

**THE EFFICIENCY OF BUDGETING FOR PROCUREMENT OF MOVABLE NON-CURRENT ASSETS IN THE ABSENCE OF SOUND ASSET MANAGEMENT**

By

**Nobuntu Rebecca Mtayisi**

Submitted in partial fulfilment of the requirements for the degree of Master of Technology:  
Cost and Management Accounting in the Faculty of Business and Economic Sciences  
to be awarded at the Nelson Mandela Metropolitan University

April 2017

**Supervisor: Mrs L Bester**  
**Co-Supervisor: Prof H Fourie**

## **PRELIMINARIES**

### **Declaration**

I, *Nobuntu Rebecca Mtayisi (210115793)*, hereby declare that the treatise for *Master of Technology: Cost and Management Accounting* to be awarded is my own work and that it has not previously been submitted for assessment or completion of any postgraduate qualification to another university or for another qualification.

.....

Student Name

.....

Signature

**Dedication**

To God, for imparting to my late grandmother (Nongquzulwana Ngame) the wisdom to understand that the significance of true freedom for a girl child is through education. She believed in me against all probabilities and gave my parents her pension money of R180.00 per month at the time, so that I could be taken to school. This gesture has and will always be an inspiration to continue working hard even when one's circumstances seem arduous.

## **Acknowledgements**

I wish to express my deep eternal gratitude to the ALMIGHTY who has always been merciful towards me. I also express my sincere gratitude to all the individuals and organisations who contributed towards the successful completion of this study. In particular, I acknowledge the assistance of the following:-

- Ms. L. Bester, for her professional guidance and patience throughout the study.
- Professor H. Fourie, for his professional assistance that came timely.
- The NMMU Faculty of Business and Economic Sciences for approaching the Research Capacity Development Unit for hosting research workshop, which was extremely informative.
- My family, Zuko (husband) and my sons Luzuko and Viwe for their support when I was unable to meet their daily needs.
- My siblings, cousin Liziwe, mother and mother-in-law for their prayers, emotional and financial support.

My colleagues for the respective roles they played, namely: the Department of Tourism and Hospitality (WSU), my study group and most importantly, the Centre for Learning and Teaching Development (CLTD) (WSU) for financing a replacement; Research Department (WSU) for sending Dr Kariyana to Ibika Campus and last but not least, the WSU library at Ibika for their assistance when I required, *inter alia*, text books and accredited journals.

## **Abstract**

Movable non-current assets are physical and mobile assets that a municipality uses to provide services to the community directly or indirectly. Therefore, effective movable non-current asset management is necessary to ensure that these assets provide value to both the municipality and the community. This study seeks to determine whether poor asset management negatively affects capital budgeting for procurement of movable non-current assets. Mbhashe Local Municipality, a Category B municipality in the Eastern Cape Province was selected for the study. A desktop research method was utilised for this study. The analysis of secondary data includes policy documents (such as National Treasury asset management guidelines and Mbhashe budgeting policy), books, journals, internet data, newspapers and research documents in order to determine asset management guidelines and budgeting theories by noteworthy scholars.

Auditor General South Africa (AGSA) and State of Local Government Finance reports were also analysed to establish the current practice and impact of the role of the municipal management in its finances as well as budget spending patterns at Mbhashe Local Municipality. The results of the study revealed that Mbhashe Local Municipality's non-compliance with asset management and budgeting policies and procedures throughout the period of the study negatively affected their capital budgeting decisions. The consequences of instability in leadership and lack of approved movable non-current asset management policy resulted in partial asset information, incorrect recording and accounting systems for assets and unauthorised disposal of strategic movable non-current assets. Although, an approved budget policy existed at Mbhashe Local Municipality, the budgetary information was unrealistic because of negligence such as: lack of public participation, consultation and alignment of the Integrated Development Plan (IDP) with the municipality's objectives. This resulted in habitual under-spending of capital assets compared to the capital budget throughout the period of the study.

**Keywords:** Movable Non-Current Assets, Asset Management and Capital Budgeting

## Definition of Key Concepts

<b>Assets</b>	Refers to resources controlled by the municipality as a result of a past event and from which future economic benefit or service potential is expected to flow to the municipality (Fourie and Opperman, 2007:304).
<b>Assets</b>	Refers to resources with economic value that an individual or a corporation controls with the expectation that it will provide future benefit. (Accounting Simplified, 2013).
For this study, the concept movable assets will be used, which refers to assets that are controlled by the municipality as a result of past event that can be moved from one location to another and from which future economic benefit or service potential is expected to flow to the municipality.	
<b>Asset Management</b>	Refers to the process that involves controlling the acquisition, use, safeguarding and disposal of movable non-current assets to ensure achievement of service delivery at minimised risk MFMA (RSA, 2003).
<b>Asset Management</b>	Asset Management is a broad function and includes a structured process of decision-making, planning and control over the acquisition, use, safeguarding and disposal of assets to maximise their service delivery potential and benefits, and to minimise their related risks and costs over their entire life (National Treasury, 2008).
For this study, movable asset management is a process that involves controlling the acquisition, use, safeguarding and disposal of movable non-current assets to ensure that service delivery is achieved at reduced risk.	
<b>Capital Budgeting</b>	According to Firer, Ross, Westerfield and Jordan (2012:02) and Correia, Flynn, Uliana and Wormald (2008:03) capital budgeting is an analysis and evaluation of investment projects that generally produce benefits over the financial period of more than one year.
<b>Capital budgeting</b>	Refers to the process of evaluating and selecting long term investments that are consistent with the goal of increasing the firm's value (Marx, De Swardt, Beaumont, Naicker and Erasmus, 2004:231).
For this study capital budgeting was defined as a forecast of capital expenditure that will be incurred over a specific financial year and the different funding options that will be used to finance capital investments.	

## Abbreviations

<b>AGSA</b>	Auditor General South Africa
<b>GRAP</b>	Generally Recognised Accounting Principles
<b>IMESA</b>	Institute of Municipal Engineering of Southern Africa
<b>LGCAMG</b>	Local Government Capital Asset Management Guidelines
<b>MFMA</b>	Municipal Finance Management Act, No. 56 of 2003
<b>MSA</b>	Municipal Systems Act, No. 32 Of 2000
<b>PPE</b>	Property Plant and Equipment
<b>PPFA</b>	Preferential Procurement Policy Framework Act
<b>SCM</b>	Supply Chain Management
<b>SDBIP</b>	Service Delivery and Budget Implementation Plan
<b>CoGTA</b>	Co-operative Governance and Traditional Affairs
<b>SABC</b>	South African Broadcasting Corporation
<b>HRSC</b>	Human Research Sciences Council
<b>IDP</b>	Integrated Development Plan
<b>SDF</b>	Spatial Development Framework
<b>VAT</b>	Value Added Tax
<b>ALCM</b>	Asset Life-Cycle Management
<b>CFO</b>	Chief Financial Officer
<b>CIPFA</b>	Chartered Institute of Public Financial Accountants
<b>MTREF</b>	Medium Term Revenue Expenditure Framework

## TABLE OF CONTENTS

<b>PRELIMINARIES.....</b>	<b>I</b>
<b>Declaration.....</b>	<b>I</b>
<b>Dedication.....</b>	<b>II</b>
<b>Acknowledgements.....</b>	<b>III</b>
<b>Abstract.....</b>	<b>IV</b>
<b>Definition of Key Concepts.....</b>	<b>V</b>
<b>Abbreviations.....</b>	<b>VI</b>
<b>CHAPTER ONE.....</b>	<b>01</b>
<b>BACKGROUND AND INTRODUCTION TO THE STUDY.....</b>	<b>01</b>
<b>1.1 BACKGROUND TO THE STUDY.....</b>	<b>01</b>
<b>1.2 INTRODUCTION TO THE STUDY.....</b>	<b>01</b>
<b>1.3 LITERATURE REVIEW.....</b>	<b>03</b>
<b>1.4 RESEARCH QUESTION.....</b>	<b>09</b>
<b>1.5 RESEARCH OBJECTIVES.....</b>	<b>09</b>
<b>1.5.1 Primary Objectives.....</b>	<b>09</b>
<b>1.5.2 Secondary Objectives.....</b>	<b>09</b>
<b>1.6 RESEARCH DESIGN AND METHODOLOGY.....</b>	<b>10</b>
<b>1.6.1 The Concept of Research.....</b>	<b>10</b>
<b>1.6.2 Research Design.....</b>	<b>11</b>
<b>1.6.3 Population.....</b>	<b>12</b>
<b>1.6.4 Data Collection Methods.....</b>	<b>13</b>
<b>1.6.5 Analysis of Data.....</b>	<b>14</b>
<b>1.7 RELEVANCE OF THE RESEARCH.....</b>	<b>14</b>
<b>1.8 RESEARCH ETHICS.....</b>	<b>16</b>
<b>1.9 CHAPTER OUTLINE.....</b>	<b>16</b>



<b>1.10</b>	<b>SUMMARY.....</b>	<b>17</b>
	<b>CHAPTER TWO.....</b>	<b>18</b>
	<b>SOUND ASSET MANAGEMENT AND ITS IMPACT ON EFFECTIVE BUDGETING FOR PROCUREMENT OF MOVABLE NON-CURRENT ASSETS.....</b>	<b>18</b>
<b>2.1</b>	<b>INTRODUCTION.....</b>	<b>18</b>
<b>2.2</b>	<b>ASSET MANAGEMENT IN THE SOUTH AFRICAN LOCAL GOVERNMENT SPHERE.....</b>	<b>19</b>
<b>2.2.1</b>	<b>Legislation.....</b>	<b>19</b>
<b>2.2.2</b>	<b>Asset Management Process.....</b>	<b>25</b>
<b>2.2.3</b>	<b>The Role of the Municipal Manager in Movable Non-current Asset Management.....</b>	<b>29</b>
<b>2.2.4</b>	<b>The Role of the Chief Financial Officer in Movable Non-current Asset Management.....</b>	<b>30</b>
<b>2.3</b>	<b>BUDGETING IN THE SOUTH AFRICAN LOCAL SPHERE OF GOVERNMENT.....</b>	<b>31</b>
<b>2.3.1</b>	<b>Legislation.....</b>	<b>31</b>
<b>2.3.2</b>	<b>Budgeting Process.....</b>	<b>32</b>
<b>2.3.2.1</b>	<b>Organising the Process.....</b>	<b>34</b>
<b>2.3.2.2</b>	<b>Developing the Process.....</b>	<b>35</b>
<b>2.3.2.3</b>	<b>Stakeholder Involvement.....</b>	<b>35</b>
<b>2.3.2.4</b>	<b>Identifying, Analysing and Classifying Projects and Funding Processes.</b>	<b>35</b>
<b>2.3.2.5</b>	<b>Selecting the suitable project to meet the community’s needs.....</b>	<b>36</b>
<b>2.3.2.6</b>	<b>Preparation and Recommendation of the Annual Budget Plans.....</b>	<b>36</b>
<b>2.3.2.7</b>	<b>Adoption and Implementation of the Annual Budget.....</b>	<b>36</b>
<b>2.3.3</b>	<b>The Role of the Municipal Manager in the Budgeting Process.....</b>	<b>36</b>
<b>2.3.4</b>	<b>The Role of the Chief Financial Officer in the Budgeting Process.....</b>	<b>37</b>

<b>2.4.</b>	<b>CAPITAL BUGDETING IN THE SOUTH AFRICAN LOCAL GOVERNMENT SPHERE.....</b>	<b>38</b>
<b>2.4.1</b>	<b>Legislation.....</b>	<b>38</b>
<b>2.4.2</b>	<b>Capital Budgeting Process.....</b>	<b>40</b>
<b>2.4.2.1</b>	<b>Inceamental (Traditional) Budgeting Approach.....</b>	<b>41</b>
<b>2.4.2.2</b>	<b>Performance (Contemporary) Budgeting Approach.....</b>	<b>41</b>
<b>2.4.2.3</b>	<b>The Zero Based(Contemporary) Budget Approach.....</b>	<b>42</b>
<b>Step 1</b>	<b>– Decision Packages are Generated and Presented.....</b>	<b>42</b>
<b>Step 2</b>	<b>– Review and Analyse Capital Projects.....</b>	<b>43</b>
<b>Step 3</b>	<b>– Decision-making.....</b>	<b>44</b>
<b>Step 4</b>	<b>- Implementation.....</b>	<b>45</b>
<b>Step 5</b>	<b>- Control.....</b>	<b>45</b>
<b>2.4.3</b>	<b>The Role of the Municipal Manager in Capital Budgeting.....</b>	<b>47</b>
<b>2.4.4</b>	<b>The Role of the Chief Financial Officer in Capital Budgeting.....</b>	<b>48</b>
<b>2.5</b>	<b>SUMMARY.....</b>	<b>49</b>
	<b>CHAPTER THREE.....</b>	<b>50</b>
	<b>THEORETICAL FRAMEWORK: ASSET MANAGEMENT, BUDGETING AND CAPITAL BUDGETING AS PRESCRIBED BY MUNICIPAL FINANCE MANAGEMENT ACT AND THE NATIONAL TREASURY.....</b>	<b>50</b>
<b>3.1</b>	<b>INTRODUCTION.....</b>	<b>50</b>
<b>3.2</b>	<b>DIFFERENTIATION OF ASSETS.....</b>	<b>51</b>
<b>3.3</b>	<b>ASSET MANAGEMENT MODELS.....</b>	<b>52</b>
<b>3.4</b>	<b>ASSET MANAGEMENT FRAMEWORK.....</b>	<b>55</b>
<b>3.4.1</b>	<b>Management Control.....</b>	<b>55</b>
<b>3.4.2</b>	<b>Asset Life Cycle Phases.....</b>	<b>55</b>
<b>a)</b>	<b>Identification of Assets Required.....</b>	<b>55</b>
<b>b)</b>	<b>Acquisition Phase.....</b>	<b>56</b>

c)	<b>Operation and Maintenance Phase.....</b>	<b>57</b>
d)	<b>Disposal Phase.....</b>	<b>58</b>
3.5	<b>ASSET PLANNING AND BUDGETING CONTROL.....</b>	<b>62</b>
3.5.1	<b>Determining Service Delivery Needs.....</b>	<b>62</b>
3.5.2	<b>Evaluate Existing Assets.....</b>	<b>63</b>
3.5.3	<b>Developing a Movable Asset Strategy.....</b>	<b>65</b>
3.5.4	<b>Capital Funding and Budgeting.....</b>	<b>69</b>
3.5.5	<b>Aligning Movable Non-current Assets with Service Delivery Programmes .....</b>	<b>71</b>
3.6	<b>ASSET ACQUISITION.....</b>	<b>71</b>
3.6.1	<b>Acquisition Methods.....</b>	<b>72</b>
3.6.2	<b>Establishing Asset Life Cycle Costs.....</b>	<b>72</b>
3.7	<b>ASSET OPERATION, SAFEGUARDING AND MAINTENANCE.....</b>	<b>73</b>
3.7.1	<b>Asset Operation Plans for Movable Assets.....</b>	<b>73</b>
3.8	<b>ASSET DISPOSAL.....</b>	<b>73</b>
3.8.1	<b>Disposal Plan.....</b>	<b>74</b>
3.9	<b>SUMMARY.....</b>	<b>74</b>
	<b>CHAPTER FOUR.....</b>	<b>76</b>
	<b>ANALYSIS OF AGSA REPORTS FOR DEVIATIONS: MOVABLE NON- CURRENT ASSETS AT MBHASHE LOCAL MUNICIPALITY.....</b>	<b>76</b>
4.1	<b>INTRODUCTION.....</b>	<b>76</b>
4.2	<b>ASSET MANAGEMENT POLICY GUIDELINES.....</b>	<b>77</b>
4.2.1	<b>Management Control.....</b>	<b>77</b>
4.2.2	<b>Asset Life Cycle Management.....</b>	<b>77</b>
4.3	<b>ASSET PLANNING (DETERMINING ASSET NEEDS) AND BUDGETING CONTROL.....</b>	<b>77</b>

<b>4.4</b>	<b>DEVELOPING THE ASSET STRATEGY.....</b>	<b>78</b>
<b>4.5</b>	<b>CAPITAL FUNDING AND BUDGETING.....</b>	<b>78</b>
<b>4.6</b>	<b>ALIGNING ASSETS WITH SERVICE DELIVERY PROGRAMMES.</b>	<b>79</b>
<b>4.7</b>	<b>BUDGET POLICY REQUIREMENTS AT MBHASHE LOCAL MUNICIPALITY.....</b>	<b>79</b>
<b>4.7.1</b>	<b>Principles of budgeting as adopted by Mbhashe Local Municipality.....</b>	<b>79</b>
<b>4.7.2</b>	<b>Budget Preparation Process.....</b>	<b>79</b>
<b>4.8</b>	<b>CAPITAL BUDGET.....</b>	<b>80</b>
<b>4.8.1</b>	<b>Approval of the Capital Budget.....</b>	<b>80</b>
<b>4.9</b>	<b>SUMMARY.....</b>	<b>119</b>
	<b>CHAPTER FIVE.....</b>	<b>125</b>
	<b>SUMMARY OF FINDINGS AND RECOMMENDATIONS.....</b>	<b>125</b>
<b>5.1</b>	<b>INTRODUCTION.....</b>	<b>125</b>
<b>5.2</b>	<b>SUMMARY.....</b>	<b>125</b>
<b>5.3</b>	<b>MANAGEMENT CONTROL.....</b>	<b>127</b>
<b>5.3.1</b>	<b>Recommendations: Improve Management Control.....</b>	<b>127</b>
<b>5.4</b>	<b>REALISTIC BUDGETING.....</b>	<b>129</b>
<b>5.4.1</b>	<b>Recommendations: Achieve Realistic Budgeting.....</b>	<b>130</b>
<b>5.5</b>	<b>ASSET LIFE CYCLE MANAGEMENT.....</b>	<b>131</b>
<b>5.5.1 a)</b>	<b>Planning Phase.....</b>	<b>132</b>
<b>5.5.1 b)</b>	<b>Recommendations: Improve Movable Non-current Asset Planning.....</b>	<b>132</b>
<b>5.5.2 a)</b>	<b>Acquisition Phase.....</b>	<b>133</b>
<b>5.5.2 b)</b>	<b>Recommendations: Acquisition of movable non- current assets is fair, equitable, transparent and cost effective.....</b>	<b>133</b>
<b>5.5.3 a)</b>	<b>Operation and Maintanance Phase.....</b>	<b>134</b>
<b>5.5.3 b)</b>	<b>Recommendations: Improve Movable Non-current Asset Operations and Maintenance.....</b>	<b>134</b>

