2011-2012 ADJUSTMENT BUDGET REPORT

28 FEBRUARY 2012

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PROPOSED 2011/2012 ADJUSTMENTS BUDGET

1. PURPOSE OF THE REPORT

To seek approval from the Council on the adjustments proposed to the 2011/2012 Original Operational and Capital Budget.

To set out the options available to MCLM to fund the adjusted capital budget and to improve the municipality's cash flow position.

2. LEGISLATIVE BACKGROUND

2.1 Section 28 of the Municipal Finance Management Act, 2003 (MFMA) allows a municipality to revise its approved annual budget through an adjustments budget.

An adjustments budget –

1. Must adjust the revenue and expenditure estimates downwards if there is a material under-collection of revenue during the current year;
2. May appropriate additional revenues that have become available over and above those anticipated in the annual budget, but only to revise or accelerate spending programmes already budgeted for;
3. May, within a prescribed framework, authorise unforeseeable and unavoidable expenditure recommended by the mayor of the municipality;
4. May authorise the utilisation of projected savings in one vote towards spending under another vote;
5. May authorise the spending of funds that were unspent at the end of the past financial year where the under-spending could not reasonably have been foreseen at the time to include projected roll-overs where the annual budget for the current year was approved by the council;
6. May correct any errors in the annual budget, and
7. May provide for any other expenditure within a prescribed framework.

2.2 Only the Mayor may table an adjustments budget in the municipal council. When an adjustments budget is so tabled it must be accompanied by-

1. An explanation of how the adjustments budget affects the annual budget;
2. A motivation of any material changes to the annual budget;
3. An explanation of the impact of any increased spending on the annual budget and the annual budgets for the next two financial years;
4. Any other supporting documentation that may be prescribed.

3. EXECUTIVE SUMMARY

The application of sound financial management principles for the compilation of the municipal's financial plan is essential and critical to ensure that the City remains financially viable and that municipal services are provided sustainably, economically and equitably to all communities.

The adjustment budget is based on the Cash flow Turnaround Strategy where implementation of effective financial management is crucial. Appropriate funds were transferred from low- to high-priority programmes so as to maintain sound financial stewardship. A critical review was also undertaken of expenditures on non-core and 'nice to have' items. **Key areas where savings were realized were on vacant posts the decision of the Executive Management is that there should be a moratorium on all non-core vacant posts, rental trucks, contract services, lease of IT equipment, legal costs, other expenditures and repairs & maintenance**.

The City will continue with its revenue enhancement project on implementing a range of revenue collection strategies to optimize the collection of debt owed by consumers. Furthermore, the City will implement various customer care initiatives and develop incentives to encourage debtors owing more than 90 days to ensure collection of the revenue due to the municipality.

The main challenges experienced during the compilation of the 2011/2012 Adjustment Budget can be summarised as follows:

- The need to reprioritise projects and high expenditure rate within the existing 2011/2012 Budget Adjustment resource envelope given the cash flow realities and declining cash position of the municipality;
- The on-going growing of debt book of the municipality ;
- Aging, inadequate and limited resources for maintenance of water, sanitation, roads and electricity infrastructure;
- The increased cost of bulk water and electricity (due to tariff increases from Rand Water and Eskom), which is placing upward pressure on service tariffs to residents. Continuous high tariff increases are not sustainable - as there will be point where services will no-longer be affordable;
- Affordability of capital own funded capital projects – original allocations had to be reduced during the current year's adjustment budget and needed to be factored into the next financial year (2012/2013) process which will be still a challenge.

In view of the aforementioned, the following table is a consolidated overview of the proposed 2011/12 Adjustment budget:

Table 1 Consolidated Overview of the 2011/12 Adjustment Budget

R thousand	**Original Budget 2011/12**	**Proposed Adjustment Budget 2011/12**
Total Operating Revenue excluding capital transfers	1,488,011,028	1,546,029,359
Total Operating Expenditure	1,374,612,048	1,663,896,050
Surplus(/Deficit) before Capital Contribution	**113,398,980**	**(117,866,692)**
Total Capital Expenditure	**226,212,770**	**176,951,393**

Total operating revenue has grown by 4 per cent or R58 million for the 2011/12 adjustment budget when compared to the 2011/12 original budget.

