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Session subject

Budget and Cash Management – Financial statement analysis

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BUDGET AND CASH MANAGEMENT

Definition of Budget

Budget is defined according to the dictionary as:
"an estimate of income and expenditure for a set period of time"

-Section 15 of the MFMA states that a Municipality may only incur expenditure as per the approved budget.

-Municipality's budgets are divided into operational (employee related costs, operational costs etc, and capital budget (assets, road infrastructure, community halls, building of stadiums etc)

-Section 19 of the MFMA states that capital projects may only be funded when sources of funding are available and not committed for any other purpose.

-Municipalities usually prepare budgets based on the performance of the previous year, for example if the previous year budget for revenue was done using a collection rate of 60% then for the next year the budget is set based on performance and adding the CPI inflation.

BUDGET AND CASH MANAGEMENT CONT..

APPROVAL OF THE BUDGET

Section 16 of the MFMA mentions that a budget must be approved before the start of a financial year.

-Section 25 of the MFMA further states that if Council fails to approve the budget at that time, then Council should reconsider the budget in the next 7 days and repeat the process until it is approved, failure to approve then the process outlined on Section 55 of MFMA should be followed.

-The provincial executive may also intervene if budget is still not approved after the new financial year has started as per Section 26 of MFMA.

MSCOA SEGMENTS

1. Project
2. Item
3. Function
4. Funding
5. Classification
6. Region
7. Costing

FUNDING OF THE BUDGET

Section 18 of the MFMA states that budget of a Municipality can only be funded from realistically anticipated revenue to be collected.

-This in a nutshell means that the budget is funded if there is sufficient revenue to be collected and the less expenditure

-When the budget is prepared using the A schedule, there is table A7 and A8 which are like the cash flow statement that depict whether or not the budget is funded. If there is a material deficit on both table A7 and A8 of the A schedule then the budget is unfunded.

-A funded budget symbolises that the going concern of a Municipality is not in question and that the Municipality will continue to have operational existence in the foreseeable future even if National Treasury can withhold equitable share in terms of Section 38 of MFMA or Section 216 of the Constitution.

TABLE A8

R thousand	Budget Year 2021/22	Budget Year +1 2022/23	Budget Year +2 2023/24
Cash and investments available			
Cash/cash equivalents at the year end	12 207	-76 673	-165 647
Other current investments > 90 days	63 736	117 526	282 196
Non current assets - Investments	–	–	–
Cash and investments available:	75 942	40 853	116 549
Application of cash and investments			
Unspent conditional transfers	–	–	–
Unspent borrowing	–	–	–
Statutory requirements			
Other working capital requirements	92 978	85 750	-266 695
Other provisions			
Long term investments committed	–	–	–
Reserves to be backed by cash/investments			
Total Application of cash and investments:	92 978	85 750	-266 695
Surplus(shortfall)	-17 036	-44 897	383 245

POLICIES

-Council must approve all budget related policies including cash management policy, budget policy, virement policy, SCM policy etc.

-All the budget related policies must follow a process of public participation so that the community can be given an opportunity to make a presentation on the policies as they involve the community

Section 17 of the MFMA also mentions budget related policies as part of the contents that must accompany the budget along with tariffs, amendments to IDP etc.

THEME:

Driving Financial Sustainability Through Innovation and Reform''

-With the advent of new methods of technology, the world is changing and Municipalities should adapt to the new way of doing things.

-There should be new innovations of doing things differently in the budget process, for example if budget engagements were done a month before the draft budget, then this should now change to 6 months before the budget is approved.

-Municipalities should also develop an app that allows community members to make their inputs on the draft budget as opposed to sending their comments through emails or the comments box.

Furthermore, to enhance the financial sustainability of Municipalities, it is incumbent upon all the revenue generating departments in Municipalities to work together to work revenue and not just BTO.

-Technical services should come with risk mitigation measures to curb illegal connections of both water and electricity as that is revenue foregone to the Municipality.

-Public Safety should assist also with collecting all the income due to the Municipality like traffic fines

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FINANCIAL STATEMENTS ANALYSIS

GRAP 1 (generally recognised accounting practices) states that financial statements of Municipalities are prepared using the accrual basis of accounting and on the basis that the Municipality will continue to be a going concern in future.

-How is going concern assessed for Municipalities?

If a Municipality is able to collect sufficient revenue (own revenue) and not be grant dependant then it continues to be a going concern in future.

-For a proper analysis of financial statements to see if the Municipality has liquidity and will be able to meet its short term commitments, current ratio should be looked at. This measures the financial position of the Municipality and looks at current assets versus current liabilities.

The norm of current ratio should always be 2:1 as this would show that the Municipality is liquid and has no cash flow challenges.

FINANCIAL STATEMENTS ANALYSIS CONT…

-For current ratio to be within the norm of 2:1, there should be more current assets like cash, fixed deposit (more reserves), the more reserves the Municipality has, the higher chances of having a funded budget.

-There should be less current liabilities such as bank overdraft, trade and other payables, provisions etc. if a Municipality has more liabilities then there is a risk of it having an unfunded budget.

There are many components on the financial statements of a Municipality such as revenue from exchange transactions (service charges for water and electricity)property rates, revenue from non-exchange transactions etc

-The Municipality should avoid using estimates and this risk can be mitigated by performing a meter audits of all meters and replace faulty meters with new ones. Also have own meter readers. This is what we did at the Municipality I work at and this resulted in obtaining an unqualified audit opinion as this was one of the qualifications paragraphs in the previous financial year.

The explanations given by the Municipality on the Statement of Comparison of Budget and Actual amounts should always be reasonable and make sense.

-All the source documents must match with information presented on the financial statements and this also includes trial balances and general ledgers etc.

The Municipality should always prepare quality financial statements that are GRAP compliant.

Thank You!

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