5.5.4 a)	<b>Disposal Phase.....</b>	<b>135</b>
5.5.4 b)	<b>Recommendations: Ensure Adherence to Asset Disposal Process.....</b>	<b>136</b>
5.6	<b>ASSET PLANNING AND BUDGETING CONTROL.....</b>	<b>137</b>
5.6.1	<b>Recommendations: Ensure Asset Planning and Budgeting Control.....</b>	<b>138</b>
5.7	<b>DEVELOPING AN ASSET STRATEGY.....</b>	<b>138</b>
5.7.1	<b>Recommendations: Develop an Effective Asset Strategy.....</b>	<b>139</b>
5.8	<b>CAPITAL FUNDING AND BUDGETING.....</b>	<b>140</b>
5.8.1	<b>Recommendations: Secure Cost Effective Capital Funding.....</b>	<b>140</b>
5.9	<b>ALIGNMENT OF ASSETS WITH SERVICE PROGRAMMES.....</b>	<b>141</b>
5.9.1	<b>Recommendations: Align Municipal Assets with Service Delivery Programmes.....</b>	<b>141</b>
5.10	<b>PRINCIPLES OF BUDGETING.....</b>	<b>142</b>
5.10.1	<b>Recommendations: Adherence to Budgeting Principles.....</b>	<b>143</b>
5.11	<b>THE BUDGETING PREPARATION PROCESS.....</b>	<b>143</b>
5.11.1	<b>Recommendations: Adherence to Budget Preparation Process.....</b>	<b>144</b>
5.12	<b>PUBLIC PARTICIPATION PROCESS.....</b>	<b>144</b>
5.12.1	<b>Recommendations: How to Improve Budget and Public Participation Process.....</b>	<b>145</b>
5.13	<b>APPROVAL OF THE BUDGET.....</b>	<b>145</b>
5.13.1	<b>Recommendations: How to ensure timely approval of municipal budget by council.....</b>	<b>146</b>
5.14	<b>PUBLICATION OF THE BUDGET.....</b>	<b>147</b>
5.14.1	<b>Recommendations: How to improve the budget publication.....</b>	<b>147</b>
5.15	<b>SERVICE DELIVERY AND BUDGET IMPLEMENTATION PLAN (SDBIP) .....</b>	<b>148</b>
5.15.1	<b>Recommendations: Effective Service Delivery Budget and Implementation Plan (SDBIP) .....</b>	<b>148</b>

<b>5.16</b>	<b>CAPITAL BUDGETING.....</b>	<b>149</b>
<b>5.16.1</b>	<b>Recommendations: Effective Capital Budgeting.....</b>	<b>149</b>
<b>5.17</b>	<b>MUNICIPAL COUNCIL: APPROVAL OF THE CAPITAL BUDGET</b>	<b>150</b>
<b>5.18</b>	<b>POSSIBLE RESEARCH AREAS.....</b>	<b>151</b>
<b>5.19</b>	<b>CONCLUSION.....</b>	<b>151</b>
	<b>REFERENCE LIST.....</b>	<b>153</b>

#### **LIST OF TABLES**

<b>Table 1:</b>	<b>Financial Governance Framework Recommended for Municipalities.</b>	<b>81</b>
<b>Table 2:</b>	<b>Comparison of Policy and Application as Outlined in the AGSA Reports from 2011/12 to 2013/14.....</b>	<b>82</b>
<b>Table 3:</b>	<b>Asset Life cycle Phases.....</b>	<b>85</b>
<b>Table 4:</b>	<b>Asset Planning and Budgeting Control.....</b>	<b>91</b>
<b>Table 5:</b>	<b>Developing the Asset Strategy.....</b>	<b>92</b>
<b>Table 6:</b>	<b>Capital Funding and Budgeting.....</b>	<b>95</b>
<b>Table 7:</b>	<b>Aligning Assets with Service Delivery Programmes.....</b>	<b>97</b>
<b>Table 8:</b>	<b>Principles of Budgeting.....</b>	<b>100</b>
<b>Table 9:</b>	<b>Budget Preparation Process.....</b>	<b>103</b>
<b>Table 10:</b>	<b>Capital Budget.....</b>	<b>116</b>
<b>Table 11:</b>	<b>Issues that the Municipality Council Should Consider Before the Approval of the Capital Budget.....</b>	<b>117</b>

#### **LIST OF FIGURES**

<b>Figure 1:</b>	<b>The Current Municipal Structure.....</b>	<b>22</b>
<b>Figure 2:</b>	<b>The Envisaged Municipal Structure.....</b>	<b>23</b>
<b>Figure 3:</b>	<b>Asset Life Cycle Phases.....</b>	<b>28</b>
<b>Figure 4:</b>	<b>Integrated Development Planning.....</b>	<b>32</b>
<b>Figure 5:</b>	<b>Integration of Planning and Annual Budgeting.....</b>	<b>39</b>
<b>Figure 6:</b>	<b>Asset Life Cycle Model.....</b>	<b>59</b>

<b>Figure 7:</b>	<b>Framework for Investment Planning.....</b>	<b>61</b>
<b>Figure 8:</b>	<b>Assessment of Asset Performance Information.....</b>	<b>64</b>
<b>Figure 9:</b>	<b>AM functions are integrated to IDP and Performance Management Plans.....</b>	<b>66</b>
<b>Figure 10:</b>	<b>The composition of an asset register.....</b>	<b>68</b>

## **CHAPTER ONE**

### **BACKGROUND AND INTRODUCTION TO THE STUDY**

#### **1.1 BACKGROUND TO THE STUDY**

Chapter 7, Section 152 (1) (a) of the Constitution of the Republic of South Africa (RSA, 1996) stipulates that a municipality must strive to achieve its objectives within its financial and administrative capacity: provide services to communities in a sustainable manner; promote a safe and healthy environment as well as encourage community involvement in matters of local government. The Constitution also prescribes municipalities to manage their administration, budgeting and planning processes as well as prioritise the basic needs of the community and promote the social and economic development of the community.

In order to ensure that municipalities become progressive, the Local Government: Municipal Systems Act 32 of 2000 (RSA, 2000) was formulated and implemented to encourage the community involvement in municipal affairs, particularly planning, service delivery and performance management. The aforementioned Act was also formulated to ensure effective, efficient, transparent local government systems that conform to constitutional principles. Moreover, Local Government: Municipal Finance Management Act (MFMA) 56 of 2003 (RSA, 2003) was formulated to address the root causes of financial difficulties in municipalities. There are seven basic policy principles that the MFMA stipulates, of which one is to ensure effective and efficient use of resources by municipalities. Consequently, in light of the aforementioned principle, this study endeavours to determine the efficiency of capital budgeting for procurement of non-current assets in the absence of effective movable non-current asset management.

#### **1.2 INTRODUCTION TO THE STUDY**

Irrespective of the constitutional guidelines as mentioned above and the interventions such as the formulation Acts, there have been continuous reports of poor financial management in government in general as well as in municipalities in particular. According to the Department of Co-operative Governance and Traditional Affairs (CoGTA, 2009:01), although all government institutions' (including municipalities') are required to deliver



services, there have been regular reports by the Auditor-General of South Africa (AGSA) of ineffective structures (such as internal audits and audit committees), poor performance management and the absence of systems. CoGTA (2009:01) cautioned that the poor internal audits and lack of guidance by the audit committees as well as absence of systems negatively affects service delivery plans in general and compliance with the rules and processes in particular. The impact is evident from the service delivery protests observed nationally as well as the reported protests that erupted at Mbhashe Local Municipality on January 28 2015. The community had been complaining, *inter alia*, about the poor condition of the roads and consistent interruption to water supply (SABC News, 2015:01).

As a consequence of poor performance by the aforementioned structures and non-existent systems, both provincial and local government have been facing several other challenges, *inter alia*, inadequate skills required to plan and budget public finances as well as poor management of expenses. In order to address the aforementioned challenges, CoGTA crafted a strategy it hoped would address the challenges and result in clean audits by 2014. The State of Local Government Finances Report (National Treasury 2014, 13) also acknowledged that Mbhashe Local municipality was dealing with similar challenges as mentioned by CoGTA. The municipality had not as yet implemented sufficient asset management processes in order to address repairs and maintenance costs relating to movable and immovable assets (National Treasury, 2014:13).

The asset management challenges at the municipality were also predicted and reported in the Human Research Sciences Council's (HRSC) Report conducted in 2010 by Dr Glass. The HRSC report predicted that the municipality would experience administrative challenges that could lead to challenges when procuring an accumulation of movable and immovable non-current assets until 2014, which was also the due date of the clean audits. According to the interview conducted with the Acting Municipal Manager, the envisaged backlog in asset acquisition and increased service delivery protests was a result of consistent political infighting and not as a result of the municipal employees being lethargic in performing their duties (Glass, 2010:10).

Movable and immovable assets are required to fulfil one of the fundamental objectives as prescribed in Section 152 1 (b) of the Constitution (RSA, 1996) "... to ensure the provision services to community in a sustainable manner". In order to achieve the objectives as

stipulated in the Constitution, the MFMA outlines effective processes to be followed to prevent misuse of the municipal resources including assets. According to Venter (2007:218), more attention should be given to infrastructure or immovable non-current assets since these have significant values compared to movable assets. Movable non-current assets may not have significant values similar to immovable non-current assets but because of their movable nature they are at risk of being stolen or misused. Hence on the contrary, this study will focus on whether realistic budgeting for the procurement of movable non-current assets in the absence of sound asset management with particular reference to the Eastern Cape Mbhashe Local Municipality in the Eastern Cape for the financial years 2011/12, 2012/13 and 2013/14 was possible.

### **1.3 LITERATURE REVIEW**

Procurement of movable non-current assets in an Eastern Cape general audit report 2012 alluded to an increase in the levels of non-compliance with laws and regulations. The report stated that only one auditee in the local government was fully compliant with the required laws and regulations. The areas of non-compliance included procurement and contract management, asset and liability management, budget and financial statements as well as annual reports (AGSA, 2012:16). According to Supply Chain Management Regulation 11, the municipality should comply with the acquisition management system during procurement of movable non-current assets. The procurement management system includes ensuring that: only authorised movable non-current assets are purchased; movable non-current expenditure is in accordance to the approved budget; threshold values are in compliance with different procurement processes; clear documentation is used and bid processes are fair, transparent and in accordance with applicable legislation and the National Treasury guidelines are adhered to when purchasing movable non-current assets.

French (1994:15) states that infrastructure challenges negatively affect service delivery. Gibson (2012:54) agrees and relates an incident where service delivery suffered because the municipality had failed to estimate the growth of households in order to provide expected water supply. In the example, Gibson revealed how a particular municipality had failed to plan appropriately and consequently was not able to honour their water accounts and subsequently had failed to provide water to the community. The example highlighted that service delivery depends on the ability of the municipality to plan their assets and finances properly. Similar with the need for realistic planning emphasised by Gibson and French

earlier, the study aims to establish the impact that poor asset management can have on capital budgeting or planning for procurement movable non-current assets. The municipalities need both immovable and movable non-current assets in order to provide services, mostly the focus had been immovable non-current assets hence the focus on this study is on movable non-current assets. Movable non-current assets include assets such as equipment, vehicles and computers.

According to National Treasury (2008:12), in order to provide sustainable service delivery, the municipality should ensure efficient, effective and economic management of assets. The asset management principles include: safeguarding assets, maintenance of assets, establishing and maintaining asset information and accounting systems, valuation of assets in accordance to Generally Recognised Accounting Principles (GRAP), establishing and maintaining systems of internal controls over assets, establishing and maintaining asset registers and clarifying responsibilities and accountability for asset management processes. The General Audit report 2012 revealed that the Eastern Cape local government had been unable to comply with the asset management principles as outlined by Local Government Capital Asset Management Guidelines (LGCAMG) (AGSA, 2012:16).

Capital budgeting can be defined as the financial plan to purchase non-current assets, whereas Asset Management relates to the process of deciding what assets to buy and how to use or control the use of those assets (National Treasury, 2003:39; Correia *et. al.*, 2007:8-3). This decision-making process is as important as the financial plan itself because it is informative of how much money would need to be set aside or when it will be necessary to buy future assets. The decisions and the activities regarding what assets to buy, how assets are bought, utilised, maintained and controlled helps to collect data about suitability, lifetime, value and replacement timing of the assets. According to Lampe and Strassner (2003:05), the collection of movable non-current asset data has been a major challenge that had resulted in the lack of detailed information regarding the use and the conditions attached to individual movable non-current assets. Information about individual movable non-current assets is important as it is used for estimation of depreciation, lifetime, maintenance costs as well as future replacement costs for movable non-current assets.

The lack of this required data includes: the physical condition of existing assets, the location of existing assets, historic values, estimated values and possible resale values of existing

movable non-current assets and unrealistic budgeting. The National Treasury listed, amongst others, concerns of underspending of capital budgets during the local government financial year 2013 as one of the indicators of financial distress (National Treasury, 2013:04). Moreover, AGSA has reported on several occasions that asset management has been a challenge among local municipalities (AGSA, 2012:6). These challenges as reported by the National Treasury and AGSA of non-compliance with purchasing procedure or asset management procedures seem to have a direct impact on the underspending of capital budgeting.

Gibson (2012:02) mentions integrated strategic planning process or a multi-layered approach as a solution to planning for assets. Multi-layered planning gradually reveals the municipality's long term objectives into practical and measurable activities that the municipality classifies as priorities. Gibson (2012:54) provides an example of how failure to realistically budget for capital assets negatively affects an operational budget and service delivery. In the example, what seemed to be a minute error led to a financial crisis, which served as a warning that failure to plan could have a disastrous outcome.

Movable non-current assets are mobile. If their data is not linked to an asset management system, they are at risk of being stolen or misused (Lampe and Strassner, 2003:05). Lampe and Strassner further suggest the integration of asset information to asset management systems in order to trace the physical location of assets and facilitate data that is collected for individual assets. Fourie and Opperman (2007:304) suggest an asset register as a cornerstone to providing reliable and relevant asset information. French (1994:15) also supports this view and refers to an asset register as the primary step by which local municipalities can assist property held to meet the service delivery needs. This is the reason why it was necessary to determine the impact of ineffectiveness on asset management in budgeting for procurement of movable non-current assets.

In order to answer the research question of the study related literature was reviewed. Leedy and Ormrod (2005:65) define a literature review as the theoretical perspective of previous research findings regarding the problem at hand. This helps to “look again” or identify what is already known so that one can associate his/her area of interest to what has been researched (Leedy and Ormrod, 2005:65). For this study, asset management theories and models as postulated by various scholars will be studied. The purpose of the review was to establish the

views other scholars have of the impact of budgeting on sound asset management and capital budgeting on the procurement of movable non-current assets.

Laldaparsad, Geyer and Du Plessis (2013:37) analysed how spending patterns can be aligned to the strategic vision of IDP's and SDF's as well as their impact on reshaping the urban structure through municipal investments. The authors acknowledged that the history of apartheid had contributed towards immovable non-current asset challenges that led to certain areas/municipalities being more resourced than others. There are also claims that the municipal budget as an instrument for spatial restructuring is less recognised. The first objective of this study is to highlight how ineffective movable non-current asset management can affect the budget and capital budgeting for the procurement of movable non-current assets.

Laldaparsad *et al.* (2013:37), acknowledge the strategic interventions (such as the IDP and SDF) that government introduced in order to address the inherited challenges and bridge immovable non-current asset challenges as the result of the apartheid era. Laldaparsad *et al.* (2013:37), also considered the criticism these strategies had received, for example, the IDP is referred to as being a wish list. According to Laldaparsad *et al.* (2013:38), regardless of the criticism of these strategic documents, the budget is the most practical mechanism to implement the SDF's and IDP's.

Gibson (2012:51) defines the SDF's as the 25-year strategic plan or as a developmental master plan for municipalities containing strategic guidelines and controls that need to be applied. Gibson (2012:51) refers to the IDP as the five-year plan that should consider required future assets to serve the community based on the likely developments that are expected to take place. The IDP's can be used proactively and reactively. The proactive use refers to the internal utilisation of the IDP by management to facilitate the achievement of the municipality's goals as set by management whereas the reactive utilisation of the IDP relates to how management should facilitate and control the manner in which external parties dictate the future services they expect from the municipality. The RSA (2000, 2003) Section 34 and Section 17(3) (d) respectively also requires that an annual reviewed IDP be taken into account when a budget is tabled for approval by the municipal council.

The second objective of this study is to describe the theoretical framework of the asset management, budgeting and capital budgeting processes as prescribed by MFMA and the National Treasury guidelines. The aforementioned sections of the MFMA and MSA stipulate that proactive action should be taken to ensure that the IDP is taken into account before the approval of the final budget by the municipal council. This assists to ensure that both the internal and external inputs are taken into account when the budget is finalised. It also helps to ensure that all planned capital purchases are approved by the municipal council and the necessary funding has been secured to fund the capital project as per Section 19(1) (b)-(d) of the MFMA (RSA, 2003).

Van der Wath (2010:01) argues that asset management is an approach the municipalities can utilise to reduce their capital spending. The author holds that investment in immovable non-current assets should not only be limited to construction of an asset, but a process that starts with a plan that is fit for the purpose. Moreover, the plan should effectively operate and maintain the asset through its lifetime and lastly consider an environmentally friendly way to retire the asset. Van der Wath (2010:01) agrees that capital investment or constructing of fixed assets such as immovable non-current assets leads to spending funds/capital but also holds that the capital spending can be minimised through effective asset management. All fixed assets (regardless movable or immovable) purchased by the municipality are used for service delivery directly or indirectly. Therefore, it is equally important when those assets can be stolen like movable non-current assets to consider ensuring effective asset management in order to reduce capital spending.

The third objective of this study is to analyse the AGSA report and identify any deviations from asset management, budgeting and capital budgeting policies and processes and assess the effect of such variances on the procurement of movable non-current assets at the Mbhashe Local Municipality. Van der Wath (2010:01) cautioned that without a plan that is fit for this purpose, the municipality is likely to spend more than what it budgeted. Furthermore, overspending can be minimised with sound asset management. Movable non-current assets are also part of fixed assets and are included during capital budgeting, hence the study's objective to determine if ineffective management of movable non-current assets is in any way negatively affecting budgeting and procurement thereof.

Joubert, Du Plessis, Von Holdt and Fourie (2014:34) agree with the views raised by Van der Wath that asset management is the way in which immovable non-current assets can be managed. In their view, the risk of total failure of immovable non-current assets can be avoided through appropriate maintenance and renewal of infrastructure. To prove their theory, they studied the Drakenstein Municipality in the Western Cape, which seemed to lead the way with regard to renewal and optimisation of their asset life cycle (how long their assets last). Joubert *et al.* (2014:35) cite reasons and strategies for the municipality's success in using a sophisticated risk model, as being the first municipality to develop a complete GRAP compliant and auditable asset register. The risk that movable assets can be stolen or used without authorisation make the sophisticated risk based model seem more suitable as a strategic asset management tool to minimise total failure and to reduce capital spending, that is why the focus of this study is movable non-current assets.

Gibson (2012:50) suggests that a practical approach to planning in compliance to a legislated budget and expenditure has a potential to structure the capital spending for municipalities. Gibson (2012:51) believes that in order to structure the municipal capital spending, the multi-layered approach can assist, whereby the SDF can serve as the municipalities' strategic guidelines for long term plans. The SDF can serve as the basis for IDP's, while the IDP's as the basis for the three year plan Medium-Term Revenue and Expenditure Framework (MTREF) that would include the annual budget as well as the following two years of planning. The multi-faceted approach would assist to ensure that the capital budget is not a baseless activity that does not consider user charges which could eventually lead to financial distress or failure of the municipality. This is the reason Gibson (2012:54) is in favour of a zero based approach to budgeting because he believes this method would force planners to include realistic figures in their budgets.

Gibson (2012:54) also revealed how including unrealistic figures in the budgets could be a serious challenge from which the municipality would experience great difficulty to recover. The aforementioned authors base their arguments on an immovable non-current asset point of view, which according to GRAP 17, is part of the property plant and equipment (PPE). It seemed fitting that the other elements of PPE such as movable non-current asset be given the same attention as infrastructure. This implies that similar to immovable non-current assets, movable non-current assets must be subject to user charges and maintenance costs such as the

repair of vehicles or costs to pay the driver which must be taken into account during planning.

#### **1.4 RESEARCH QUESTION**

In the context of the aforementioned discussions, the research question is formulated as follows:

Does ineffectiveness of movable non-current asset management limit the efficiency of capital budgeting for the procurement of movable non-current assets at Mbhashe Local Municipality?