Total operating expenditure for the 2011/12 Adjustment Budget has been appropriated at R1,663 billion and **translates into an operating budgeted deficit of R118 million**. **This operating deficit is a non-cash deficit due to depreciation of about R209 million.** MFMA Circular no.55 states that "there is no legal requirement that the operating budget (i.e. the Financial Performance Budget as reflected in **Tables B2, B3 and B4)** of a municipality must be balanced or be in surplus"). Furthermore MFMA Circular no.58 of the 2012/2013 Budget preparation states that, in preparation for 2012/2013 budget municipalities that have chosen the 'revaluation model' when implementing GRAP 17 must exclude the depreciation resulting from the revaluation of PPE when preparing their budgets and calculating any tariff increases. Mogale City when implementing GRAP 17 in 2008/09 financial year used the 'revaluation model' and subsequent to that used 'cost model' moving forward.

Section 18 of the MFMA requires that the budget must be funded from realistically anticipated revenues to be collected; cash-backed accumulated funds from previous years' surplus not committed and borrowed funds but only for capital projects. **Tables B7 and Table B8** provide the information required to evaluate whether Mogale City's operating and capital budgets are funded or not.

Table B7 Adjusted Budgeted Cash Flow shows how the operations are expected to impact on its cash position. If a municipality's cash position at year end is **negative** it is a strong indication that the overall budget is not funded. The cash position for Mogale City's cash position at year end **predicts a surplus of R160k**.

Table B8 Cash Backed reserves/ accumulated surplus reconciliation shows whether the municipality has "cash-backed accumulated funds from previous years' surpluses not committed for other purposes' that can be used to fund a deficit on the Financial Performance Budget or to fund 'internally generated funds' on the Capital Budget.

The adjusted capital budget of R177 million for 2011/12 is 22 per cent lesser when compared to the Original Budget**. The decrease is due to financial constraints experienced by the municipality currently, thus a decision was taken that all own funded capital budget projects** be adjusted to nil expect trading services projects and projects already committed or spent. **Only R66 million** from operating revenue will be used to fund capital budget. **Own funding contributes 38 per cent of adjusted capital expenditure**, when government grants and transfers are included.

Operating Revenue Framework

For Mogale City to continue improving the quality of services provided to its citizens it needs to generate the required revenue. In these tough economic times, strong revenue management and stringent expenditure management is fundamental to the financial sustainability of every municipality. The reality is that we are faced with development backlogs, growing debt book, over commitments in terms of expenditure and poverty. **The expenditure required to address these challenges will inevitably always exceed available funding; hence difficult choices had to be made in reducing some line items and balancing expenditures against realistically anticipated revenues.**

