence during 2014. The outcome of these negotiations cannot be known in advance. Nevertheless, government must begin planning for the next three year spending window and compensation budgets account for the largest share of spending. In the absence of certainty, government will continue to plan budgets on the assumption that cost of living adjustments will track CPI projections. This does not imply any attempt to pre-empt the outcome of negotiations; it is a neutral assumption on which to proceed in constructing medium-term expenditure baselines.

1.3 That said, budget institutions should take note that there will be very limited scope to augment resources to support wage increases that are higher than budgeted for. In previous budget cycles significant resources were available above the baseline to accommodate unanticipated wage pressure. This included drawdowns on the contingency reserves and other additions to baseline. Given current fiscal constraints, scope for the provision of additional resources will be very limited.

1.4 Institutions will, therefore, need to reprioritise from existing baselines and manage headcount growth to respond to above-inflation wage pressures over the next three years, particularly if negotiations result in an outcome that deviates significantly from CPI. Institutions are urged to pro-actively manage their personnel establishments and take action to reduce costs associated with promotions and progression over the medium term.

1.5 As in previous years, institutions in all sectors must achieve value for money and control growth in personnel expenditure. Institutions must cost and budget realistically for all compensation expenditures. Moreover, careful consideration should be given to the filling of funded vacancies and the potential to utilise available resources to finance future compensation pressures.

# 2 BASIC COSTING PROCEDURES

2.1 Institutions are expected to continue to budget for compensation of employees within their existing baselines. Institutions must ensure alignment between compensation of employees budgets and personnel headcount. Where MTEF baseline budgets are clearly inadequate to maintain personnel headcount, institutions must rectify this and reflect it in budget submissions. Budget submissions that do not comply with this requirement will be referred back to institutions by the relevant Treasury.

2.2 The 2015 MTEF indicative baseline does not provide for general funding of new posts, except in cases where departments were specifically allocated funding to create new critical posts in the 2014 Budget. Funding for employment of personnel over and above already agreed funded establishments will be considered only where critical skills are required and where mandates and functions are expanded as a result of factors such as macro organisation of the state. This must be properly motivated to the relevant Treasury. In most instances, these allocations will need to be financed by reallocated resources from funded vacancies or elsewhere within the institution's baseline.

2.3 Effective management of work that is outsourced to consultants is also important. Consultants should not be required to do work that should be done by staff employed within institutions. That is, all personnel in institutions should be fully utilised to avoid unnecessary use of consultants.

2.4 Institutions should ensure that the following are taken into account when budgeting for compensation of employees:

- Ministerial determinations;
- Public Sector Co-ordinating Bargaining Council (PSCBC) agreements;
- Cabinet decisions relating to remuneration and personnel management matters, including decision on Youth Employment Accord requiring the upscaling the implementation of internships, learnerships and artisans development in the public service departments (i.e. annual target of 5% of staff establishment); and
- Section 30 of the Skills Development Act.

2.5 The personnel sheet of the 2015 MTEF database provides two separate panels: one to estimate costs of filled posts and the other for vacant funded posts. The sum of these two elements should be equal to the *revised estimate* for the compensation of employees' baseline.

2.6 To cost personnel budgets the projected annual cost of filled posts as at end of June 2014 plus cost of vacant funded posts to be filled for the remainder of the financial year should be used as a base for projections over the MTEF. This is the *revised estimate* for 2014/15 as at the end of June 2014.

2.7 Revised estimate figures need to be generated *per item of payments per salary level* within the COE line item to allow for application of the different dispensations such as Senior Management Service (SMS) and Occupation-Specific Dispensations (OSDs). For instance, the COE line item is composed of items of payments such as basic salary, pension, overtime, performance bonus[1], medical allowances, etc.

2.8 Actual expenditure figures on filled posts must be generated from PERSAL for each item of payments for SMS and non-SMS employees, respectively. Costs of posts to be filled for the remainder of the financial year, as well as financial implications of promotions and demotions, should be generated from departmental Human Resource Management (HRM) plan.

2.9 To generate COE costs over the MTEF, the revised estimate for 2014/15 financial year for each item of payments should first be increased by the cost of living adjustment *escalation factors* applicable to each fiscal year. This operation yields the cost of personnel taking account of cost of living adjustment (COLA), which in this case is projected to equal inflation. These escalation factors are shown in the table below.

[1] Institutions should ensure that performance bonuses constitute a maximum of 1.5% of annual remuneration budget as per remuneration policy.