In order to give effect to the research question, the following research objectives were formulated.

#### **1.5 RESEARCH OBJECTIVES**

For the purpose of this study, both primary and secondary objectives have been formulated.

##### **1.5.1 Primary objective**

The primary objective of this study is to determine whether ineffective movable non-current asset management limits the efficiency of capital budgeting for the procurement of movable non-current assets at the Mbhashe Local Municipality.

##### **1.5.2 Secondary objectives**

The following secondary objectives were formulated in order to give effect to the primary objective:

- To consider the literature of other scholars of how ineffective movable non-current asset management can affect budgeting and capital budgeting for purchasing movable non-current assets (*see Chapter 2*).
- To describe the theoretical framework of asset management processes, budgeting and capital budgeting as prescribed by the Municipal Finance Management Act no 56 of 2003 and the National Treasury (*see Chapter 3*).
- To analyse AGSA reports related to movable non-current asset management, budgeting and capital budgeting policies and processes as well as how deviations affect the procurement of movable non-current assets at Mbhashe Local Municipality (*see Chapter 4*).



- To summarise and recommend how the application of movable non-current assets and budgeting processes can be improved (*see Chapter 5*).

Following is a brief discussion of various procedures and tasks required to complete the study as well as ensure whether these procedures and activities are adequate to achieve the research objectives or to answer the research question of the study.

## **1.6 RESEARCH DESIGN AND METHODOLOGY**

In order to respond to the research question as well as achieve the objectives as outlined above, a research design and methodology will be briefly discussed. This brief description will include, amongst others, the concept of research, research design, the population to be studied and data collection methods.

### **1.6.1 The concept of research**

Leedy and Ormrod (2005:02) describe research as a “systematic process of collecting, analysing, and interpreting information (data) in order to increase our understanding of the phenomenon about which we are interested or concerned”. The research process also involves identifying an appropriate research design, data collection techniques as well as data analysis methods that are suitable for the study. According to Leedy and Ormrod (2005:94), there are three broad categories of research techniques which can be used by the researcher, namely:

- Qualitative research
- Quantitative research
- Mixed Research

Leedy (2005:02) asserts that the qualitative research method can be used to respond to questions about the complex nature of a phenomenon with the aim to understand the phenomena from the participant’s point of view while the quantitative research methodology is used to answer questions about relationships amongst measurable variables. The aim of the quantitative research method is to explain, predict and control the phenomena. Johnson and Christensen (2008:34) refer to mixed research as “research that involves the mixing of qualitative and quantitative methods or other paradigm characteristics”. Determining the suitable combination relies on the research questions and the situational and practical concerns facing the researcher. Furthermore, Johnson and Christensen (2008:35) state that

the mixed research approach considers both the quantitative and qualitative views significantly.

For this study, the qualitative research method has been selected in order to provide descriptive evidence regarding the significance of adherence to asset management processes and the impact thereof on capital budgeting decisions for purchasing movable non-current assets. The research process will include outlining the scope and the limitations of the research design selected.

### **1.6.2 Research design**

Leedy and Ormrod (2005:85) refer to a research design as a plan for the study. Similarly, Kumar (2014:122) defines research design as the road map that the researcher decides to follow during a research journey to find answers to a research question, as validly, objectively, accurately and economically as possible. According to Mouton (2001:56), the plan or the research design focuses on the end result for the study. This implies that the function of the research design is to conceptualise the operational plan and various procedures and tasks required to complete the study as well as ensure whether these procedures and activities are adequate to answer the research question. For the purpose of this study, the desktop research method was adopted.

Desktop research method uses secondary information collected from government publications, related literature and internet sources relevant to this study. According to Hague and Wilcock, (2015:01) desktop research method refers to the collection of secondary data or information which had been previously collected and processed such as published policies, reports and statistics. Although desktop research method has its advantages, such as being relatively quick, cost effective and the ease of access to information such as statistics and policy documents, it can still be a waste of time and money if not properly planned. Another weakness of desktop research method is that data collected is not primary data (Hague and Wilcock, 2015:01). However, unlike primary data that has not been subjected to criticism, secondary data has already been subjected to scrutiny.

According to Leedy and Ormrod (2005:89), secondary data is information that is farther from the truth while primary data refers to information that is manifested as the truth. The use of desktop research method limits the researcher from the benefits of primary data which

involves the research participants to justify their beliefs, actions and behaviour. For the purpose of this study credible document such as, AGSA reports, the National Treasury guidelines regarding asset management and the performance reports of the municipalities were used to examine the level of deviation between policy and practice. Hague and Wilcock (2015:01) assert that although desktop reports cannot be said to be correct, they are considered reliable since they have been produced by reliable government departments and institutions. In order to achieve the research objectives, the following data collection methods, processes and tools were used.

### **1.6.3 Population**

Chapter 7, Section 155 of the Constitution provides for three categories of municipalities, namely (RSA, 1996):

- Category A municipalities (Metropolitan) - municipalities that have exclusive municipal administrative and governmental authority.
- Category B municipalities (Local) - municipalities that shares municipal administrative and governmental authority in its area with a local municipality surrounded by the area it falls.
- Category C municipalities (District) - municipalities that has municipal administrative and governmental authority in an area that includes more than one municipality.

According to the RSA (2016:01), there are 278 municipalities in South Africa, of which eight are metropolitan municipalities, 44 district municipalities and 226 local municipalities. The AGSA, National Treasury and the media reports have stated that the Eastern Cape municipalities face significant challenges regarding capital budgeting, operational budgeting and asset management. According to the media reports (Daily Dispatch), these challenges have led to 13 of the 37 Eastern Cape local municipalities' to be in a financial predicament (Phandle, 2015:02). Mbhashe Local Municipality is amongst the 13 municipalities that the Daily Dispatch mentioned as municipalities that required intervention.

In order to manage the relevant information for this study, (such as audit and financial reports) three financial years were analysed, that is, three audit reports and three state of local government finances reports. Mbhashe Local Municipality is a low capacity municipality. According to Mahabir and Mabena (2015:247), a municipality's capacity determines its ability to fund their fixed or non-current assets/capital budgets. The authors also posit that

local municipality's operational and funding capacity differs from local, metropolitan and district municipalities. As a result of the differences in the municipalities' operational capacity and their source of funding for fixed assets, Mbhashe Local Municipality one of the seven local municipalities which are predominantly rural under Amathole District Municipality was selected for this study.

#### **1.6.4 Data collection methods**

Neuman (2006:364) identifies the following (as several of many) data collection tools:

- Interviews
- Observations
- Reports and other written data
- Oral data

Leedy and Ormrod (2005:95) characterise quantitative research as a methodology that examines the amount or a sum of variables while the qualitative research methodology explores the attributes that cannot be easily reduced to numerical values. For this study, the qualitative research methodology was adopted because it is expected that it will explain the quality of capital budgeting decisions made in the absence of sound asset management. This implies that data collected will be in the form of words not numerals. Typical data collection tools such as interviews and group discussions utilised in qualitative research will not be used. Instead, policy and process documents as reported by the municipality and AGSA will be scrutinised.

The comprehensive analysis of policy and process documents and audit reports was analysed to ensure that reliable and valid information was secured to draw the final conclusion. An analysis of existing and credible policy documents and AGSA reports was conducted to ensure that the findings were not bias. Most importantly, the analysis sought to collect information that was systematic, truthful and transparent could be reproduced. The analysis of the asset management and budgeting processes, AGSA reports and National Treasury policy documents to extract relevant information eliminated the bias that could have resulted from using respondents.

According to Kumar (2014:171), "the difference between qualitative and quantitative approaches, in brief, depends upon three things: how the data was collected; how it was analysed; and how the findings were communicated". Consistent with the objectives of the

study, literature related to asset management, budgeting and capital budgeting processes was discussed. In Chapter 2, Asset management, budgeting and capital budgeting policy and process set by the municipality as per the National Treasury guidelines will be discussed in Chapter 3. In Chapter 4, an analytical table will be used to compare the policies and processes at the Mbhashe Local Municipality to identify any deviations from policies and processes. The analysis revealed how Mbhashe Local Municipality's asset management and budgeting practice deviated from the policies for the 2011/12, 2012/13 and 2013/14 financial year.

### **1.6.5 Analysis of data**

Literature related to movable non-current asset management and capital budgeting policies and procedures was reviewed. Following the analysis of the framework and literature review, Mbhashe Local Municipality's application of these processes was analysed against movable non-current asset management and budgeting policy to determine any deviations. According to Leedy and Ormrod (2005:31), deductive reasoning is when the researcher uses self-evident and generally accepted "truths" to make judgements about practice, while inductive reasoning uses observations to make judgements. For this study, deductive reasoning will be used to make judgement about whether capital budgeting for procurement of movable non-current assets is effective in the absence of sound asset management at Mbhashe Local Municipality.

Asset management and capital budgeting policies and procedures provide steps to follow for managing procurement and control of movable non-current assets. However, AGSA still continues to mention non-compliance and in some cases non-existence of approved policies as guidelines. Below the relevance of the study will be identified and the contribution the study will have towards efficiency of capital budgeting and the sound asset management.

## **1.7 RELEVANCE OF THE RESEARCH**

Studies undertaken by scholars such as Gibson (2012) and Laldaparsad *et al.* (2013) focused on improving immovable non-current asset/infrastructure management while others such as Du Toit and Pienaar (2005); Bester (2006) focused on identifying effective capital budgeting techniques to improve decision-making. There are concerns regarding the time and effort that has been put into the budgeting process (Tewary, 2011:09). However, the purpose of this study is to establish how ineffective movable non-current asset management procedures can

affect budgeting and capital budgeting for purchasing movable non-current assets at the Mbhashe Local Municipality.

There has been consistent lamentation from the AGSA that poor financial management has been the main concern in the local government sphere. The Eastern Cape municipalities have faced challenges to account for their assets. The results in the FAR revealed that the value reflected in their balance sheets had been materially overstated (AGSA, 2012). Also, the Daily Dispatch reports claim that amongst the reasons for this “financial mess” is underspending of the capital budget, while there is also overspending of operational budget which is an indication of poor capital budgeting (Phandle, 2015:02).

According to the AGSA (2012), several reasons cited for inadequate financial reporting in municipalities have been poor compliance with GRAP 17 and Directive 7 procedures as well as capitalisation of Value Added Tax (VAT) resulting in over-statement of assets in the balance sheet. According to National Treasury (2012:04), GRAP 17 provides guidance to the municipalities of how to differentiate PPE from other non-current assets as well as provides guidelines of how these assets should be managed. Mbhashe Local Municipality is faced with similar challenges, regardless of asset management and budgeting policies and processes suggested by the National Treasury. The study is expected to contribute as follows:

- Encourage the development and implementation of movable asset management policies and procedures in local government in general and local municipalities in particular.
- Improve compliance with the developed movable asset management policies and procedures.
- Improve compliance with budgeting and capital budgeting policy and processes.
- Improve capital budgeting for procurement of movable non-current assets.
- Contribute to literature regarding the importance of asset management to budgeting and procurement of movable non-current assets.

Following the relevance of the research, the research ethics to observe when conducting research will be briefly discussed and how compliance in this study will be ensured.

## **1.8 RESEARCH ETHICS**

According to Leedy and Ormrod (2005:101), whenever human beings are the subjects of the study, careful attention should be given to ethical implications of what the study proposes to do. The ethics application for the research committee's approval should clearly outline how the concerns will be dealt with. For this study annual reports and policy documents will be analysed to solve the research problem. Consequently, there was no interaction between the researcher and the persons who prepared the financial, audit and policy documents. Moreover, it is against the university's policy to intentionally or unintentionally use someone else's work as your own, therefore, careful attention to referencing was observed at all times. Following a brief description of chapters is outlined.

## **1.9 CHAPTER OUTLINE**

The study consists of five chapters:-

- **Chapter 1.**

Background and introduction of the study, the chapter outlines the context, objectives and the purpose of the study.

- **Chapter 2.**

A literature review of contributions by various scholars in relation to how ineffective asset management can affect budgeting and capital budgeting for the procurement of movable non-current assets will be presented.

- **Chapter 3.**

The theoretical framework regarding the asset management process, budgeting and capital budgeting as prescribed by the MFMA and the National Treasury will be presented.

- **Chapter 4.**

An analysis of 2012, 2013 and 2014 AGSA reports with an emphasis on establishing deviations in movable non-current asset management, budgeting and capital budgeting policies and processes. Furthermore, an analysis of how the deviations affect the procurement of movable non-current assets at the Mbhashe Local Municipality is conducted.

- **Chapter 5.**

A summary and recommendations of how an efficient application of movable non-current assets management can improve budgeting and capital budgeting for the procurement of movable non-current assets at the Mbhashe Local Municipality will be provided.

### **1.10 SUMMARY**

In this chapter, the context of the research statement was outlined. The AGSA and media reports regularly highlighted the challenges of asset management and capital budgeting. The research question aims to establish “whether ineffective movable non-current asset management negatively affects capital budgeting at Mbhashe Local Municipality?”.

The aims and objectives of the study were to determine if ineffective asset management procedures negatively impact the efficiency of capital budgeting for procurement of movable non-current assets. National Treasury guidelines for movable non-current asset management and budgeting policies and procedures and AGSA reports have been examined to identify any deviations in the functions carried out at the Mbhashe Local Municipality. A summary of the views held by various authors of the topic was provided. Several authors agreed that asset management was the correct approach while others supported integrated development planning as an approach to improve capital budgeting. An area which received much attention was infrastructure. This study hopes that the findings will contribute to the movable non-current asset management theory as well as improve the application of asset management and capital budgeting processes for municipalities in general and Mbhashe Local Municipality in particular. A detailed literature review will be provided in Chapters 2 and 3.



## **CHAPTER TWO**

### **SOUND ASSET MANAGEMENT AND ITS IMPACT ON EFFECTIVE BUDGETING FOR PROCUREMENT OF MOVABLE NON-CURRENT ASSETS**

#### **2.1 INTRODUCTION**

Assets represent a significant value in an organisation. As a result, Section 19(1) (a) (b) (d) of the MFMA (RSA, 2003) stipulates that the municipality can only spend money on capital projects if there are funds set aside in the budget. MFMA also requires that the total cost has to be approved by the municipal council and sources of funding have been carefully considered and were not committed for other purposes. Section 96 of the MFMA (RSA, 2003) also declares asset management as a process that includes among others: safeguarding and maintenance of existing assets, ensuring that the municipality maintains a management accounting, information and internal control system such as asset registers that effectively account for assets as prescribed by the National Treasury.

It is clear that effective asset management and accounting systems is expected to assist the municipality to better manage their existing assets, and in order to justify future purchase assets. The primary objective of this study is to determine whether ineffective movable non-current asset management limits the efficiency of capital budgeting for the procurement of movable non-current assets at the Mbhashe Local Municipality. This chapter will investigate the views of various scholars to establish the impact of ineffective asset management on capital budgeting for the procurement of movable non-current assets.

Asset management in the South African local government sphere will be discussed to identify the deviations that exist between the National Treasury guidelines and the implementation at Mbhashe Local Municipality.

## **2.2 ASSET MANAGEMENT IN THE SOUTH AFRICAN LOCAL SPHERE OF GOVERNMENT**

### **2.2.1 Legislation**

Section 152 of the Constitution (RSA, 1996) requires local government to fulfil its primary mandate, that is, to provide services in a sustainable manner. This conforms to the MSA (RSA, 2000) Section 4 (2) (d) which stipulates that the municipality has a duty to ensure that the municipal services are provided in a financially and sustainable manner. This implies that asset management is necessary. The MFMA (RSA, 2003) Section 63(1) (2) tasks the Accounting Officer (henceforth Municipal Manager) with the responsibility of managing the municipal assets by taking reasonable steps to ensure that there are effective systems that control and account for assets.

According to Boshoff (2009:01), the extent, value and the condition of assets are fundamental to determining the service delivery potential of a municipality and the post-acquisition funding required in order to realise the service potential of the assets. This implies that good management of assets increase the useful life thereof and reduces the costs of servicing the assets. Boshoff (2009:01) also acknowledges that, presently, municipal asset information is either outdated, unreliable or simply non-existent. Joubert, Du Plessis, Van Holdt and Fourie (2014:01) concur that asset information that is incomplete or non-existent makes the assessment of asset service potential difficult.

The observations by Boshoff (2009:01); Joubert *et al.* (2014:01), are substantiated by the National Treasury (2008:04) which confirmed that the lack of reliable data regarding asset values and conditions of assets is the reason for the challenges experienced by asset managers when they are required to justify scarce resources to maintain and renew existing assets. In an attempt to provide additional support for municipalities and asset managers, the National Treasury drafted LGCAMG which provides practical assistance regarding the procedures for managing public assets. The guidelines address the essential asset management steps which include, amongst others, identification of assets, recognition and complete recording of all existing assets and new asset acquisitions.

The National Treasury (2008:04) also encourages the establishment of credible and accurate data foundation in asset registers in order to facilitate the implementation of Section 63 in the

MFMA as referred to above. Slogrove (2008:14) acknowledges that municipalities face challenges to account and report their assets. Slogrove (2008:14) mentions that the recording of transferred assets between municipalities, the lack of sufficient knowledge and skills, inaccurate financial records and recording of assets as projects rather than individual assets are challenges that result in poor asset management.

Overall, Slogrove is critical of the amount of work that creating a complete asset register takes in order to achieve "... little returns of just an unqualified report". If reporting assets is a challenge, this means even information on which asset needs are based is incorrect. Joubert *et al.* (2014:38), share the following lessons that could be learnt from the Drakenstein Municipality. The municipality managed to use the risk based approach to prolong and manage the life cycle of their critical assets while simultaneously managing to develop and maintain a complete and GRAP compliant asset register. The following lessons can be learnt from the Drakenstein Municipality:

- The Drakenstein Municipality developed an up-to-date asset register based on the asset data, renewal treatments and tactics as well as risks related to non-maintenance of infrastructural assets.
- They also managed to establish a continuous process for maintaining their fixed assets.
- The Drakenstein Municipality created a continuous documentation of all the processes that affected infrastructural assets.
- They established regular checks of asset conditions, especially the critical assets in order to eliminate any risk of complete failure of those assets.
- They were able to compare theoretical outputs to actual budgets to identify any areas of improvement.
- The municipality managed to keep records of operational and maintenance expenditure to facilitate maintenance schedules and pro-long the infrastructural lifespan.

These lessons prove that although developing a complete and a GRAP compliant assets register may be challenging as mentioned by Slogrove (2008:14) above, it is not impossible to achieve and that the benefits are not only limited to just an audit opinion. Moreover, when the municipality maintains a detailed GRAP compliant asset register this could eliminate social, environmental and economic risks that the community is exposed to. Also, assets can

fail because of limited data relating to risks that were not prevented, detected and corrected on time (Joubert *et al.*, 2014:34).

Similarly, Ault, Van Der Meijden, Toneguzzo, and Welch (2004:06) shares the views by Slogrove who blames the lack of skills, inadequate capital budgeting and separation of data collection and input information systems as possible reasons that lead to poor asset management and poor investment decision-making. The National Treasury (2013:14) also condemned the weak multi-year budgeting, limited planning and project management and supply chain management inefficiencies as the root causes of poor financial management and poor asset management systems.