Chart 1: Adjusted Main operational revenue categories

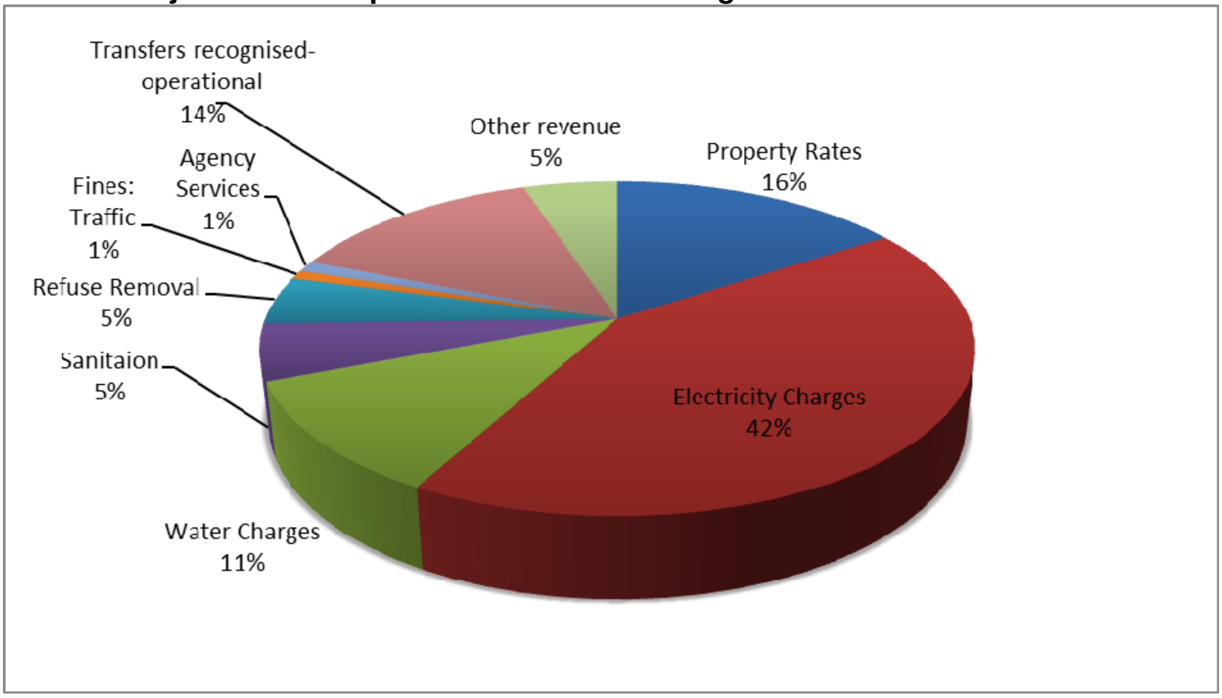


Chart 2: Adjusted main operational expenditure categories