**TABLE 1: COLA ESCALATION FACTORS**

| PAYMENT ITEM | 2015/16 | 2016/17 | 2017/18 |
|---|---|---|---|
| Basic salary (non SMS) | 5.6% | 5.5% | 5.0% |
| Basic salary (SMS) | 5.6% | 5.5% | 5.0% |
| Housing allowance | 0% | 0% | 0% |
| Overtime | 5.6% | 5.5% | 5.0% |
| Employer contribution: Medical | 5.6% | 5.5% | 5.0% |
| Employer contribution: Pension | 5.6% | 5.5% | 5.0% |
| Performance bonus | 5.6% | 5.5% | 5.0% |
| All other | 5.6% | 5.5% | 5.0% |

2.10 Having applied escalation factors to the baseline to yield the wage bill cost per item, *progression factors* are then applied to the results of the previous operation. This operation yields the wage bill cost per item of payments with escalation and progression factors. The 2012 wage agreement has extended the qualifying period for progression for first time participants from 12 to 24 months. Thereafter, employees qualify for progression annually. Note that, progression rates differ according to the remuneration policies in different sectors. The following are progression rates applicable to each of the sectors:

a) Education: 1% every year;

b) Correctional Services: 3% every other year;

c) Police: 4% every three years;

d) Defence: 4% every two years; and

e) All other sectors: 1.5% every year.

2.11 Progression rates applicable to each of the sectors are divided by the applicable number of years to yield *effective progression factors*[2] for each year. The following table shows the annual effective progression factors to be applied to each item of payment. Note that progression does not apply to housing and medical allowances, bargaining chamber contributions or Unemployment Insurance Fund contributions.

**TABLE 2: EFFECTIVE PROGRESSION FACTORS (APPLIED TO EVERY YEAR OF THE 2015 MTEF)**

| PAYMENT ITEM | ALL OTHER DEPARTMENTS | PROVINCIAL EDUCATION | SAPS | DEFENCE |
|---|---|---|---|---|
| Basic salary | 1.5% | 1.0% | 1.3% | 2.0% |
| Overtime | 1.5% | 1.0% | 1.3% | 2.0% |
| Employer contribution: Pension | 1.5% | 1.0% | 1.3% | 2.0% |
| Performance bonus | 1.5% | 1.0% | 1.3% | 2.0% |
| Other items | 1.5% | 1.0% | 1.3% | 2.0% |

2.12 Having applied escalation and progression factors, the third element is to apply a personnel *headcount growth factor*. This operation yields the total wage bill cost per item of payments with escalation, progression and personnel growth factors. Headcount growth must be kept to a minimum, but where headcount growth is built into the 2014 MTEF baseline this should

[2] Institutions are urged to manage their staff establishments to ensure that all costs of progression (both notch and grade progression for OSD and non-OSD employees) are met within the effective progression factors provided in Table 2.

be reflected. Any planned headcount growth to fill critical posts over and above that built into the 2014 MTEF baseline should be explicitly approved by the relevant Treasury. In most cases increases in personnel with critical skills will be funded through reprioritisation from less critical areas.

2.13 In summary, to generate personnel costs for the 2015/16 financial year, the following computational procedures must be followed:

**A**: Take revised estimate for 2014/15 per item of payments as at 30 June 2014

**B**: Multiply each payment item in (A) by the applicable cost of living adjustment rates for 2015/16 given in Table 1. Add the results to each payment item respectively.

**C:** For each item of payment, multiply the result obtained in B by the applicable effective progression rate as given in Table 2. Add the results to each payment item respectively

**D:** For each item of payment, multiply the result obtained in C by the headcount growth factor for 2015/16. Add the results to each payment item respectively

**E:** Add together all the item of payment to generate the 2015/16 revised baseline.

**F:** Use the new baseline obtained for 2015/16 (using steps B to E to calculate 2016/17. Then use the new 2016/17 baseline to calculate 2017/18.

2.14 An excel based costing and budgeting tool is provided on the National Treasury website[3] to assist institutions with costing of personnel budgets. The tool is built to allow ease of application of the five steps described above and should be used to cost both filled and vacant funded posts to be filled.

## 3 OTHER COSTS TO BE TAKEN INTO ACCOUNT

3.1 In addition to the basic costing procedure, institutions should take account of relevant policies, Ministerial Determinations and Cabinet decisions for items not specifically covered in section 2 above.