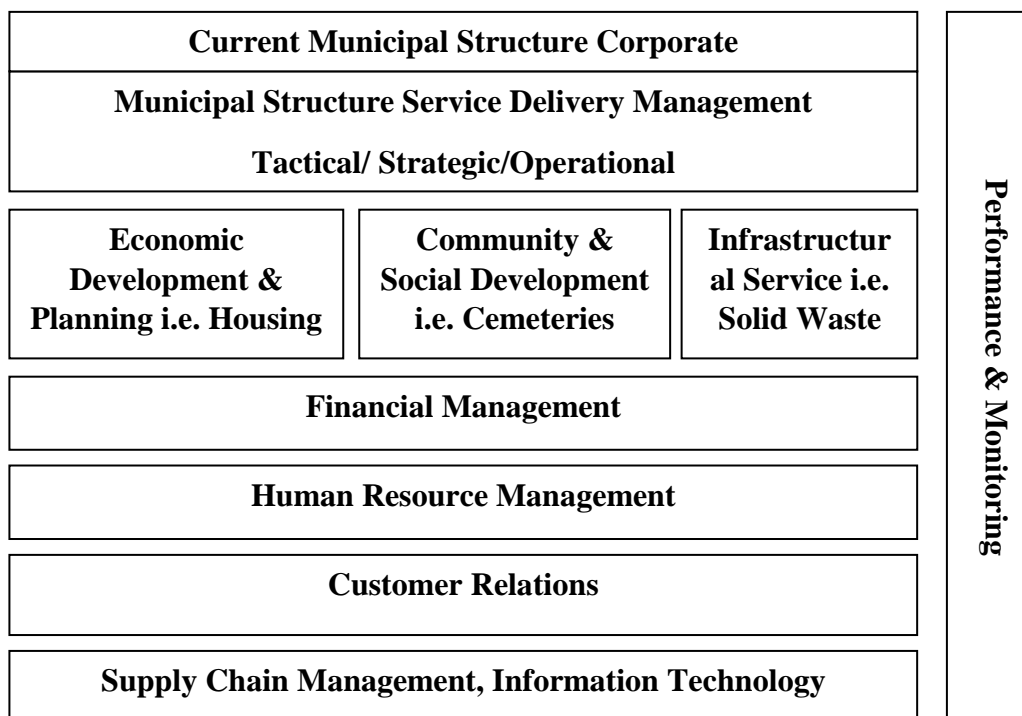
The National Treasury also noticed that there was an increase in underspending of actual capital expenditure compared to expected capital budgets, while there was a rise in operational spending from 2009/10 to 2013/14 at the Mbhashe Local Municipality. The National Treasury also cited that this increasing trend of underspending was an indication of financial distress. This was confirmed by the media reports as cited earlier that the Eastern Cape municipalities are in a financial mess. The Mbhashe Local Municipality was included in the list.

Although Myburg, Dreyer and Van Der Westhuizen (2011:46) agree with the multi-layered approach to planning, they also call for a paradigm shift from the current municipal structure to a new municipal organisational structure that is more structured and has organised asset management systems. Myburg *et al.* (2011:46) believe that an organised approach to asset management systems can lead to sustainable service delivery if municipalities can have a clear organisational structure, authority and allocation of responsibility. These authors are also aware that the responsibility of asset management falls within the financial management function in the current structure, but have concerns with the current municipal structure.

Myburg *et al.* (2011:48), realise the challenges municipalities face under this current structure, such as, developing a GRAP compliant and auditable FAR. They believe the challenges of developing a GRAP compliant and auditable FAR are well-known, but they are more concerned about the actual maintenance of a FAR, managing the life cycle of critical assets and ultimately coping with the ever increasing service delivery levels. In order to address the unrecognised challenges of maintaining a FAR, Myburg *et al.* (2011:48), suggest

asset life cycle management as necessary strategy to cope with the current service delivery needs. Myburg *et al.* (2011: 49), recommend that Asset Management should be established as a separate but fundamental function that will serve as a strategic business function for service delivery.

In the envisaged structure, Myburg *et al.* (2011:50) paint a picture of how municipal service delivery management will be structured and asset management as a business function will be a permanent and a noticeable feature. The current structure only features the following functions: economic and development, community and social development as well as infrastructural service function. Myburg *et al.* (2011:50), argue that the existing structure does not enhance the attainment of service delivery goals. According to Myburg *et al.* (2011:50), the municipality’s organisational structure requires assets that are in good condition as and when required. Hence, the need to have asset management as a strategic business function that can ensure the availability of well-performing assets. The current and envisaged municipal structure as proposed by Myburg *et al.* (2011:50) is as follows:-



Source: Myburg *et al.* (2011:50)

**Figure 1:** *The Current Municipal Structure*



Source: Myburg *et al.* (2011:50)

**Figure 2:** *The Envisaged Municipal Structure*

According to Myburg *et al.* (2011:50), the above municipal structure is expected to have the following benefits:-

- The envisaged municipal structure is anticipated to result in improved municipal direction in the form of clear strategic plans and improved asset management policy objectives and plans.
- It is also predicted that it will lead to a functional organisational structure that has clear plans for performance improvement.
- It is also projected that it will lead to an established asset management system, established physical asset performance systems and the ability to correct issues as and when required.
- It is also expected to improve business processes, such as identifying the need for new assets or replacements of existing assets.
- The predicted municipal structure is also expected to ensure that assets perform according to set standards.

Myburg *et al.* (2011:50), in their argument recommend an overall integration of the asset management function as strategy to all the other functions in the municipal structure. The additional benefit of the proposed structure is that, it is expected to identify and clarify roles which had been unclear because of the inclusion of asset management in the financial management section. Moreover, a department will be solely responsible to safeguard and keep movable non-current assets in good working condition.

Van der Wath (2010:01) concurs with Myburg *et al.* (2011:47) that asset management has a potential to optimally preserve assets. According to Van der Wath (2010: 01), the protection of assets can be achieved if the municipalities focus on safety, risk control and accurate information collection relating to assets. The latter author also asserts that these focus areas are fundamental to strategic decisions and could assist to establish future funding needs for assets.

Gibson (2012:54) uses the example of water supply that collapsed due to poor maintenance plans that resulted in unplanned costs. The incorrect estimation of costs and incomplete information about how many households should receive the supply of water did not only affect the audit reports but affected the entire municipality socially, environmentally and economically. Incorrect information and incorrect estimation of movable non-current asset costs consequently would result in similar effects, for example incorrect values reflected in the balance sheet of the municipality.

Matthias (2011:05) expressed similar concerns as Myburg *et al.* (2011) that the asset management function seemed to be misunderstood and misplaced in the municipal structure. Mathiba conducted a study that outlined the responsibilities of the Municipal Manager, the Chief Financial Officer (CFO) and the managers concerned with movable asset management in the correctional services. Mathiba (2011:05) used an evaluation tool to compare the actual practise to the policy guidelines of asset management. Amongst the issues that Mathiba identified were the following as reasons for poor asset management:

- Lack of continuous training for employees.
- The organisational structure excludes the asset management section and the positions of asset administrators.
- Certain departments assumed asset management to be the responsibility of the finance departments.

The concerns listed above are similar to those highlighted by (CoGTA, 2009:01); Myburg *et al.* (2011:50), where all agree that there seems to be uncertainty of who is responsible for the asset management function. As a probable solution, Mathiba (2011:90) recommends the inclusion of asset management in the department's structure in order to clearly place the asset administrators in the hierarchy. Mathiba (2011:90) also suggested that in order to prevent unauthorised use of movable non-current assets, the latter should be chained to the walls. Chaining movable assets to the walls, though unconventional and unreasonable reveals that unauthorised use of assets is a valid risk that needs effective asset management. The suggestion also acknowledges that mobile assets are at risk of being moved from one location to another without authorisation.

It is evident from the literature cited above that, poor skills, lack of knowledge in key positions, poor leadership, poor asset management and the lack of budgeting skills seem to be the major root causes for the poor financial health in local government. Moreover, Mathiba (2011:90); Myburg *et al.* (2011:50), suggest that not having asset management as a feature in the municipality's organisational structure is the reason for misunderstanding of whose responsibility is asset management within an organisation.

Mbhashe Local Municipality audit and the State of Local Government Finances reports will be examined in order to establish the consistency of the audit queries related to asset management, budgeting and capital budgeting. The ability to spend was another performance area that was examined from 2012; 2013; 2014 to respond to the study's research question. The study also examined whether key positions such as the Municipal Manager and the CFO were filled throughout the period of the study. The Municipal Manager as a custodian of assets is responsible to ensure that the asset management policy in general and the movable asset management policy in particular are implemented. The CFO is administratively responsible to account for the assets including the preparation of budgets (Fourie and Opperman, 2007:08). An analysis of the role of the aforementioned role-players is necessary to determine whether they were available to perform their roles.

### **2.2.2 Asset Management Process**

Fourie and Opperman (2007:335) highlight that movable non-current assets are at risk and recommend municipalities to have a formal fixed asset management policy and procedures to



address the risk associated with fixed assets in general as well as movable assets in particular. The risks associated with movable non-current assets include amongst others:

- Wastage of resources through abuse or neglect of movable non-current assets.
- The financial risk as a result of unnecessary and early replacement of movable non-current assets because of failure to implement adequate maintenance programmes.
- The financial risk such as loss or theft of movable non-current assets due to inadequate security measures.
- Operational risk as the result of impairment or destruction of movable non-current assets due to the lack of adequately skilled staff.

According to the National Treasury (2003:08), asset management consists of the following phases where strategic decisions related to movable non-current assets can be identified and suitable responses can be developed:

- Strategic planning phase;
- acquisition phase;
- operation and maintenance phase and
- disposal phase.

Strategic business decisions that need to be taken into account during planning include, *inter alia*, the details of proposed movable non-current asset acquisitions, maintenance and the expected revenue from the sale of the asset. The National Treasury (2003:08) prescribes that these decisions should be made with the municipality's service strategy in mind. Consideration of a service delivery strategy also implies that future asset acquisitions are directly linked to the municipality's long term strategy or they might be inadequate for service delivery. According to Schuman and Brent (2005:02), asset management is an integrated set of comprehensive processes to gain maximum effectiveness, utilisation and return from the use of assets.

Schuman and Brent (2005:02) believe that effective asset management is essential to increase the returns or service rendering potential throughout the asset lifetime. The authors also acknowledge the challenges that are encountered from managing assets from a lifecycle perspective, for example, managing costs that are fragmented. For example, there are costs associated with the planning phase such as evaluate whether assets are suitable. During the

acquisition phase, there are budget and technical specification as well as operational costs during the utilisation phase such as maintenance.

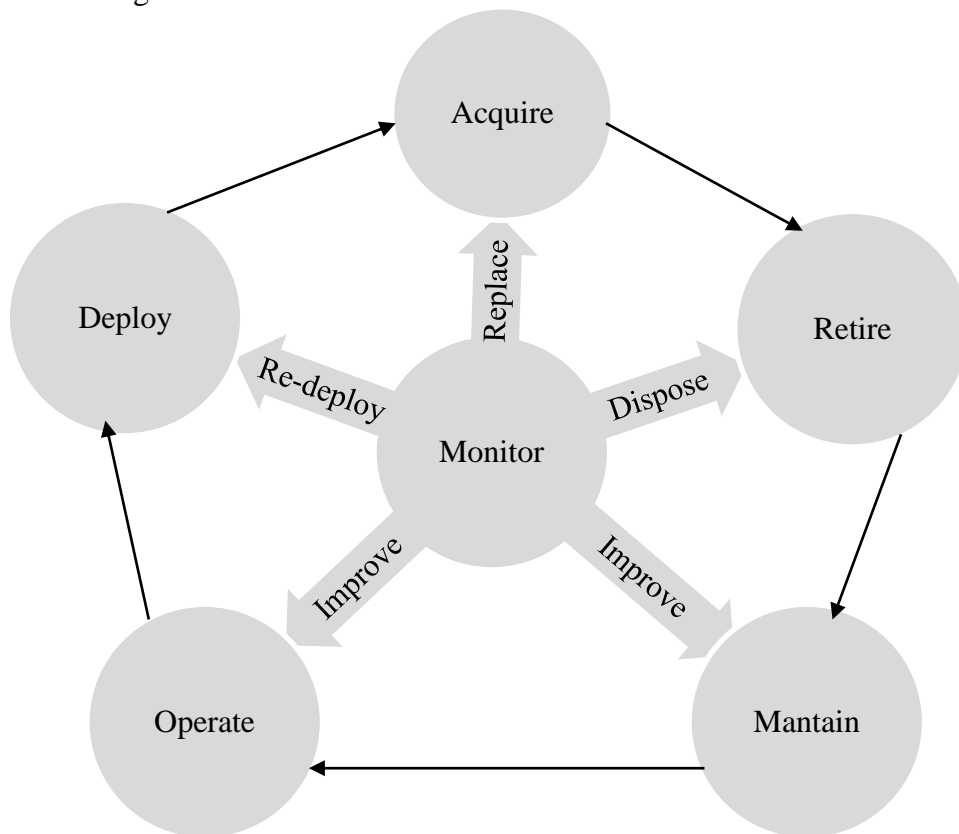
All these costs occur at different stages of an asset's life cycle and Schuman and Brent (2005:02) suggest a holistic lifecycle management model to manage the fragmented costs at the different life stages of assets. When asset costs are integrated throughout the life cycle of the assets, it is referred to as the holistic lifecycle management model (Schuman and Brent, 2005:02). The following benefits can be achieved from asset lifecycle management (ALCM) (Schuman and Brent, 2005:02):

- ALCM reduces maintenance costs during the utilisation phase.
- Managing assets from the planning phase to the disposal phase prolongs the life of an asset.
- ALCM increases the reliability of an asset.

Ouertani, Parlikad and McFarlane (2008:06) also believe in asset life cycle management which considers the beginning of the life, middle-of-life and the end of life as interdependent processes. Considering these asset stages as interdependent processes is vital for effective asset management. Ouertani *et al.* (2008:06) emphasise that monitoring and capturing information of key events throughout the asset lifecycle can help achieve effective asset management. Similarly to the National Treasury (2003:08) above, the following are asset life cycle phases that are interdependent and should be observed to collect key asset related information (Ouertani *et al.*, 2008:06):

- Acquire
- Deploy
- Operate and maintain
- Retire

Figure 3 illustrates that the asset life cycle phases are interdependent and the importance of monitoring assets:



Source: Ouertani *et al.* (2008:07)

**Figure 3:** *Asset Life Cycle Phases*

Ouertani *et al.* (2008:07) also believe that periodic monitoring of assets is possible if the municipality has a clear asset information strategy. The asset information strategy would assist to minimise the challenges concerning the availability of assets that are reflected on the balance sheet. Hence, the emphasis on monitoring is expected to help confirm the availability and the condition of assets in order to justify future asset decisions. Abdelhamid, Beshara, and Ghoneim (2015:02) support this view and suggest that strategic asset management can serve as a valuable tool to provide the municipality with a systematic and consistent approach of meeting the community's service delivery requirements. This is evidence that managing assets from 'Cradle to Grave' can be beneficial in fulfilling the fundamental constitutional mandate of the municipality and provide services for the community. Moreover, it could assist to justify the capital decisions made by asset managers.

Amongst the issues identified by National Treasury (2014:30) in their report of local government finances was, inadequate budget for maintenance and repairs and ineffective asset management. The National Treasury financial report attributes this neglect to maintain

assets and poor management of assets for the negative financial health of municipalities. The National Treasury (2014:30) outlined the medium-to-long-term consequences of cutting back the budget for repairs of assets as follows:

- Deteriorating reliability of assets and quality of services.
- Crisis maintenance rather than scheduled maintenance.
- Deferred maintenance costs and refurbishment.
- Shortening useful life of assets leading to premature replacement or disposal.
- Reduced revenue as a result of asset failure.

National Treasury (2004:03) formulated the LGCAMG to help minimise the challenges highlighted above and assist asset managers who labour to justify their asset acquisition decisions to be armed with better decision-making tools. The literature revealed that there are concerns and uncertainty of the timing when assets should be replaced, especially when there is poor asset management throughout all the lifecycle phases. As a result, the asset managers find it difficult to justify their asset acquisition needs because of the lack of complete asset information. The research question sought to establish: “Whether there could be effective capital budgeting for the procurement of movable non-current assets in the absence of sound asset management?”.

### **2.2.3 The Role of the Municipal Manager in Asset Management**

According to Fourie and Opperman (2007:335), effective asset management is dependent on assigning municipal officials with specific functions and duties. The Municipal Manager is considered as the principal custodian of the municipality’s fixed assets (Fourie and Opperman, 2007:335). The primary role of the Municipal Manager is to ensure that:

- The municipality’s assets are safeguarded and maintained.
- Municipal assets are valued in accordance with GRAP.
- The municipal fixed asset management policy is implemented.
- The policy permits the CFO to amend, delete or add entries to the FAR (Fourie and Opperman, 2007:335).

The following are the responsibilities of the Municipal Manager regarding asset management as prescribed by the National Treasury (2012:125):

- The Municipal Manager is the principal custodian of assets and is responsible for establishing asset management policies and procedures as well as ensuring that these policies are adopted by the municipal council.
- The Municipal Manager should ensure appropriate systems to account for assets exist.
- The Municipal Manager is expected to guarantee that assets are valued in accordance with GRAP and that an asset register is established and maintained.
- The Municipal Manager is expected to ensure that internal control for assets are established and exercised.
- Lastly, the Municipal Manager is required to ensure that Heads of Department comply with the movable asset policies as adopted by the municipal council.

#### **2.2.4 The Role of the CFO in Movable Non-current Asset Management**

Fourie and Opperman (2007:95) refer to the CFO as the Registrar of the municipality's fixed assets. The responsibilities of the CFO include, amongst others:

- Implement the FAR.
- Responsible for any amendments in the FAR.
- Prescribe the format of the FAR.
- Ensure that the format of the FAR conforms to the broad requirements of the National Treasury, Accounting Standard Board and sound accounting principles (Fourie and Opperman, 2007:335).

The aforementioned requires that relevant data of non-current assets is promptly, accurately and fully recorded in the FAR. Since assets are not only utilised by the CFO, Fourie and Opperman (2007:335) suggest that the senior officials in charge of the departments where assets are allocated should take direct responsibility for adequate maintenance, physical security and effective use of movable non-current assets.

The CFO is responsible for the management of the following movable non-current assets as prescribed by National Treasury (2012:125):

- The CFO is the registrar of fixed assets who is tasked to ensure that an accurate and complete asset register is maintained. The CFO should ensure that no additions or deletions should be made without his/her written approval.

- The CFO has to ensure the implementation of proper asset management procedures, that is, assets that are bought are budgeted for, accounted for and are safeguarded.
- He/she should also ensure that appropriate financial management and internal control systems related to assets are designed and applied diligently.
- The CFO has to ensure that financial and other resources such as municipal movable assets are utilised effectively, efficiently, economically and transparently.
- The CFO should also prevent any unauthorised, irregular, or fruitless or wasteful expenditure and losses resulting from criminal and negligent conduct.
- Lastly, the CFO should ensure that all revenue due to the municipality as a result of use of assets is collected.

Budgeting procedures in the South African local government sphere will be discussed to identify the deviations that exist between the National Treasury guidelines and the implementation at Mbhashe Local Municipality.