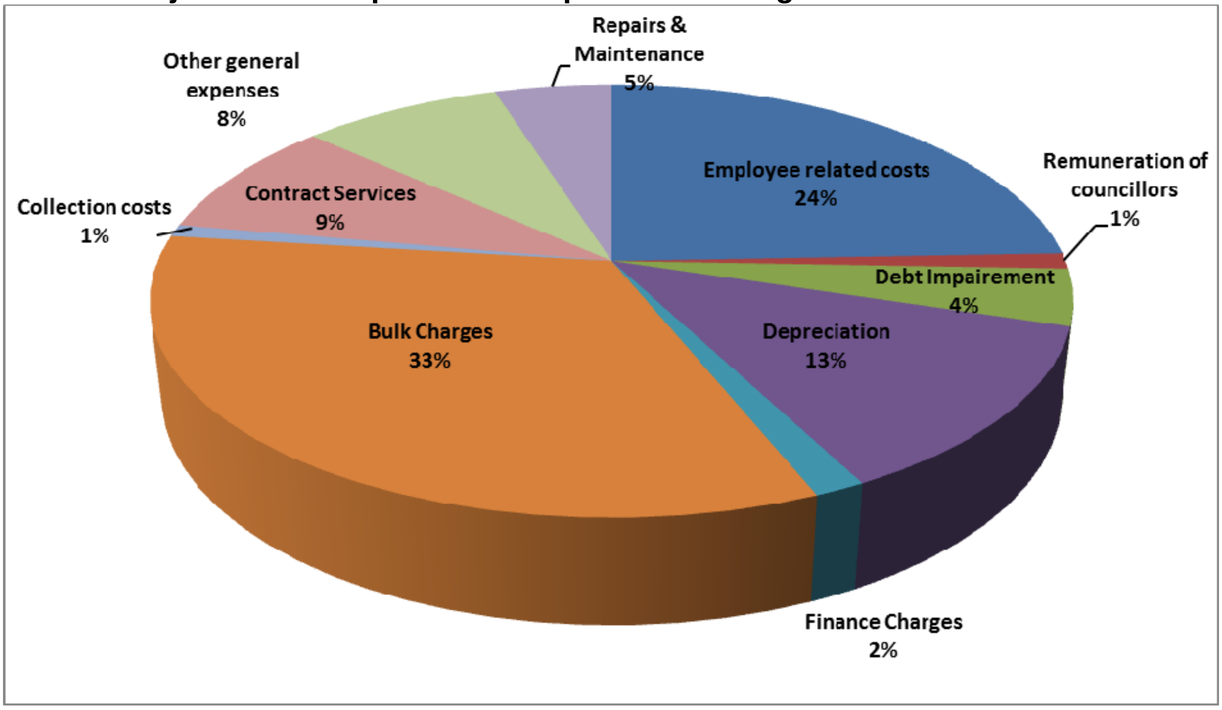
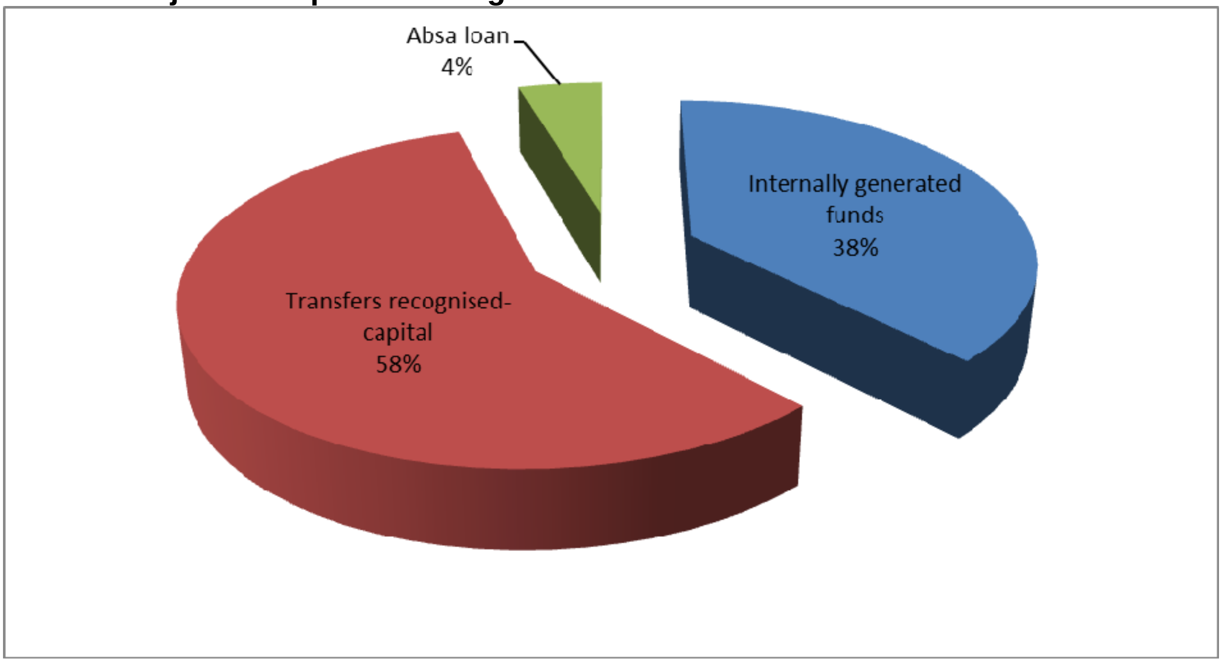
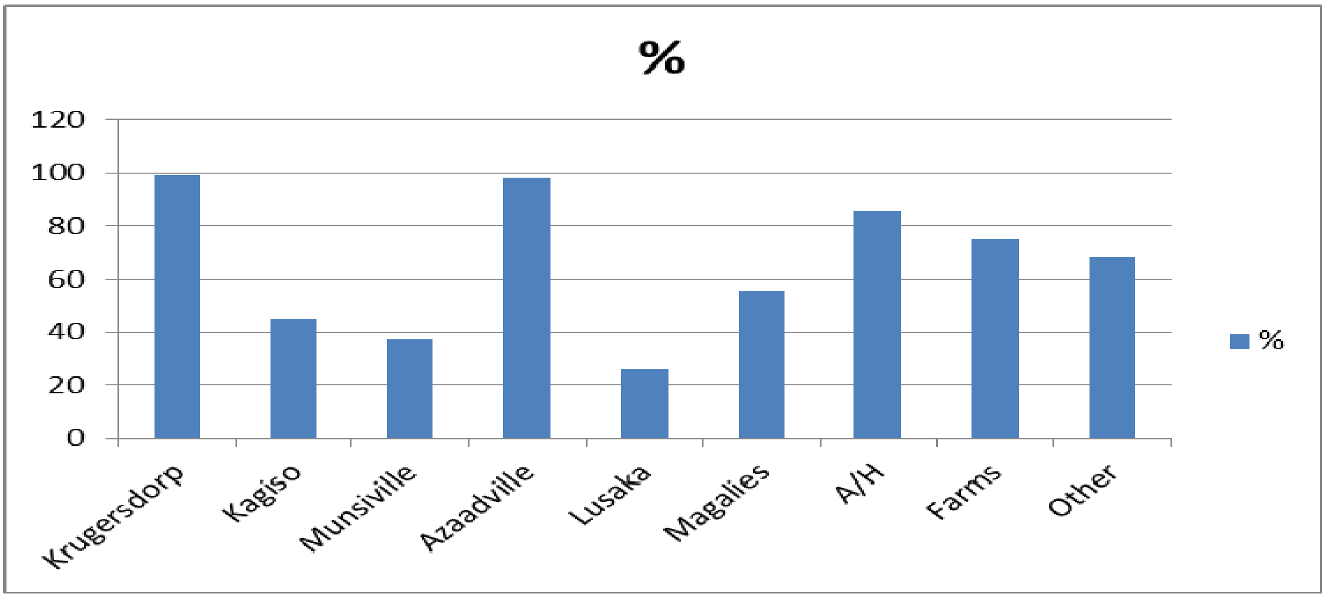