3.2 Furthermore, institutions affected by PSCBC resolutions should apply the following costing procedures for items covered in the 2012 wage agreement:

a) For *long service recognition* falling under the age cohorts prescribed by the 2012 wage agreement, costs should be calculated by taking the projected number of qualifying employees and multiplying them by the long service recognition monetary amount. This should be done for each of the years over the 2015 MTEF. For costing and budgeting purposes, the following amounts (as published by the DPSA and applicable to the 2014/15 financial year) should be increased by projected inflation for each of the years over the 2015 MTEF:

i. 20 years continuous service: a cash award of R8,371

ii. 30 years continuous service: a cash award of R16,743

iii. 40 years continuous service: a cash award of R22,324

[3] www.treasury.gov.za/publications/guidelines

b) For *night shift allowance*, an amount of R4 per hour is applicable from 1 July 2014. For budgeting purposes, this figure should be adjusted by projected inflation for each of the financial years of the 2015 MTEF. The new night shift allowance rate should be multiplied by the projected number of people qualifying for such an allowance for each of the financial years over the 2015 MTEF.

c) Housing allowance remains at R900.00 per person per month for each of the years over the 2015 MTEF.

d) For improved qualifications, institutions should budget for 10% of employee salary notch, limited to notch 1 of Salary Level 8. This should be applied to projected number of employees that are likely to qualify.

3.3 The 2015/16 and 2016/17 revised baseline arrived after taking account of section 2 and 3 of this document should be equal to the budget baseline from the 2014 MTEF. Where this is not the case, the institution must reprioritise its budget to ensure that all projected personnel costs are funded.

# 4 COMPLETING THE PERSONNEL SHEETS FOR 2015 MTEF DATABASE SUBMISSIONS

4.1 The personnel sheet for departments has been broken up into two separate panels. The first panel concerns *filled posts*. The total cost of filled posts for each of the financial years is compared with the baseline budgets to assess the adequacy of budgets to sustain filled posts over the MTEF.

4.2 The second panel provides for a costing of *funded vacant posts*. This should only be used where budgets are adequate to sustain filled posts and allow for and sustain the filling of new critical vacant posts. Departments should ensure that where funds are available to fill vacant funded posts in one financial year, adequate funds are also available over the MTEF to sustain posts to be filled[4]. In this case, departments should show how available funding will be used to fill posts at various salary levels for each of the financial years. The same costing procedures described in these guidelines apply to vacant funded posts.

4.3 Only filled posts or vacancies that are funded should be included in the expenditure estimation process. Unfunded vacancies are not budgeted for. Data mismatches and discrepancies between PERSAL and budget systems mean that PERSAL cannot be solely relied upon to quantify the vacant funded posts. Posts that have no matching funds available in budgets must be considered to be unfunded, even if they are tagged as funded on the PERSAL system. Filling such posts without appropriated funding would give rise to unauthorised expenditure.

4.4 The excel-based *personnel costing and budgeting tool* posted on the National Treasury website[5] can assist institutions in assessing the value and average quantity of vacant funded posts. Instructions on how to use the tool are included in the spreadsheet. The tool can be

[4] For instance, where costing information reveals that there are adequate funds in 2015/16 to fill critical vacant funded posts but those funds are not available for the rest of the MTEF period, posts identified in 2015/16 are effectively unfunded as they cannot be sustained. That is, decisions to fill critical vacant funded posts should be made within the context of the MTEF and should fulfil the principle of sustainability.

[5] www.treasury.gov.za/publications/guidelines

used during the budget process before the beginning of the financial year to measure the value of funds available to fill critical vacant funded posts. It can also be used during the financial year to reconcile the personnel budget with expenditure and Human Resource information on posts that are funded and available to be filled.

4.5 In cases where budgets are inadequate to sustain filled posts, plans on how the department intends to deal with the shortfall should also be shown in the second panel on vacant posts. In the first instance, departments must explore whether their staff establishments can be rationalised (by not filling posts that become vacant, for instance) to ensure that they remain within the baseline.

4.6 Where this is not possible, departments should explore reprioritisation of funds from personnel budgets allocated in less critical areas in other programmes within the department. Where the latter is also not possible, departments should explore reprioritisation of funds from identified areas of savings from other line items within their baseline budgets.

4.7 The sum of costed budgets contained in the first and second panel should be equal to the 2014 baseline personnel budget and the figures in the summary personnel budget sheet. Where funds have been reprioritised towards COE, the sum of the two panels should still be equal to the figures in the summary personnel budget sheet. Where misalignment is identified by the relevant Treasury, resubmission will be required.

4.8 Guidelines for completing the Personnel sheet of Public Entities are included in the "technical Guidelines" sheet in the database.