## **2.3 BUDGETING IN THE SOUTH AFRICAN LOCAL SPHERE OF GOVERNMENT**

### **2.3.1 Legislation**

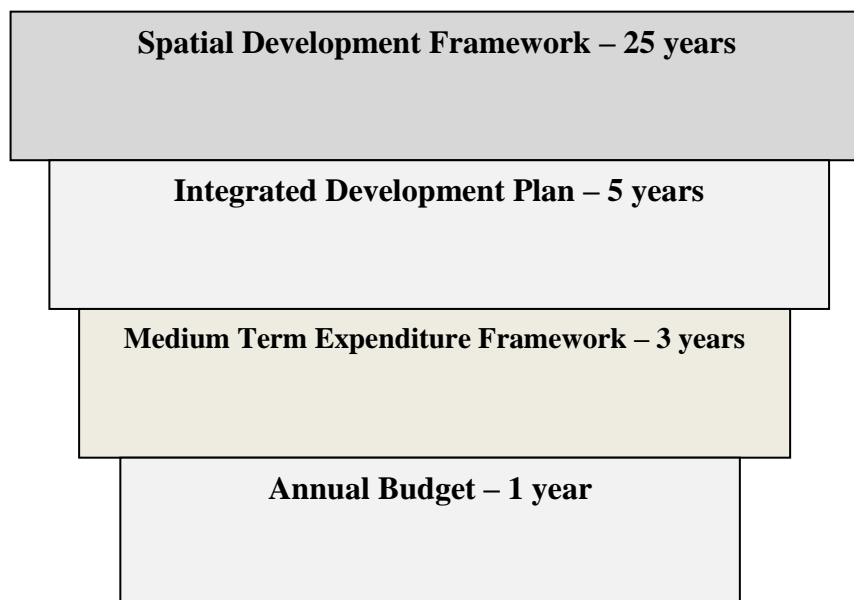
Amongst the challenges faced by the provincial and the local government, CoGTA (2009:01) highlighted "... inadequate skills on planning, budgeting and public financial management and expenditure". As a probable solution, (RSA, 2003) Section 21(1) suggests the use of IDP as a tool to improve financial management and planning for municipalities. Fourie and Opperman (2007:95) suggest that a budget should credibly allocate estimated resources in order to achieve performance objectives that were identified as priorities in the IDP. According to Gibson (2012:51), the primary objective of the IDP is to identify future assets needed for service delivery and inform the capital and the operational budget of the municipality's priorities.

Fourie and Opperman (2007:95); Teary (2011:09); Marimutu and Cloete (2010:145); Fourie (2005:04) define the budget as a strategic tool for implementing the IDP or as a standard against which financial performance can be measured. The planning can be short-term, medium-term and long-term. The different planning horizons help to deal with both strategic costs such as capital assets and the short term costs such as operational costs. Gibson (2012:50) supports the multi-layered approach to budgeting because the author believes that

the strategic plans inform the IDP, the IDP informs the medium term plans and medium term plans are the bases for the annual budget.

### 2.3.2 Budgeting Process

Gibson (2012:50) suggests that the use of practical budgeting and compliance with the legislative requirements encourages a more structured approach to planning. Gibson (2012:50) believes the IDP prescribed by the RSA (2003) Section 21 (1) will assist the municipality to produce effective budgets and enable municipalities to spend their money in a more structured manner. Figure 4 illustrates how compliance with the MFMA prescriptions may assist to create the budgeting structure for municipalities (Gibson 2012:50):



**Source: Gibson (2012:50)**

**Figure 4:** *Integrated Development Planning*

Figure 4 illustrates connections between planning horizons and how each planning stage can be used to inform the following stage. Figure 4 also illustrates the multi-layered approach to budgeting and the benefits of each planning step. Gibson’s view is primarily based on the use of a practical budgeting approach. This implies that in order to achieve a “credible” budget, all the planning phases should be considered and reflected on the annual budget.

Laldaparsad *et al.* (2013:37) examined whether capital investments affected the spending patterns of specific municipalities and to prove if these spending patterns can be aligned with

the SDF and the municipal IDP's. In their quest they acknowledged the historic background of the municipalities and the interventions that the current government had undertaken to address the challenges. Laldaparsad *et al.* (2013:31) also acknowledged the views of the current government strategies and interventions. Certain individuals perceive the IDP as a wish list and municipal budgeting as an instrument that is less recognised.

Laldaparsad *et al.* (2013:31), hold that although the municipal budget is not a strategic document, it is the most practical mechanism to implement the SDF or to execute the “master plan”. In their study, Laldaparsad *et al.* (2013:31) were able to provide evidence using a case study of municipalities at which the SDF positively influenced capital spending patterns and there were relatively high spending patterns in areas that were previously disadvantaged compared to those areas that were not. Laldaparsad *et al.* (2013:31) were able to prove that the history of infrastructure challenges contributed to strategic plans that were appropriate and also informed the capital budgeting plans to achieve those strategic plans.

Van der Wath (2010:01) argues that unnecessary capital spending can be minimised through effective asset management. Van der Wath (2010: 01) cites that infrastructure delivery goes beyond construction, but a process that involves the following:

- A plan that is fit-for-purpose – This plan will include what suitable assets to buy or construct and the appropriate methods of capital finance.
- An effective plan of how to operate and maintain assets through their lifetime - This is where the users for assets are specified and the maintenance intervals are decided.
- A detailed retirement and disposal plan that is environmental friendly – This is when the timing to withdraw the asset and the environmental approaches to discard withdrawn assets are decided.

Van der Wath (2010:01) posits that the integration of asset management to the planning process or budgeting has the potential to improve policy formulation, practice and delivery of services by the public sector.

Tewary (2011:09) and Craythorne (2006:255) concur with the RSA (2003) Section 21 (i) that prescribes the procedure to be followed during the budgeting process:



- The Mayor must ensure that the IDP and the agreed changes are realised in the final budget as approved by the majority of the municipal council. The IDP is the wish list that needs to be analysed and prioritised then approved by the municipal council. This means only the priorities of the IDP make it to form an annual budget.
- The Mayor should table the budget to the municipal council 90 days before the budget date. The budget date is the date of commencement of the budgeted financial year.
- The preparation, tabling and approval of the annual budget should be completed before the budget date.
- An annual appraisal of the IDP in terms of the MSA and the budget related policies are performed to finalise the budget.
- The budget should be tabled to the municipal council and adopted. Any amendments to the IDP, budget related policies should also be implemented and any consultative input should inform the final budget.

According to the RSA (2003) Section 21 (i), the Mayor must ensure that the above steps are completed so that the annual budget is approved. The delay in the approval of the budget by the municipal council may defer the process (Tewary, 2011:09). The RSA (2003) Section 19(1) (a) also stipulates that only items included in the annual budget can be purchased. This implies that the budget has to be approved before the start of the budget period, failing which delays may occur. Elmer (2005:16) outlines the same budgeting steps as the RSA (2003) Section 21 (i) which includes: organising and developing, identifying, selecting suitable assets as well as preparation and adoption of the budgeting process before its implementation.

### **2.3.2.1 Organising the Process**

This step of the process involves selecting the lead department to commence the process. The finance department should be selected to lead the process as well as establish a committee to co-ordinate the process. Having a dedicated department will help to control the process and will ensure accountability for the ultimate success or failure of the project (Elmer, 2005:16).

The finance department will be responsible to plan the meetings with the municipal council and enable a consultative process to take place in advance. This process, according to Tewary (2011:09), should start as early as before the end of the municipal financial year and not when approaching the commencement of the budgeting period (for example, the process

should start as soon as the final budget of the following year is adopted by the municipal council at the end May).

### **2.3.2.2 Developing the Process**

The Finance Department should create an overall budget schedule which outlines the dates of meetings in preparation for the final submission. This helps the internal participants (Departmental Heads) and external participants (the municipal council) to ready their inputs when required. The Finance Department should send relevant forms to departments to facilitate the internal participation and contribution towards the budget (Elmer, 2005:16).

### **2.3.2.3 Stakeholder Involvement**

Stakeholder involvement includes both internal (employees) and external stakeholders (community). Although the municipalities in South Africa are considered to be community institutions, they are still perceived as behind in implementing participatory budgeting (Matsiliza, 2012:451). Matsiliza suggests that more efforts still need to be made to encourage public participation. This implies that input is expected to emanate from external and internal participants. The lack of participation from external participants may result in consideration of only internal input. This implies that the municipality plans may not include what is considered as a priority for the community.

There has been criticism that the budget process seems to be getting more attention than the actual results (Tewary, 2011:10). Hofert (2006:22) addressed this concern and suggested that emails should be used to facilitate internal contributions in order to limit the number of budgeting meetings held in order to collect departmental contributions. Hofert (2006:22) proposes that the Financial Department should control the process centrally. This real time budgeting process will enable the municipality to focus on service delivery and other issues such as preparing the annual financial report which takes place at the same time as the beginning of the budgeting period.

### **2.3.2.4 Identifying, Analysing and Classifying Projects and Funding Processes**

This step of the budgeting process includes reviewing municipal operations and identifying priorities and classifying them as projects. The community at this stage should be involved to identify the projects that they would like the municipality to prioritise. The involvement of the community implies that management is not in complete control of what to purchase as far as capital projects are concerned, hence, the consultation of outside stakeholders is necessary.

When there is common agreement of priorities and approval by the municipal council, the appropriate funding sources should be selected (Elmer, 2005:17).

#### **2.3.2.5 Selecting the Suitable Project to Meet the Community's Needs**

Based on priorities identified by both the community and the municipality management, proposals are submitted, evaluated and classified. The common priorities of the submissions will be selected and included in the annual budget (Elmer, 2005:17).

#### **2.3.2.6 Preparation and Recommendation of Annual Budget Plans**

This includes the process of completing the National Treasury budget packs and the finalisation and the adoption of the annual budget. Consultation with the relevant district municipalities and other local municipalities is conducted for feedback. This is where performance indicators and project development milestones should be established for the successive reporting process (Elmer, 2005:17; Craythorne, 2006:256).

#### **2.3.2.7 Adoption and Implementation of the Annual Budget**

If the municipal budget council is satisfied that all the processes have been followed, the annual budget should be adopted and be ready for implementation by the end of May. However, if not, the adjustments should be finalised and adopted by the end of June each year. Tewary (2011:10) acknowledges that although the budgeting process is a prolonged, preparation of an annual budget on time could help so that activities such as financial reports and service delivery programmes can be completed timely. When the actual plans are incomplete or inaccurate, the annual budget may not serve its purpose, which is to measure performance against plans. Tewary (2011:11) also asserts that if the budget is to serve its purpose of being a standard to measure performance, actual performance should be analysed in order to establish whether it is reflective of the budget.

### **2.3.3 The Role of the Municipal Manager in the Budgeting Process**

Fourie and Opperman (2007:95) refer to a budget as the most immediate and important mechanism of giving effect to service delivery by the municipality. Fourie and Opperman (2007:95) also emphasise that municipalities must ensure that the annual budget is output driven and conforms to the service delivery objectives outlined in the IDP. Moreover, the emphasis is on realistic allocation of expected resources to secure the defined objectives as approved in the IDP. The following are the responsibilities of the Municipal Manager in relation to the budgeting process:

- Implementing the annual budget.
- Ensure that all the expenses conform to the budget.
- Ensure that revenue and expenses are monitored properly.
- Report to the municipal council when there is an impending shortfall in budgeted revenue or overspending of the budget as well as outline steps to correct identified deviations.
- Inform the National Treasury in the advent of a bank account being overdrawn.
- Within ten working days of each calendar month the Municipal Manager must inform the National Treasury about the status of the municipality's budget for the month concerned.

According to Section 100 (a)-(c) of the RSA (2003), the role of the Municipal Manager includes implementing the municipality's budget which includes taking effective and appropriate steps to ensure that:

- Funds are spent in accordance with the budget;
- revenue and expenditure are properly monitored; and
- spending is controlled when the anticipated revenue is less than as expected in the budget.

#### **2.3.4 The Role of the CFO in Budgeting**

According to Fourie and Opperman (2007:40), the responsibilities of the CFO includes, amongst others:

- If the duty to invest has been delegated to him/her by the municipal council, the CFO should do so on behalf of the municipality in accordance with the framework recommended by the Minister of Finance.
- Report progress on a regular basis to the municipal council that delegated his/her duties and
- To adhere to the municipal staff members code.

According Section 81 (a) and (e) of RSA (2003), the CFO of the municipality is responsible administratively for the budget that includes:

- The preparation and implementation of the municipality's budget.
- The performance review and analysis of the municipality's budget.

Capital budgeting procedures in the South African local government sphere will be discussed to identify the deviations that exist between the National Treasury guidelines and the implementation at Mbhashe Local Municipality.

## **2.4 CAPITAL BUDGETING IN THE SOUTH AFRICAN LOCAL GOVERNMENT SPHERE**

### **2.4.1 Legislation**

Unlike a budget which is defined as a strategic tool to implement the IDP, capital budgeting is an analysis and evaluation of investment projects that generally produce benefits over a number of years (Correia *et al.*, 2008:03). The following are capital budgeting examples as listed by Correia *et al.* (2008:03): replacement or expansion project, independent and mutually exclusive projects and divisible and indivisible projects. Correia *et al.* (2008:03), emphasise that capital budgets play a vital role and if not accurately evaluated, the investment decisions taken may be irreversible and impact negatively on the growth of the municipality.

Firer, Ross, Westerfield and Jordan (2012:03), also state that determining the size, timing and the risk of cash flow are essential to identifying whether the cost of the asset/project does not exceed its worth. Marx, De Swardt, Beaumont, Naicker and Erasmus (2004:231) define capital budgeting as the process of evaluating and selecting long term investments that conform to the goal of increasing the firm's value. Selecting movable non-current assets which exceed the costs of the cash inflows or their service potential would not add value. Elmer (2005:05) illustrates why capital budgeting should be considered as an integral part of overall planning without neglecting the operational costs embedded from the capital investments.

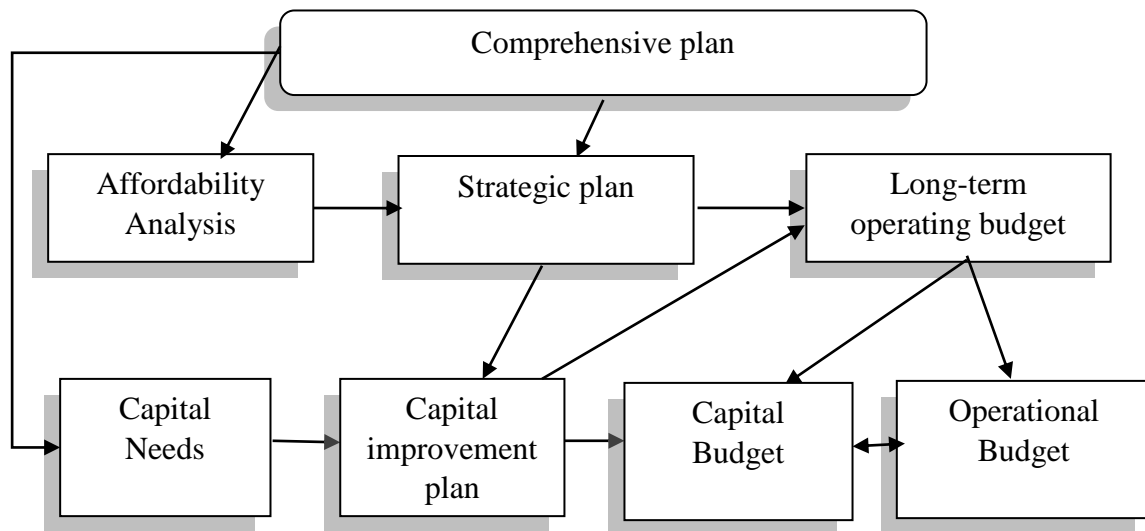


Figure Source: Elmer (2005:05)

**Figure 5:** *Integration of Planning and Annual Budgeting (capital budgeting and operating budget).*

Figure 5 is similar to the multi-layered approach as suggested by Gibson. Similar to Gibson's multi-layered approach, Elmer (2005:05) also explains the integrated approach to planning that commences with the comprehensive plan which is analysed to determine capital needs and affordability of those needs. The affordability analysis forms the basis of the municipality's strategic plan which has two objectives, that is, to identify and develop the capital improvement plan and the long term operational plan.

The long-term operational plan has two components which are capital budget and operational budget. Capital budgeting is the detailed plan of buying and funding capital assets such as buildings, equipment and vehicles whereas operational budget is a plan of operational costs that will be incurred to support capital assets to be purchased and how those costs will be funded. It is important to note that these planning stages are interdependent, which means one plan informs another, that is why the whole processes is referred to as integrated planning (Elmer, 2005:05).

Fourie and Opperman (2007:114) agree with Figure 5 that there is an influence between planning, capital budgeting and operational budget. Consequently, they propose that when preparing an annual budget, the municipal council should be made aware of the operational costs that are a direct consequence of capital expenditure. The authors also suggest that when approving the annual capital budget, the municipal council should be made aware of the

possible costs that could go beyond the planning period. The operational costs that the municipal council should be made aware of during capital budgeting includes:

- **Finance charges** - this would be included if the source of financing was a loan or a finance lease.
- **Annual depreciation expenses** - must also be estimated on all new purchases of movable assets.
- **Maintenance costs** - these are costs to preserve or prolong the service life of the asset. Maintenance expenses should also be brought to the attention of the municipal council.

There are two types of budgets, namely: operating budget and capital budget. The capital budget is a complete financial plan to purchase long term assets such as vehicles, equipment and other capital assets, while the operating budget refers to the monetary plan that deals with the daily costs and income to deliver municipal services (Local Government Finances and Budgets, (2015:01). According to Fourie and Opperman (2007:114), the local municipal budgeting council should be made aware of probable future costs that will have to be incurred as a direct result of buying fixed assets. Hence, the need for preparation of an operational budget to ensure fixed assets work as intended. For the operating and capital budget there is a process that the municipality has to follow which is referred to as the budget and the capital budgeting process.

#### **2.4.2 Capital Budgeting Process**

According to Firer *et al.* (2012:04), capital budgeting steps includes, amongst others, deciding on suitable assets, determining the total cost of the asset and the cost effective way of funding the assets as well as the effective management and use of those assets. Firer *et al.* (2012:04), assert that following the budgeting steps ensures that assets to purchase are worth more than they cost to purchase. Fourie and Opperman (2007:115) also recommend that South African municipalities adhere to budgeting steps, so that they can avoid any unwelcomed surprises. As such, the objective of this chapter is to review literature regarding how ineffective asset management can affect capital budgeting for the procurement of movable non-current assets.

The following are the capital budgeting techniques used by municipalities:

- Incremental (traditional) budgeting
- Performance (contemporary) budgeting and

- Zero based (contemporary) budgeting techniques

The municipalities have been using these techniques as a means to quantify their financial plans to purchase capital assets. The last two are considered as contemporary based techniques while incremental budgeting is considered as traditional. Following an overview of the budgeting techniques is provided.

#### **2.4.2.1 Incremental (Traditional) Budgeting Approach**

Fourie and Opperman (2007:115) assert that municipalities previously used traditional methods of budgeting techniques such as incremental budgeting because of its advantages. Although traditional budgeting has its advantages, such as easy to prepare and a strong control of expenditure limits, it also has its challenges, for example, failure to provide information regarding detailed activities such as how the money was spent. Mkhize and Ajam (2006:763) state that traditional budgeting focused only on keeping control of the expenditure of government resources in order to achieve a standard financial limit.

Mkhize and Ajam (2006:763) also assert that the advancement from traditional budgeting to performance or contemporary budgeting is a strength that can improve financial management and capital decisions within the municipalities. On the contrary, Asha (2014:803) blames the lack of municipal capacity and not budgeting techniques used for decision-making as the major factor that prevents the municipalities from achieving the policy mandates as prescribed by the National Treasury.