Chart 3: Adjusted Capital Funding



4. OVERVIEW OF BUDGET ASSUMPTIONS

During the first half of the period under consideration Mogale City was able to attain average payment level of 91% (until Dec 2011) however the average collection rate as at end of January 2012 was 94%, the projected collection rate assumed during the original budget period was 94%. **The graph below demonstrates payment levels per suburb**.



Consumer Price Index (CPI) is expected to remain above the upper end of the targeted range of 3-6% during the remaining budget period, however with the price of Crude Oil hovering around $124/barrel, currently fuel is selling at R10.95 per litre. The high price of petrol has resulted in price of commodities like agricultural products, food and other fuel influenced commodities taking an upswing in price. Considering that transport weighs more on determining the CPI, it is expected that the inflation rate will average 6.1% during 2012.

The recent increases in price of electricity and somehow water, did not lead to reduction in the quantity demanded of electricity and water, meaning that the demand of electricity and water is relatively inelastic, the risk posed by this position is that considering that the price of these commodities grew at a rate higher than inflation (CPI) which is a benchmark for salary demands, eventually more and more consumers may start experiencing difficulty in making payment for these services leading to increase in both value and number of debtors.

5. PROPOSED ADJUSTMENT BUDGET

Major Movements

Component	Movement	Value
Revenue (excluding capital grants transfers)	Increased	R58,018,331
Employee Related Costs	Decreased	(R11,903,535)
Transfer to and from Provisions	Increased	R190,828,038
Bulk Purchases	Increased	R62,754,203
General Expenses	Increased	R79,396,538
Repairs and Maintenance	Decreased	(R31,791,241)
Total Operating Expenditure	**Increased**	**R289,284,002**

It is proposed that total revenue be adjusted from R1,488,011,028 (excluding capital transfer) to R1,546,029,359 and total expenditure be adjusted from R1,374,612,048 to R1,663,896,050 to accommodate expenditure that were initially underprovided or excluded from the original budget, depreciation which is a non-cash item and unanticipated increase in expenditure on some of the line items and constantly growing debt book.

In line with the formats prescribed by the Municipal Budget and Reporting Regulations, capital transfers and contributions are excluded from the operating statement, as inclusion of these revenue sources would distort the calculation of the operating surplus/deficit.

5.1 Revenue Adjustments

Component	Movement	Value
Original Budget		**1,488,011,028**
Property Rates	Decreased	(10,385,551)
Sales of Electricity	Increased	25,301,466
Sales of Water	Increased	100,179
Sanitation revenue	Increased	2,118,882
Refuse Removal	Increased	61,194
Landfill sites fees	Increased	3,925,168
Rental of facilities and equipment	Decreased	(2,924,302)
Interest –External Investments	Decreased	(1,737,746)
Interest –Outstanding Debtors	Increased	5,216,378
Fines	Decreased	(695,584)
Transfer recognized – operational	Increased	13,158,551
Other income	Increased	23,879,695
Total excluding Transfers and Contributions		**1,546,029,359**
Transfers and Contributions		102,105,697
Total Adjustment Budget		**1,648,135,056**

1. **Property Rates**

Revenue from property rates was adjusted down to net of R242, 697,957 from the original budgeted amount of R253, 083,508. This was mainly due to corrections on the general valuation incorporated on the supplementary valuation roll and increasing number of registered indigents. As per Mogale City Property Rates Policy "owners who qualify and who are registered as indigents are exempted from paying rates".

2. **Sales of Electricity**

Electricity revenue was adjusted upward from total of R628,067,923 inclusive of pre-paid electricity to R653,369,389 based on the high increase of tariffs, this adjustment only represent 4% of this revenue category. The City will implement revenue enhancement vigorously to recover outstanding debts as indicated in the Cash Flow Turnaround Strategy.

3. **Sales of Water**

Water revenue increased from R171,680,789 to R171,780,969 inclusive of prepaid water based on the predictions; also taking into consideration that we are currently on the peak of the high demand season for water, which is expected to subside soon. Mogale City has put together a strategy to mitigate the water losses to acceptable levels.

4. **Sanitation Revenue**

Sanitation revenue was increased by R2, 118,882 based on the predictions of the Management.

5. **Refuse Removal**

Refuse removal revenue was increased by R61, 194k based on the seven months performance until January 2012.

6. **Rental of facilities and equipment**

Rental of facilities and equipment was reduced by R2, 9 million or 58%. The original budgeted income was based on the audited actual of 2009/10 financial year, as per GRAP 13 lease revenue from operating leases shall be recognized as revenue on a straight-line basis over the lease term. Normally we apply this standard during the process of closing the financial year.

7. **Interest on outstanding debtors**

Even though our debtor's book is on the increase, interest emanating from this source has increased by R5, 216,378.

8. **Transfer recognised – operational**

Operational grants increased by R13, 158,551 mainly due to grant to be received from Department of Water & Forestry, Expanded Public Works Programme Incentive grant moved from capital budget to operating budget and funds rolled over from 2010/11 financial year and R7 million to be sourced from West Rand District Municipality to fund relocation of District Management Areas (DMA) due to demarcation.

9. **Fines**

Fines were reduced by R695, 584 based on seven months performance of the budget period to January 2012.

10. **Other revenue**

Other revenue includes licenses and permits, agency fees, new connections, gain on disposal of assets. These categories of revenue were increased by R23, 879,695 mainly based on a R2, 568, 671 received during the auction of assets and **R20 million to be received from sale of land**.

5.2 Operating Expenditure

Operating Budget

Component	Movement	Value
Original Budget		**1,374,612,048**
Employee Related Costs	Decreased	(11,903,535)
Debt impairment, Depreciation & Finance charges	Increased	190,828,038
Bulk Purchases	Increased	62,754,203
General Expenses(including contracted services)	Increased	75,902,130
Repairs and Maintenance	Decreased	(31,791,241)
Internal Charges	Increased	3,494,408
Total Adjustment Budget		**1,663,896,050**

1. **Employee Related Costs**

Employee related costs decreased by R12 million mainly due to moratorium on all vacant posts amounting to **R12 million**.

2. **Bulk Purchases**

Bulk purchases were increased by R63 million based on the performance of the past seven months and predictions from Electricity Distribution unit. **During the original budget process we did not incorporate the distribution losses for both water and electricity and the bulk water purchases exclude a tariff of 4.05 cents per kilolitre which is payable to Rand Water for Water Research Commission (WRC)**. The council should note that Rand Water still have to inform Municipalities about the gazetted 2011/12 WRC which will be back dated, this can lead to over expenditure on this line item.

3. Contracted Services

Contracted Services and collection costs were increased by R48 million due to the following:

- Collection costs increased by R4 million due to connection via contractor which increased from R7 million to R10 million. The income derived from connections via contract is about R14 million.

- Contracted service was increased by R44 million due vehicle leases by R22million, rental water tanks by R5 million, security services by about R9million, Implementation of new system (Lefatshe) and Refuse Removal: Tedcor these expenditures were not budgeted for during the original budget. The Budget requested by Information and Knowledge unit for implementation of new system was inadvertently cut during the compilation of the Original Budget and the cost for Refuse removal: Tedcor was never part of the Original Budget.