#### **2.4.2.2 Performance (Contemporary) Budgeting Approach**

According to Mkhize and Ajam (2006:763), an evolution from the traditional to the contemporary approach has benefits for the municipalities. The contemporary budgeting approach allocates resources in terms of objectives to be achieved and relates resources to results. It also acknowledges the relationship between input, process and output. For example, it acknowledges that inaccurate input results in an incorrect process and output (Tewary, 2011:09). Using the contemporary budgeting approach integrates strategic planning, financial planning and performance management. It also emphasises the need for accountability of results and not merely procedural accountability based on the system's rules. Unlike the traditional method that focuses on meeting only the standard of performance, the emphasis on the contemporary budgeting approach also focuses on effective service delivery (Erasmus, 2008:60).



Overall, performance or contemporary budgeting is concerned with effective and efficient management of resources linking input, output and performance management of resources. Several authors such as (MFMA RSA, 2003; Mkhize and Ajam 2006:764; Fourie and Opperman 2007:115) suggest that each annual budget must be aligned with the municipality's approved IDP's. This implies that there is no need to "re-invent the wheel". The IDP priorities should form the basis for the annual budget, capital budget and operational budget (Gibson, 2012:49).

#### **2.4.2.3 The Zero based (Contemporary) Budgeting Approach**

Fourie and Opperman (2007:117) recommend that the zero based budget is the suitable budgeting technique for capital budgeting. Zero based budgeting means there is no automatic inclusion of expenses or purchases and all purchases should be justified before they are included in the annual budget. For example, even though operational costs are unavoidable and uniform, these can be changed due to acquisition of new assets. As a result of the possible acquisition, additional expenses have to be accommodated and presented during the finalisation and tabling of the IDP. Zero Based budgeting is unlike incremental budgeting. In the case of the latter, the budget items are increased by a percentage regardless of their relevance whereas the zero based approach reviews the relevance of the budget items before including them on the budget (Fourie and Opperman, 2007:117).

Gibson (2012:50) also highlights the adversity that could happen if user charges are accounted for inappropriately. Gibson (2012:53) supports the implementation of the zero based budgeting approach. Gibson also reveals that a municipality had not included inadequate user charges for housing. That municipality's budgeted amount for water was unable to cover the water bill to the Water Board because the increase did not cover the amount of water required for the developed households. Gibson also believes that capital budgeting should not be a surprise as it is informed by the SDF and IDP's. In order to ensure a practical approach to budgeting, Gibson suggests business plans and the implementation of service delivery budgets as a means to supplement the annual and capital budget. Zero based budgeting consists of five key steps, namely:

#### **Step1 - Decision Packages are Generated and Presented**

In this step the Financial Manager should develop and present alternatives to the asset portfolio committee to persuade them for their approval to purchase the asset. To convince an asset portfolio committee, the financial manager has to show that there are future

economic benefits that can be derived from investing in the project. According to Fourie and Opperman (2007:96), unlike the companies whose objective is to make a profit, the evaluation of projects is based on accrued income and expenditure for the asset and not on cash flows.

The process of selecting packages involves a detailed plan to justify the need for the project/capital assets. This includes the “what if” scenarios to address the possibility if any, of withdrawal, postponement or termination of the project. The presentation of the scenarios should be accompanied by the performance indicators. The performance indicators such as over and under performance should be explained at this stage. Based on the community’s needs and the priorities of the municipality, the decision packages are evaluated and the best project/asset is selected (Fourie and Opperman, 2007:96).

## **Step 2 - Review and Analyse Capital Projects**

Marx *et al.* (2004:230), note that an evaluation and analysis of capital projects/assets helps to determine if the projects/assets fits the needs of the community. Mkhize and Ajam (2006:764) state that effective asset management starts from understanding the service delivery and community needs to minimise future capital outlays. Consequently, review and analysis is encouraged to determine whether the asset or the project is suitable and cost effective to purchase.

Mkhize and Ajam (2006:764) believe that review and analysis of possible investments helps to plan for assets that are suitable for the community’s needs. This review of assets ensures that the municipality’s asset operations are effective. The review and analysis of capital projects allows an opportunity to outline or explain to the asset portfolio committee what it will take to maintain the asset throughout its lifetime. The financial manager can also use this opportunity to explain when the asset will be disposed and the amount at which the asset can be disposed. Finally, a report can be written recommending whether or not to invest in an asset.

Joubert *et al.* (2014:34) state that minimising capital investments is an activity that starts from evaluating and maintaining the existing assets. Hence, the capital outlays or capital spending can be minimised when maintenance of existing and critical assets is given priority.

The authors conducted a study to determine how the Drakenstein Municipality developed, completed and maintained a GRAP compliant infrastructure asset register.

Joubert *et al.* (2014:34) established how the Drakenstein Municipality managed to optimise their entire asset portfolio. The municipality uses a sophisticated risk based model which takes social, environmental and economic risks associated with infrastructure into account. The reported benefits over and above a complete GRAP compliant asset register revealed that the municipality was also able to establish a set of data that facilitates the renewal of their asset portfolio.

The risk based model utilised by the Drakenstein Municipality has enabled them to collect fundamental data such as asset data, renewal treatment and tactics as well as the extent to which the risk maybe exposed to if not maintained properly. This broad detail helps to justify prioritisation of maintenance and renewal of critical assets. For example, if an asset provides water supply to the community, complete failure of such an asset due to non-maintenance could risk the health of the community, the environmental hygiene and revenue loss for the municipality. Joubert *et al.* (2014:36) also confirmed that the Drakenstein Municipality like other municipalities faces similar financial constraints, but prioritisation guided by a risk based approach has helped them to justify what is most important in their long term planning and capital budgeting for infrastructure.

### **Step 3 – Decision-making**

According to Marx *et al.* (2004:40), when making capital investment decisions, the size of capital outlay determines the level within the municipality where the investment decision should be made. There is contradiction between MFMA (RSA, 2003) and the MSA (RSA, 2000) regarding who has the final decision regarding procurement of assets/investments outside or below a specific threshold. MSA RSA (2000) stipulates that the municipal council may only delegate the responsibility of the Municipal Manager or the Asset Portfolio Committee to make investment decisions on behalf of the municipality for assets that are below the threshold while, on the other hand, the RSA (2003) Section 63 (1) stipulates that the Municipal Manager is the one responsible for the management of assets within the municipality.

Whoever is responsible to make the decision, must ensure that the investment decision is worth more than its cost. Erasmus (2008:60) supports the idea of choosing economic, efficient and effective investments. Erasmus believes that expenditure control alone does not ensure that quality or value is received. Simply put, the decision to invest or not to invest should be based on investment costs versus economic benefits due to the municipality.

#### **Step 4 - Implementation**

Once a decision to buy the asset has been made and the funding to finance the asset is taken, greater control can be exercised. According to Marx *et al.* (2004:40), capital assets have relatively high capital outlays. Consequently, on receipt of the asset it should be inspected to determine whether it was approved and is the actual asset that was purchased. Payments such as maintenance costs and repairs should also be monitored and controlled. For example, where the actual expenditure deviates to what was presented during the evaluation and analysis stage, any variances must be investigated and corrective action should be taken (Marx *et al.*, 2004:40).

According to Erasmus (2008:60), the budget does not serve as a control if it is only used at the end of the year, by then the damage may have already been done. Erasmus agrees with Marx *et al.* (2004: 232), that continuous review of the appropriateness of assets would help to determine whether to terminate or to take corrective action that will reduce the related expenses.

#### **Step 5 - Control**

According to Mkhize and Ajam (2006:763), the evolution from traditional budgeting encourages the use of input, process and output as a means to contemporary budgeting. This implies that the importance of control does not end with the implementation phase but continues throughout the lifetime of the asset. Analysing the outputs also helps to provide feedback of whether the expected costs and economic benefits that were outlined when the proposals were presented have been achieved.

The comparison of inputs and outputs helps to compare the current output to the previous output to establish whether there has been any improvement or decline over time. The analysis also helps to identify any variances and actions to be taken to improve where there has been a decline and also take the positives and use them to improve future performance. If the project is a multi-period one and it is not performing as expected, a decision may be taken

to withdraw or suspend the project. The analysis of inputs and outputs can assist the municipality to terminate a project that is less profitable. Marx *et al.* (2004:232), hold that the control stage of the budgeting process helps to identify the overall risk, returns and the value that is created through the asset or project.

There seems to be an understanding that although the National Treasury has given the necessary support to improve financial management, risk control and decision-making for the municipalities, they still lack capacity to implement the remedial strategies. Asha (2014: 803) also acknowledges that the issue of poor financial management and budgeting, lack of performance systems, fraud and corruption and political influence continue to be challenges. To correct the aforementioned challenges, interventions such as the turnaround strategy, MFMA, MSA, (RSA, 2008) and IDP were implemented. Asha (2014:803) believes that these interventions have not been yielding results because of the lack of capacity within the municipality.

Ajam (2008:45) emphasises that “budgeting is both a political and a technical financial process which creates a unique set of contradictions”. Ajam (2008:45) does acknowledge that the lack of skills is a serious concern but there is also another element, the political aspect. For example, for major assets to be purchased, municipal council approval should be acquired as prescribed by Section 19 (1) of MFMA (RSA, 2003). In other words, although budgeting is a technical matter, it is dependent on the political power for approval. Although this seems to be a contradiction, Ajam sees this as an opportunity to create culture. Instead of seeing the budget as a technical exercise it should be perceived as an inherently social process that is meant to shape the fabric of an organisation (Ajam, 2008:45).

Ajam (2008:46) suggests that instead of reducing a Management by Objective Budgeting (MOB) process to a paper work programme, it should rather be used as a conversation about service delivery. Management by Objective (MOB) is when managers decide whether to include in the budget on what they want to achieve for the municipality without the input of the internal and external community. Ajam believes that budgeting and planning should be viewed as aligned processes rather than be seen as the driver of the process. Ajam (2008:46) also criticises the lack of alignment between budgeting and planning. The author believes that it “... encourages the status quo and prevents transformation”.

### **2.4.3 The Role of the Municipal Manager in Capital Budgeting.**

According to Fourie and Opperman (2007:113), just like the annual budget, the capital budget must also be aligned with the municipality's approved IDP. Alignment of the capital budget simply implies that the municipality's planned IDP priorities should be reflected in the capital budget. The reflection of IDP priorities in the capital budget implies that it is not just a wish list of projects or assets (Fourie and Opperman, 2007:113). Fourie and Opperman also urge that a credible budget is the one in which expenditure is matched with realistically forecasted revenues. The following are the responsibilities of the Municipal Manager in capital budgeting:

- To ensure that the municipality spends money on capital projects only if the monies for such projects has been allocated in the capital budget.
- To ensure that the total costs of purchasing an asset has been approved by the municipality council.
- To ensure the capital funds for funding assets have been secured and that the funds have not been committed for other projects.
- To ensure that any transfer of capital assets conforms to the supply chain management policy, for example, no assets that provide basic services are transferred or sold unless otherwise approved by the council in an open meeting to the public (Fourie and Opperman, 2007:27).

According to the Section 19(1) (a) - (d) of the MFMA (RSA, 2003) the Municipal Manager must ensure that:

- Cost feasibility studies have been conducted and the funds appropriated in the capital budget.
- The total cost of the capital budget is approved by the municipal council.
- The capital project contracts having future budgetary implications are carefully considered and
- The sources of funding are considered and not committed for other purposes.

These responsibilities reflect that purchasing non-current assets should not be a random activity, there has to be an assessment of the need, feasibility and affordability by the municipality.

#### **2.4.4 The Role of the CFO in Capital Budgeting**

Fourie and Opperman (2007:138) list the following capital budgeting responsibilities of the CFO:

- Comparison of average annual or revised operating and capital budgeting with the actual results obtained.
- Provide justified comments of material deviations that exist between actual results and the capital and operating budget.
- Provide an overview of the following year's operating and capital budget, with comments on the significant features thereof as well as compare the budgets with the previous financial year's performance.
- Assess the levels of payment of rates and service charges and the evidence of what has been done or will be done to encourage the community to pay rates or service charges.
- Evaluate and comment on the treatment of accumulated profits or deficit.
- Assess the extent to which the municipality has used and continues to depend on external funding and grants.
- Comment on the municipality's reserves and their appropriateness to handle the municipality's future requirements.
- Assess whether the post-balance sheet items are significant to have any bearing on the information contained in the balance sheet.
- Evaluate the extent to which vital financial risks have been managed.

According to the Section 19(1) (a) - (d) of the MFMA (RSA, 2003) the Municipal Manager must:

- Conduct the cost feasibility studies and ensure that the necessary funds are set aside in the capital budget;
- Present the total cost of the capital budget and seek approval from the council;
- Carefully consider capital project contracts that have future budgetary implications and
- Circumspectly consider the sources of funding capital projects and ensure that these have not been committed for other purposes.

The evaluation of actual performance of all the budgets as well as the assessment of the municipality's ability to generate their own revenue rather than depend on external funding

would assist with realistic preparation of the budget. It also assists to assess the municipality's potential risk as a result of poor budgeting and managing their capital expenditure.

Following, a summary of literature review regarding asset management, budgeting and capital budgeting is provided.

## **2.5 SUMMARY**

From this literature review, it was noted that budgeting does not start from the date when the schedule of the annual budget has to be drafted and issued to departments but immediately when the financial year begins. Authors such as; Elmer, Gibson, Ajam, Matsiliza and others agree that the strategic planning informs the budgeting process. There is also indication that it is a time consuming and overwhelming process since it falls at the same time as when annual financial statements are finalised. Although the timing of budgeting process is a concern, there are constructive suggestions of how to avoid the pressure that must be adhered to with the process.

There is evidence that although the process seems challenging, there are success stories, for example, that of Drakenstein Municipality which succeeded in developing and implementing a complete GRAP compliant asset register. For example, starting the budgeting process early at the beginning of the financial year in order to complete the process within a reasonable time has also been recommended as a way in which to ease the municipal official's busy schedules.

There seems to be consensus among most researchers cited in this chapter that the challenges faced by municipalities are as the result of the lack of knowledge and skills, poor budgeting, asset management systems. These challenges are also credited to misunderstanding the role of annual budgeting and its use. For example, others feel that much more is time dedicated to budgeting than implementation. Positive suggestions have also been made that instead of perceiving the budget as the driver of the budgeting process, it should rather be seen as the tool to start service delivery dialogue. This is possible only if the municipality develops the capacity and communities would be active participants rather than passive while others decide on their needs. The approach has been towards embracing contemporary as opposed to traditional budgeting because of its holistic element.



## **CHAPTER THREE**

### **THEORETICAL FRAMEWORK: ASSET MANAGEMENT, BUDGETING AND CAPITAL BUDGETING AS PRESCRIBED BY MUNICIPAL FINANCE MANAGEMENT ACT AND THE NATIONAL TREASURY**

#### **3.1 INTRODUCTION**

In Chapter 2, the literature revealed that under-spending compared to capital budgets remains a concern. Tewary (2011:09) on one hand questioned the attention given to the budgeting process rather than the actual operations thereof. Moreover, Myburg *et al.* (2011:46); Mathiba (2011:90); Van der Wath (2010:01) are concerned with asset management and its impact on service delivery. The aforementioned authors suggest that asset management should be given more attention because it could reduce capital spending and thereby enhance service delivery. Gibson (2012:54); Macfarlane *et al.* (2008:06), also support the view that asset management is important for service delivery and correct asset information should be provided to prevent risks associated with movable non-current assets such as misuse or destruction.

Fourie and Opperman (2007:335) recommend that municipalities should have a formal fixed asset management policy which could prevent and address such risks. Bester (2006:4-8) cautioned that once an investment is made or an asset is bought, it is difficult to reverse without excessive loss or decline in the organisation's growth. Bester (2006:4-8) advises that the proper evaluation of investment options should be conducted before taking an investment decision. The concern is that purchasing non-current assets takes more than an accounting period. Moreover, because of time value of money, there is a risk that the promised cash flows will differ from the actual cash flow, hence the need for extensive investigation of different projects (Bester, 2006:4-8).

The objective of this chapter is to describe the theoretical framework of the asset management process, budgeting and capital budgeting as prescribed by the MFMA and the National Treasury. It is evident from the literature in Chapter 2 that asset management implies taking decisions and is not only about when to acquire assets, but also, how to maximise their service potential/cash flow generation. It can be thus concluded that asset management is a business process or a framework that takes into account cost effective

investment decisions, considers time value of money, economic factors and lifetime costs associated with the assets. This chapter expounds upon the definition of assets and the asset management process, followed by an explanation of each asset management step and how each step can affect capital budgeting decisions.

Following the description for different assets is provided. The description looks at different characteristics of assets in general and the attributes of movable non-current assets in particular.

### **3.2 DIFFERENTIATION OF ASSETS**

There are numerous definitions of assets. Fourie and Opperman (2007:431) define assets as: assets that are used for generating net cash flow while, the service potential assets as those that are used to deliver goods and services according to the municipalities objectives. National Treasury (2003:5) classifies assets as non-current and current assets. Non-current assets have a useful life of more than a year, while current assets have an estimated shorter life span which can be changed to a new asset or consumed within one year. Viljoen (2009:1) further classifies assets as movable and immovable non-current assets. Immovable assets are fixed to land (for example land or buildings). Movable assets (for example: vehicles, equipment and machinery), which can easily be misused or stolen are not attached to land and buildings.

According to Venter (2007:238), the life span for short-term assets (for example: inventory) is relatively easy to plan for than long-term assets (for example: vehicles). The study focuses on movable non-current assets because these are mobile. There is adequate literature that reveals the risk of these assets like being misused, damaged, misplaced or stolen if not secured properly. Mathiba (2011:90) suggests that over and above tagging movable assets with barcodes in order to prevent misuse, they should be chained to the wall or the floor. The risk of misuse or unauthorised use may have been the reason Mathiba earlier made the radical suggestion to chain movable assets to the wall. The use of unconventional methods to control assets implies that safety is a real concern; one which if not addressed, could create challenges when asset managers plan asset replacements.

The following discussion expounds upon the asset management framework and models that serve as guidelines to exercise control of assets.

### 3.3 ASSET MANAGEMENT MODELS

This chapter will focus on asset management models that must be adhered to when planning, purchasing, using and selling of movable non-current assets and its impact on capital budgeting decisions. As mentioned in Chapter 2, asset managers struggle to justify their capital budgeting decisions because information of existing assets is either incomplete or non-existent (National Treasury, 2008:04). The incomplete or non-existent asset information and the risks related with movable non-current assets impede the decision-making process.

Fourie and Opperman (2007:335) including Tewary (2011:20) highlight the possible risks the municipality could encounter if movable assets are not managed. These include, *inter alia*:

- The depletion of assets through abuse or neglect of movable non-current assets.
- Financial risk as a result of early replacement that may be required.
- Financial risk resulting from inadequate security or control of assets.
- Unnecessary impairment or destruction as result of incompetent staff or poor controls.

In the previous chapter it was suggested that holistic life cycle management is a probable solution to ensure that assets are available as and when required. This implies that the fundamental objective of the municipality to provide services to the community can be fulfilled if assets are maintained in good working condition. Fourie and Opperman (2007:335) assert that fixed assets are the substantial portion of investments by municipalities that are instrumental for service delivery. They emphasise the reduction of the extent of risk related to movable non-current assets in order to maximise their economic benefits. They also suggest that in order to reasonably control risks that movable non-current assets are exposed to, the municipality must ensure that the roles and responsibilities of the municipal officials are clear.

The Municipal Manager, who is the protector of movable assets should develop a movable asset management policy that conforms to the Accounting Standard Board, the National Treasury and GRAP17 (Fourie and Opperman, 2007:08). The Financial Officer, who serves as the fixed asset registrar should ensure that a complete and accurate asset register is maintained with complete and current movable non-current asset information (Fourie and Opperman, 2007:08). Myburg *et al.* (2011:50); Mathiba (2011:91) conclude that the municipal structure should reflect asset management as a fundamental function and the responsibility of movable asset manager.

The risks identified above by Tewary (2011:20) should be addressed in order to safeguard the municipal investment as highlighted by Fourie and Opperman (2007:335). National Treasury (2003:01) suggests that effective asset management principles depend on the proper application of management control and asset life cycle management. They also prescribe an integrated approach to asset management to enable the municipality to provide effective and efficient quality services. National Treasury also proposes a strategic approach to asset management, where each step of the process is followed and where service delivery would be the centre of asset management, thereby result in informed budgeting decisions.

Moreover, National Treasury (2012:128) suggests that asset management should be viewed as a process chain and not as individual components. In other words, capital budgeting is dependent on all the remaining steps of asset management. The “value chain” process includes, *inter alia*, the following steps in the asset management process (National Treasury, 2012:128):

- The development of policies and procedures to guide acquisition, use and disposal of assets.
- Approval of assets to purchase, determine the appropriate financing options, acquire the approved asset and receive assets purchased.
- Create a detailed record for movable non-current assets and ensure that they are marked and allocated to appropriate individuals and location.
- Update financial records with the details of new movable non-current assets, set depreciation estimates and ensure assets are insured.
- Comply with the set policies and procedures, maintain and secure movable non-current assets while in use in order to control/avoid incurring excessive costs due to misuse, loss or damage of those assets.
- Approve disposal of excess movable non-current assets and replace those that are retired.
- Manage movable non-current asset information which involves stock count, asset reports, updated FAR, monitor usage and ensure a financial plan to replace movable non-current assets.

Rahim, Refsdal and Kenett (2010:04) support the National Treasury (2003:01) stipulations that management control should drive asset management while they perceive leadership as authors of asset management policies and procedures. Rahim *et al.* (2010:04), suggest that

the municipal leadership ensure that “... no harm is done by people and that the environment leads to reduced risk”. The authors introduced the so-called “5 C model” which aims to maintain the integrity of the asset. Rahim *et al.* (2010:02), assert that the “5 C model” is vital to ensure a reduction in operating costs as well as increased efficiency and productivity of assets.

The “5 C model” encourages asset integrity which also implies the level of reliance on the entity’s assets. The components of “5 C model” include (Rahim *et al.*, 2010:02):

- Competency of the municipal personnel to operate the assets.
- Compliance with policies and procedures as recommended.
- Communicate the policies and procedures to the municipal personnel.
- Co-ordinate the functions in order to collect complete asset information.
- Control the asset management processes and subsequently, the use of assets.

Mathiba (2011:90) believes failure to train employees regularly results in poor financial and asset management. Mathiba (2011:90) blames absence of Asset Administrators as one of the reasons that may lead to poor asset management, supply chain management, strategic budgeting and movable asset control. Lastly, Rahim *et al.* (2010:02), posit that when skilled and qualified employees are employed who comply with the prescribed and well communicated policies and procedures, a clear direction and control of movable non-current assets is provided, which can result in controlled operating costs and productive movable non-current assets.

Reliance or lack thereof on movable non-current assets can affect productivity (for production assets) or service delivery for service delivery assets. Therefore, having strong principles or values would ensure that movable non-current assets are used for the municipality and the community’s benefit and are not misused.

Next, the Asset Management Framework will be discussed to ascertain whether adherence to asset management process enhances asset life and thereby improves the effectiveness of capital budget.

### **3.4 ASSET MANAGEMENT FRAMEWORK**

According to the National Treasury (2003:02), the asset management framework “... focuses on the ‘what to do’ in embarking on the process of asset management”. Management control and asset life cycle management is discussed hereunder. Management control refers to leadership that is provided by the Municipal Manager and the municipal council. Life cycle asset management involves managing movable non-current assets from the planning stage to the disposal stage of those assets (National Treasury, 2003:02). Municipal management formulates policies and procedures or represents the “Tone at the top” which means they play an important role in the management of movable non-current asset (National Treasury, 2003:02).

#### **3.4.1 Management Control**

National Treasury (2003:02) expects the municipal management to encourage adherence to movable non-current asset policies and procedures as well as ensure that there are complete records to confirm existence thereof. The municipal management must ensure that a complete movable non-current asset register is kept and reviewed to facilitate improved financial reporting, reliable operations and effective asset management (National Treasury, 2003:04).

#### **3.4.2 Asset Life Cycle Phases**

According to the National Treasury (2003:07), the Asset Management Framework suggests that assets should be treated from a life cycle perspective. According to Schuman and Brent (2005:567), asset lifecycle management is an approach to improve physical asset performance. Movable asset performance plans should include the following:

- Management should design activity plans to collect the level of service provided. This will assist to provide operating costs based on activity plans.
- Performance documents like clock cards should be recorded weekly and monthly reports should be compiled.
- Employees should be provided with the necessary training to operate movable non-current assets.

The asset life cycle phases include:

##### **a) Identification of Assets Required**

According to the National Treasury (2003:09), identifying of required assets should be based on strategic programme delivery, the scope and the standard of service delivery. The

municipality at this stage assesses the method of delivering the service, develop techniques of how to meet the service delivery demands which includes identifying movable non-current assets required to deliver those services. Asset identification should also take into account the financial, economic, social and environmental benefits that can be attained from purchasing movable non-current assets (National Treasury, 2003:10).

At this stage, decisions to use existing assets, contractors to provide required services or redesign the service to reduce the need to purchase movable non-current assets can be considered. The municipal objectives and the community priorities should be made a priority during the identification of assets process. This is undertaken within the guidelines of the strategic asset policies and procedures as developed by management or the Municipal Leadership.

#### **b) Acquisition Phase**

Following the policies and procedures that were developed during the strategic planning phase in compliance with Preferential Procurement Policies Framework and Supply Chain Policies, assets are bought, built or created. For example, appropriate procedures to purchase assets should be adhered to. Adherence to the policies will help to avoid any unnecessary capital and operational expenditure. It is important that the user of the asset suggests the movable non-current assets they require, timing of asset requirements, the projected method to purchase and the funding options that will be used when purchasing or constructing movable non-current assets (National Treasury, 2003:15).

The careful consideration of what and when to purchase movable non-current assets would help to ensure that assets that are fit-for-purpose are bought/constructed as and when required. Matsiliza (2012:451) encourages the use of participatory budgeting as a tool municipality can use to avoid purchasing movable non-current assets that are irrelevant for the community. Matsiliza (2012:451) explains participatory budgeting as the contributions that are made both by the external and internal community during the budgeting process.

This is the pre-acquisition plan which encompasses strategic planning where policies and procedures are formulated to guide asset purchases, operations and disposal of movable assets. This acquisition plan requires the evaluation of alternative assets, possible asset life cycle cash flows, alternative means to finance the asset or select the appropriate method to

acquire an asset (National Treasury, 2003:15). The acquisition phase is not an event, but a step in a process because it is important to what will be included in a capital budget. Therefore, the purchasing, operations and maintenance phase also require the same attention.

### **c) Operation and Maintenance Phase**

The strategic operational and maintenance policies that were developed by management during strategic planning should be followed by the development and implementation of the operational and maintenance plans. National Treasury (2003:10) prescribes that operational control is exercised while individual assets are assessed to estimate the amount that should be budgeted as the operating costs in the funding plan. An estimation of the operating costs will also help to determine whether the function of the movable non-current asset that the municipality intends to purchase can be outsourced at a reasonable rate than to purchase the asset.

The maintenance standards are explained and the costs are estimated to ensure that these expenses are also taken into consideration when preparing an operational budget (National Treasury, 2003:10). Defining the maintenance standards will ensure that the possible failure as a result of poor maintenance of movable non-current assets is prevented, detected and corrected timely. This will also ensure that the assets are maintained according to pre-determined maintenance plans. According to Joubert *et al.* (2014:34), prioritising the maintenance of strategic assets is the strategy that the Drakenstein Municipality used to manage and maximise their asset portfolio. The operational control and definition of maintenance standards helps to monitor and control asset performance, maintenance costs as well as safeguard the movable non-current assets.

Schuman and Brent (2005:567) emphasise that “to gain even greater value” maintenance programmes should be adhered to throughout the life cycle of assets. According to Fourie and Opperman (2007:311), the assets will only attain their assigned operating ‘lives’ if they are maintained properly. Therefore, to ensure that movable non-current assets reach their assigned useful life, maintenance plan should be adhered to and plans should include:

- Specific maintenance standards to ensure asset performance throughout its expected lifetime;
- The maintenance standard will prevent assets from collapsing; and



- Estimation of the necessary maintenance such as major repairs and preventative maintenance expenditure for the planning period.

These maintenance plans may improve asset performance and service delivery (National Treasury, 2003:34). Most importantly, they improve asset reliability and prevent premature withdrawal and disposal of movable non-current assets.

#### **d) Disposal Phase**

According to the National Treasury (2003:46), the municipality must develop an asset disposal plan which conforms to the strategic asset disposal policies as suggested by the municipal management. The disposal plan should include a detailed analysis and financial assessment, the reasons for the disposal decision and the alternatives to asset disposal (National Treasury, 2003:46). The detailed asset disposal plan can be used as a reference when it is time for disposal or replacement of assets. National Treasury (2003:46) also advises that service delivery needs, financial and budgeting constraints as well as overall municipal resource objectives should be considered when drafting a movable non-current asset disposal plan.

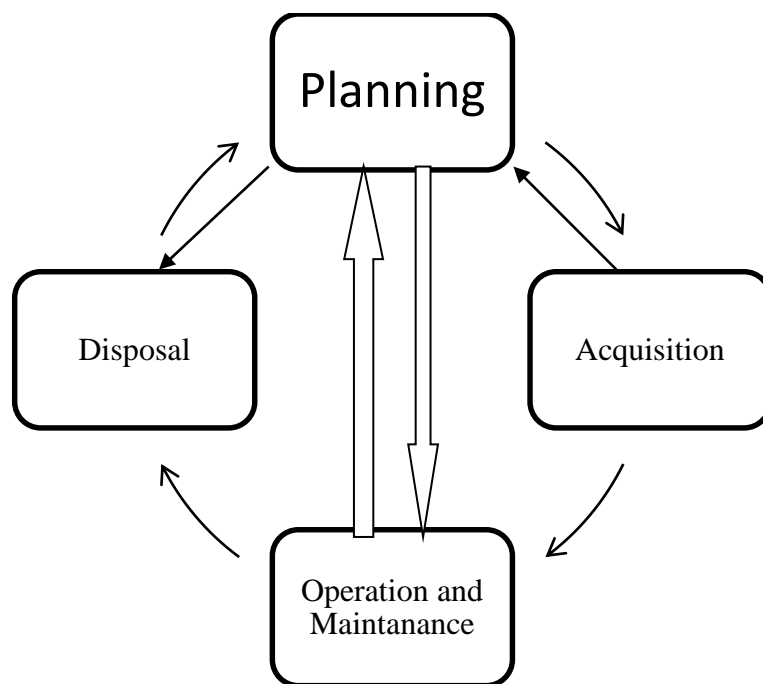
According to Visser (2006:16), a disposal plan is dependent on an up-to-date asset register that is reviewed annually and supplemented with annual random asset register reviews. Decisions related to disposal of an asset can only be taken with the approval of the Asset Committee. Approval from an Asset Committee helps to ensure that assets are not sold prematurely (Visser, 2006:16). An Asset Committee will also ensure that no strategic or basic assets are sold without authorisation and will ensure that economic value (profit) is attained when disposing movable non-current assets.

National Treasury (2003:46) refers to an asset register as a starting point for effective asset management because it records the useful lives of the class of assets and is able to provide an indication of the timing of major replacements in the normal course of business. Guided by the performance standards as per movable asset management policy, the following factors should be included when considering performance and disposal decisions:

- Performance assessment will determine if there are movable assets that should be retired.
- Condition monitoring will assist to identify movable assets that have exceeded their economic life and identify those that should be sold.

- When assessing conditions or performance of movable assets, the municipality could find redundant assets that can be transferred to another municipality.

It is important that when the decision to transfer/sell/lease or retire movable non-current assets is taken, the approval by the council should be obtained. In order to justify why assets were included on the disposal list, the National Treasury (2003:47) suggests that the physical condition, performance assessment and the cost-benefit analysis for the methods of disposal be analysed. Asset managers are also required to compare the actual life at disposal including the expected useful life at the beginning and explain any significant variations. Figure 6 illustrates the impact of asset lifecycle management to capital budgeting for the acquisition of movable non-current asset:



Source: National Treasury (2003:07)

**Figure 6:** *Asset Life Cycle Model*

Figure 6 illustrates that planning affects acquisition. The two arrows indicate phases that are interdependent. For example, if anything goes wrong with planning it may affect operations. Moreover, failure to effectively use and maintain the asset may result in early disposal and thereby affect future planning.

According to Schuman and Brent (2005:567), asset life cycle management is an approach to improve physical asset performance in the process industry. Schuman and Brent (2005:567) emphasise that in order to gain even greater value, asset management should be extended from design, procurement, installation, operation, maintenance and retirement of an asset (that is, over the lifetime of an asset). This means, to manage assets is a process that should

start at the inception thereof and should continue through to the sale/disposal of an asset. Schuman and Brent (2005:567) refer to this as a “holistic asset life cycle model (ALCM)” to asset management.

This “holistic” approach to asset management may also be considered for movable assets such as equipment, vehicles and machinery from the planning to the disposal stage. This would assist to estimate future costs for purchases and maintenance of similar assets. According to Schuman and Brent (2005:577), the “holistic” asset life cycle model increases output and growth for the organisation. This is the reason the aforementioned authors recommend that asset management should commence at the inception of the project and not only during the operational stage.

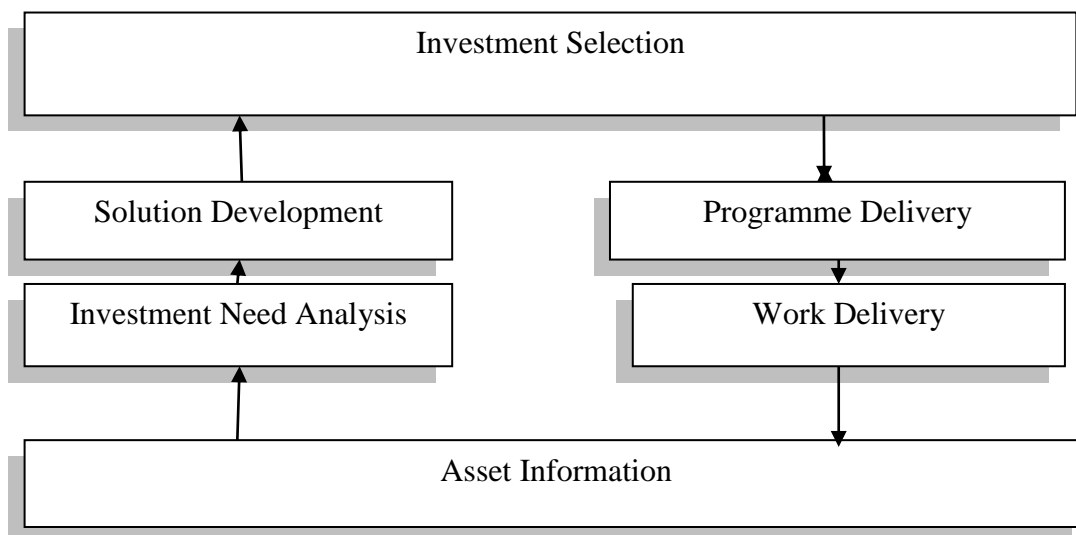
The “holistic” asset life cycle approach suggested by Schuman and Brent has been proven to reduce costs and increase asset returns. The increase in asset returns seems possible when there is effective asset management. The study’s primary objective is to determine whether ineffective movable non-current asset management limits the efficiency of capital budgeting for procurement of movable non-current assets. According to Ault *et al.* (2004:05), information is an important factor for making good investment decisions. Moreover, the authors emphasise that asset management is dependent on the quality of information. They also suggest that the following information is essential to facilitate optimal investment decisions such as age, state/condition, ability/capacity, use and the price or value of the asset.

Detailed asset information would help to collect the life cycle costs while, on the other hand, provide information that will justify future movable non-current asset needs. Ault *et al.* (2004:07), assert that investment decisions have proven challenging because data collection and input into information systems are tasks that are often seen to be disconnected from each other. As a probable solution, the literature suggests a state of the art or integrated ICT system. According to the state of local government finances, one of the challenges that local municipalities face is not only underspending on capital budgets but also lag behind from attracting employees with technical skills such as Information Technology(IT) (National Treasury, 2013:07).

This study will not examine whether the municipality has IT systems to assist with asset management. This study examined whether capital budgeting for procurement of movable

non-current assets can be executed without adherence to appropriate asset management processes. In order to respond to the research question, the existing asset management procedures will be examined to establish its effectiveness as well as review whether the (asset management) processes can assist the Mbashe Local Municipality to improve their capital budgeting decisions. According to Gibson (2012:50), properly managed assets will defer capital outlays while at the same time create a pool of funds that can be used to enhance growth in the municipality.

Figure 7 illustrates information framework for investment planning as suggested by Ault *et al.* (2004:06). The illustration reveals the value of asset information in facilitating investment decisions.



**Source: Ault *et al.* (2004:06)**

**Figure 7: Framework for Investment Planning**

Figure 7 illustrates that asset information is essential when making investment decisions. This “holistic asset life cycle model” as suggested by Schuman and Brent (2005:577) helps to improve productivity of assets as well as assist to determine the realistic values that should be included when compiling a capital budget. Budgeting by nature is based on estimated figures and not actual figures. It consequently requires one tasked with budgeting to use realistic figures. To make this process more complex, capital budgeting refers to planning for long term periods, hence careful attention needs to be given at every stage of the asset life cycle management. Bester (2006:15) supports this view of using realistic values when evaluating capital projects and also advises that a detailed investigation of a capital project be undertaken since it may be difficult to reverse these decisions. The use of realistic figures

helps with asset planning and ensures that realistic quantities of movable non-current assets are included in the capital budgets.

Next asset planning and budgeting control will be explained in detail in order to identify the benefits of effective planning and budgeting for procurement of movable non-current assets.

### **3.5 ASSET PLANNING AND BUDGETING CONTROL**

Correia *et al.* (2008:03) define “capital budgeting as an analysis and evaluation of investment projects that normally produce benefits over a number of years”. Correia *et al.* (2008:3), also adds that capital investment decisions determine the future of an organisation. Plans for new assets must be supported by a systematic estimation of all service delivery alternatives that are cost effective. In order to control the unexpected purchases of movable non-current assets that may be difficult to reverse as indicated by Bester (2006:15), the National Treasury (2004:21) suggests that the municipal management include the following steps in their asset planning and budgeting:

- To determine service delivery needs;
- To evaluate existing assets;
- To develop an asset strategy;
- To choose the appropriate capital funding and budgeting; and
- To align movable assets with service delivery plans.

Adherence to the asset planning and budgeting steps will reduce unnecessary spending and thereby generate additional returns from the effective utilisation of assets (Schuman and Brent, 2005:02). The asset planning steps will be discussed next.