4. Other Expenditures

This category increased by R28 million mainly due to:

- An increase of R11 million from transfer and grants for indigent's subsidies and grants from Expanded Public Works Incentives.
- Special projects increased from R6 million to R8 million an increase of 23%, some of the projects which amount to R1,3 million are funded by grants like DWAF for water demand management, SRAC for libraries and WRDM for HIV and local tourism organisation launch.
- Telephones & Faxes increased by R1 million based on the seven months performance.
- Municipal Charges which are services consumed internally was increased by R4million. This is a non-cash item.
- Other expenditure increased by R12,8 million, the main contributors of this increase are Bursary Scheme-External, Skills levy, Training, Bank Charges, License fees-computers, Electricity-Purchases for consumption, settlement fees, Membership fees-Salga, Postage, Management Fees-Game Reserve, Traveling & Subsistence and COIDA.

5. Debt impairment and Finance charges

Debt impairment decreased by R10 million, we have assumed collection rate of 94% for the main tariffs excluding prepaid revenue that means the City will not receive 6% of the total receipts billed to consumers.

6. Depreciation

Depreciation shows an increase of 1902 per cent, due to implementation of GRAP 17 which increases the depreciation and asset impairment that is not fully accommodated in the municipality’s tariffs and as a result drives the operating budget into deficit.

7. Repairs and Maintenance

Repairs and maintenance shows a decrease of R32 million or 28%. For the past two financial years the audited outcome had shown under spending as follows: (2010: R73, 9 million and 2011: R88, 6 million).

6. Capital Expenditure

Capital Budget

Component	Movement	Proposed Adjustment	2010/11 Roll overs	Total Proposed
Original Budget				**226,212,770**
Internal Auditing	Decreased	(120,375)	0	(120,375)
Project Management Office	Increased	197, 000	0	197, 000
Project Management Unit	Decreased	(4,091,000)	0	(4,091,000)
Information & Knowledge Management	Decreased	(2,585,201)	0	(2,585,201)
Corporate Support Services	Decreased	(12,365,903)	0	(12,365,903)
Municipal Financial Management	Decreased	(450,000)	0	(450, 000)
Economic Services	Decreased	(34,262,978)	0	(34,262,978)
Integrated Environmental Services	Decreased	(12,074,708)	57,191	(12,017,517)
Social Services	Increased	16,170,530	3,602,358	19,772,888
Infrastructure Services	Decreased	(13,478,151)	10,139,861	(3,338,291)
Adjustment Budget		**(63,060,786)**	**13,799,409**	**176,951,393**

1. Projects funded by own revenue which was not committed was reduced from R110, 774, 593 to R44, 018,237 a reduction of 40%.

2. <u>Project Management Unit</u>

Allocations in the Project Management Unit under the COO's Office were decreased by R4, 091 million due to a reduction of provision for their capital projects funded by MIG and the transfer of R4, 064 million of Expanded Public Works Programme Incentive to the operating budget.

3. <u>Social Services</u>

An increase of R19 million was made on the allocation made to Social Services department mainly due to new funding from Provincial Department of Social Development and roll over from unspent grants from previous financial year to the value of R4 million.

7. Cash flow

1. Projected cash flow is attached (**as table B7**) and suggests the projected cash flow positive balance of R160k at year end.

2. The projected debtors' impairment will be R80, 796 million compared to the initial anticipated impairment of R70 million resulting in estimated decrease in debt impairment of R10 million.

8. Recommendation to Council

1. That the operational expenditure budget be adjusted from R1, 374,612,048 to R1, 663,896,050.

2. That the revenue budget be adjusted from R1,603,435,206 to R1,648,135,056 including capital transfers and contributions as attached in **Annexure A (Schedule 1).**

3. That the capital budget be adjusted from R226, 212, 770 to R176, 951,393 as attached in **Annexure A (Schedule 2).**

4. That the payment levels to remain at 94%.

5. To implement and monitor the cash flow turnaround strategy to improve effective financial management.

6. To monitor collection levels during the remaining budget period to ensure that funding is available to finance expenditure.

7. That under no circumstances should expenditure be incurred that is not budgeted for. Disciplinary action be taken against the person liable for that unbudgeted expenditure.