#### **3.5.1 Determining Service Delivery Needs**

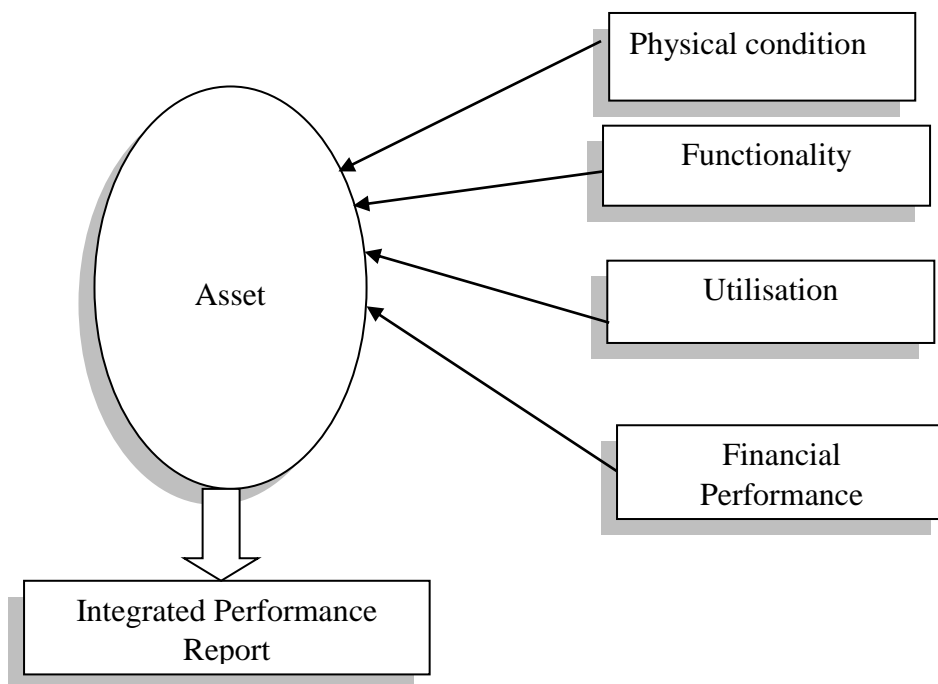
In order to link the municipality’s asset needs to provision of services, the National Treasury (2003:09) suggests defining the expected aspect of service delivery. For example, if the plan is to buy a refuse truck to collect solid waste in Idutywa, the specific areas that will be serviced should be clearly defined. The municipality should also establish various approaches to deliver services. Using the example of a refuse truck, the municipality has to decide on the time table that the truck will use to collect garbage; every day or every other day.

National Treasury (2003:15) suggests that a detailed analysis of the projected method to purchase and suitable funding options should be conducted to determine the operating and capital costs which should be compared to leasing costs. This process will reveal why the option to buy/lease is selected. The municipality should also determine how to get the maximum benefit from using the movable non-current assets. For example, the refuse truck can be used to collect waste in the city on specific days. To avoid under-utilisation, the refuse can be collected from the nearby areas.

Collecting garbage is a basic compulsory municipal service to avoid any health hazards. According to Joubert *et al.* (2014:34), the risk based approach to asset management was successful at Drakenstein Municipality because critical assets were given priority to avoid any social, environmental and financial risks. The example used at Idutywa revealed a detailed utilisation plan (what resources were required to collect waste, on which days and how much area would be covered). The details revealed why there was a need for the movable non-current asset or the refuse truck. This implies that if one is aware of the service delivery needs, one should prioritise the needs. This can be achieved by evaluating the municipal capacity and the condition of existing movable non-current assets.

### **3.5.2 Evaluate Existing Assets**

Park (1998:20) promotes that periodic review of existing physical asset information should be carried out to reduce risk associated with assets. National Treasury (2003:01) suggests that physical condition, functionality, utilisation and financial performance of movable assets should be evaluated and a report be compiled of the existing assets. Figure 8 illustrates how performance information of assets can be assessed.



**Source: National Treasury (2003:11)**

**Figure 8:** *Assessment of Asset Performance Information*

An evaluation of the existing assets against the set standards will help to determine whether the movable non-current assets are being utilised according to the set standard. National Treasury (2003:11) suggests that the evaluation of whether assets are functional according to set standards should be conducted before the movable non-current assets are issued to users, and that the initial test results serve as the standard against which the performance of the later test is compared. This follow-up performance evaluation will reveal the following (National Treasury, 2003:11):

- Establish whether existing movable non-current assets have been operated and maintained as per predetermined standards?
- Identify whether there are movable non-current assets that are damaged, missing or stolen?
- Identify movable non-current assets that are idle, underutilised or need replacement?
- Assist with the analysis and investigation of the movable non-current asset operation and maintenance cost trends and suggest what can be done to minimise the costs.

It is evident that having knowledge of the details of the existing assets, such as the performance level of assets would assist to determine if the asset meets the set performance

standards. Assets that do not meet set performance standards that are removed to develop a movable asset strategy that conforms to the performance standards and the objective of the municipality.

### **3.5.3 Developing a Movable Asset Strategy**

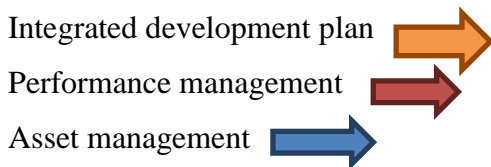
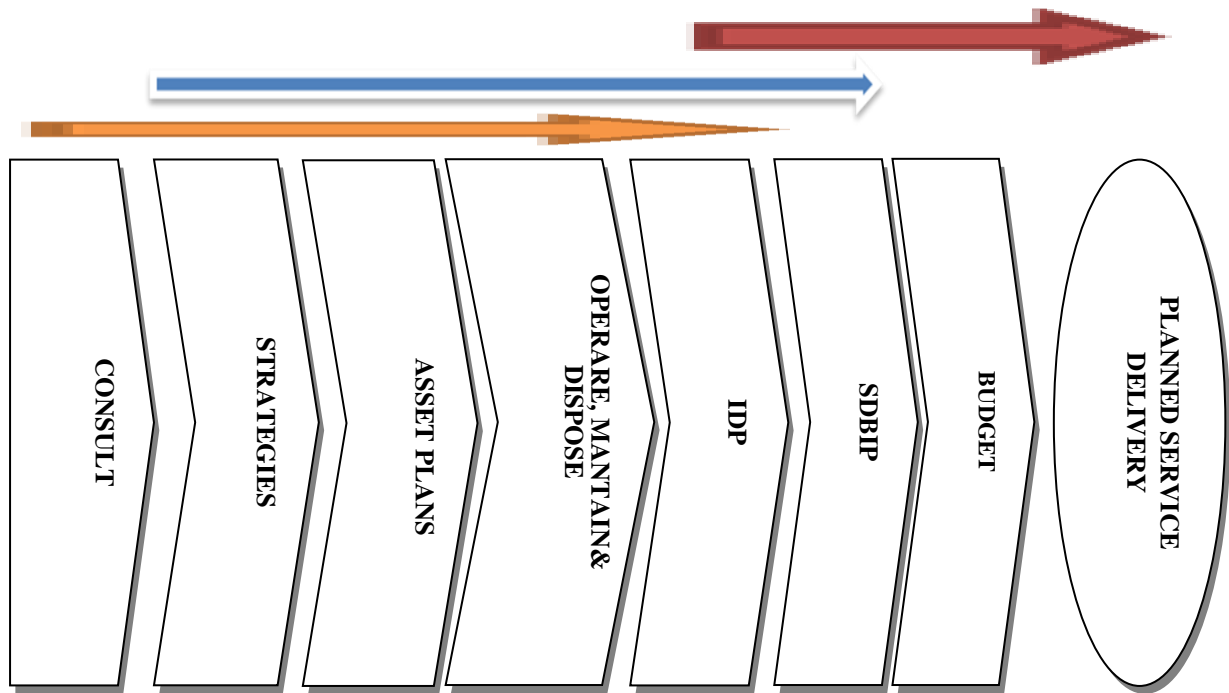
National Treasury (2004:23) suggests that municipalities should establish systems or processes to support the preparation of movable asset strategy. The movable asset strategy should cover acquisition, safeguarding, maintenance, refurbishment, redeployment and disposal including capital costs and operating costs. Factors to be addressed by a movable non-current asset strategy include, amongst others (National Treasury, 2004:23):

- Ensuring that service delivery changes are identified and new plans are adjusted accordingly.
- May identify technological developments and means to address these developments.
- May identify solutions that can be explored on finding idle assets (using the same example of the refuse truck, whether the truck may be leased to other municipalities during its idle time) and also analyse what can be done to improve the performance of those assets.

When service delivery changes are identified and means to address them are suggested, crafting a movable non-current asset strategy will apportion an opportunity for movable non-current asset gaps identified in the capital budget to be adjusted and filled.

The Chartered Institute of Public Financial Accountants (CIPFA) (2008: 59-61) proposes that there should be integration between planning and asset management planning rather than have the two as separate functions. National Treasury (2004:23) also agrees that for effective asset management, municipalities should adopt an integrated approach to asset management. This could be a probable solution to the concerns raised by Ault *et al.* (2004:06), about the difficulty encountered when making investment decisions. The difficulty is as a result of the disconnection between data collection and input into the information system. Figure 9 illustrates how to integrate asset management process and its impact on capital budgeting during strategic planning:





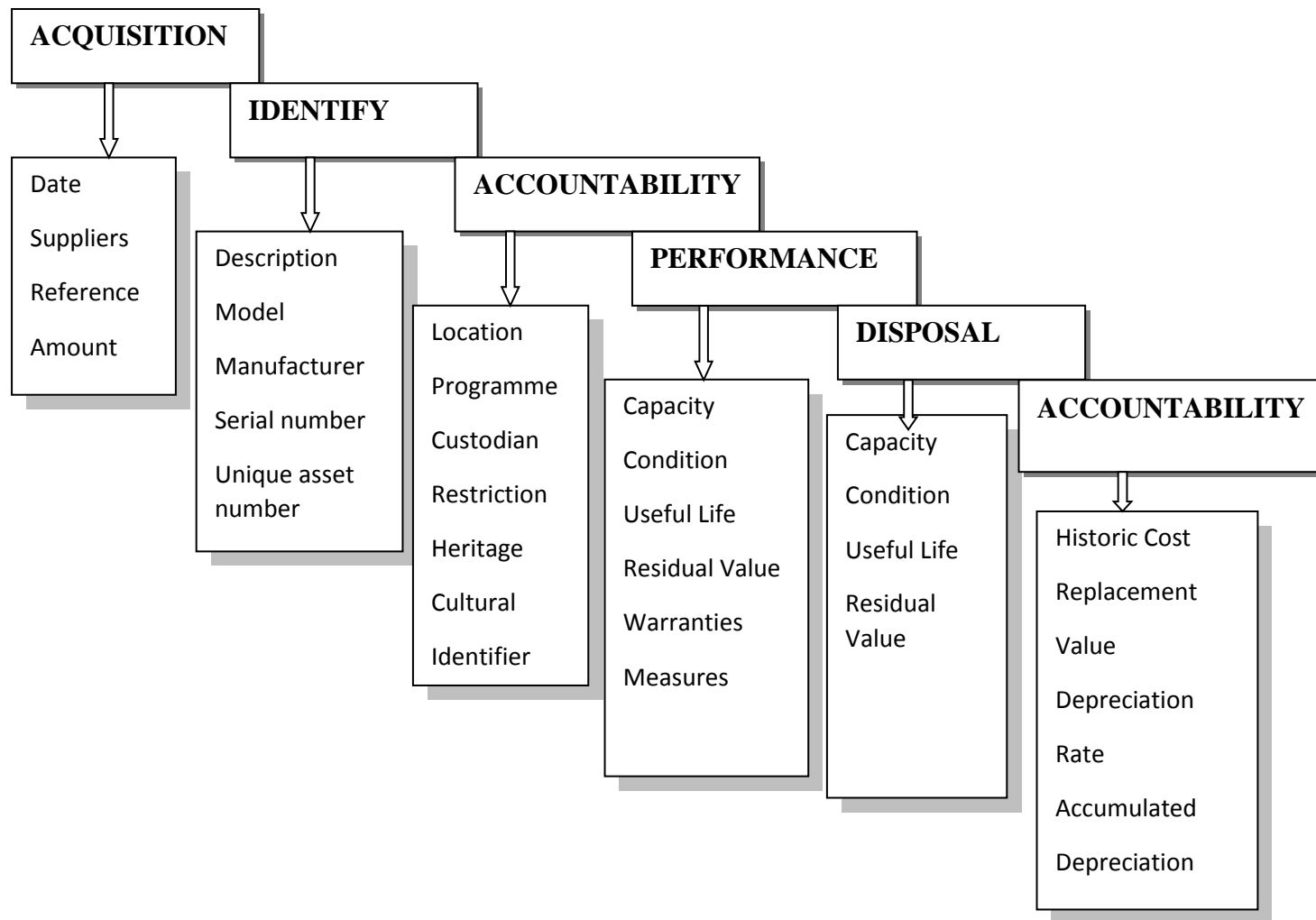
Source: National Treasury (2004:28)

**Figure 9:** *Integration of Asset Management Functions to IDP and Performance Management Plans*

Figure 9 illustrates that the budget plans affect both the asset management process as much as the performance management plan for movable non-current assets. In Figure 9, the green line reveals a plan without a budget which is an IDP and not a complete asset management process. Failure to include a budget will impact on service delivery which is at the final stage. This is a clear indication why it is important that plans for service delivery include a budget.

Venter (2007:213) and Treasury (2004:12) suggest that what should be at the centre of asset management is service delivery. The figure also reveals that service delivery depends on asset management, IDP and performance management. Providing services involves making informed decisions based on asset management policies and procedures, considering planning and management of assets as an organised function and most importantly, taking into consideration accountable and responsible use of movable non-current assets. The FAR has

been proposed to collect asset information which is referred to in the literature in the previous chapter as a cornerstone of service delivery (Venter, 2007:213). French (1994:15) also supports the idea of FAR as a means to collect complete asset information. The researcher holds that asset management should not conclude with an analysis of the suitability of assets before purchasing but be complemented with monitoring and ongoing review of movable non-current assets while in use. The continued monitoring and reviewing of the effectiveness of movable non-current assets will ensure that service delivery is not disrupted because of the poor condition of assets. Figure 10 illustrates how and what asset information can be collected to support asset management and provide fundamental information for decision-making including capital budgeting decisions.



Source: National Treasury (2004:35)

Figure 10: The Composition of an Asset Register

According to French (1994:16), even if the asset register has been based on limited information, it will still address the following information about existing assets:

- The organisation will be able to identify, assess and value existing assets. This assists when buying assets and how much should be budgeted for future assets.
- Knowledge of the physical location and condition of assets helps to identify existence and to ascertain whether they are in good working condition.
- Lastly, it can also provide research information of what future assets can be ideal based on the models that were utilised over an extended period, assets which have extended warranty plans, or which models or assets have an improved economic lifespan.

Park (1998:18) proposes consistent FAR evaluation as an additional measure that could expose several irregularities such as:

- Inadequate equipment or assets may be found;
- Unauthorised removal of assets from their original location;
- Equipment or machinery may be missing completely; and
- Useless / broken equipment may be found.

Park (1998:20) further cautions that if there is no review system, it perpetuates theft/misplacement of assets. Inadequate equipment, unauthorised removal of equipment or broken equipment may be an indication that some assets have been stolen and replaced with sub-standard assets. Whether stolen or broken, it could cripple service delivery which is the primary aim of buying assets (Venter, 2007:213). This untimely loss/damage of assets may even result in unauthorised expenditure for repairs, or replacement cost for lost/damaged assets. Consequently, physical control at the gate is very important to prevent such incidents while regular monitoring and review of FAR is necessary to detect and minimise the unexpected purchase of movable non-current assets. Thorough analysis of capital projects help to identify suitable projects which can be included in the capital budget and appropriate capital funding sources.

### **3.5.4 Capital Funding and Budgeting**

According to Craythorne (2006:255), “the municipality can only spend money on a capital project only if the money for the project/assets has been appropriated in the capital budget”. Craythorne also recommends that the capital expenditure should be approved by council and

the sources of funding be considered. Fourie and Opperman (2007:121) caution against using a capital budget as a wish list and recommend that a “credible capital budget”, is therefore, one in which realistically intended capital purchases are matched with realistically expected capital finances. In order to support a “credible budget”, the National Treasury (2003:18) also recommends that municipalities should consider asset acquisition, asset enhancement and priorities as outlined in the IDP and MTREF as fundamental to the capital budget. National Treasury (2003:18) also advises that the municipality’s objectives should be the guide and value for money should be created when selecting capital investments and funding for capital budgets.

The following steps explain how the municipality can add value by selecting the best financing option (Firer *et al.*, 2012:03):

- Alternative financing options are evaluated;
- Confirm and select the best financing option that is cost effective; and
- Ensure that effective working capital decisions are made.

There are two financing options from which the municipality may fund assets; state dedicated funds and annual capital works (Fourie and Opperman, 2007:121). Fourie and Opperman (2007:121) recommend that costs covering the lifetime of the asset and realistically operational costs such as depreciation, interest, repairs and administrative costs are considered when evaluating a possible capital asset or capital investments.

National Treasury (2003:19) lists costs to include during capital budgeting;

- Full costs including future operational and maintenance costs.
- Additional economic benefits or outflows that the municipality will generate or incur to buy the assets, for example, any cost savings or additional revenues that the municipality will realise when buying the asset.
- The timing, quality and the service delivery capacity to purchasing an asset.
- Include timeframes to indicate when the benefits will accrue to the municipality.

Considering all the expected costs, revenues, quality of service and timeframes will ensure that all the details were considered and unexpected surprises are minimised.

Fourie and Opperman (2007:121) recommend that the Procurement Committee should approve a proposal based on service delivery needs as a priority, financial impact, cost versus benefit and the ability of the municipality to operate and manage such assets.

This study's primary objective is to determine whether ineffective movable non-current asset management limits the efficiency of capital budgeting for procurement of movable non-current assets. For example, if the full cost is not known and there is a lack of a consistent evaluation system to identify the physical condition, utilisation, functionality and financial performance of existing assets, the question arises whether the municipality will know what to include in the capital budget? Moreover, if an asset register is incomplete and no regular review, will the municipality know their needs or what movable non-current assets to sell? Will there be time to accurately investigate future investments or assets? Will the municipality have access to timely information in order to establish what assets they will require? Craythorne (2006:255) asserts that only assets which have been planned for and included in the capital budget will be approved by the municipal council. This requires that the movable non-current assets which need to be purchased are aligned with service delivery programmes and are presented to the municipal council for approval.

### **3.5.5 Aligning Movable Non-Current Assets with Service Delivery Programmes**

The municipality is expected to assess if they have been using their assets to their full capacity. This assessment will help the municipality to identify whether:

- Movable assets are suitable for their needs;
- There are movable assets that are underutilised; and
- There are assets that are damaged/broken and useless.

National Treasury (2003:21) posit that "aligning movable assets allows the full cost of programme delivery to be more readily determined". The practise also offers the opportunity for service delivery needs and municipality assets to be compared with the assets currently used. Alignment of movable non-current assets to service delivery programmes also helps to determine if there is a need for asset replacement/transfer or asset acquisition in the case where underutilised, damaged and unsuitable assets are identified.

## **3.6 ASSET ACQUISITION**

Asset acquisition is considered as the key component of asset management. Acquisition decisions should be taken within the integrated planning framework that reflect service delivery needs, municipality objectives, financial and budgetary limitations and the municipal resource allocation priorities (National Treasury, 2003:21). This implies there are guidelines which need to be considered in order to justify whether additional assets are necessary together with suitable acquisition methods.

### **3.6.1 Acquisition Methods for Movable Non-Current Asset**

There are different methods with which movable assets may be acquired. It is important that the municipality carefully selects the cost effective method to purchase/acquire movable non-current assets. National Treasury (2003:26) suggests asset purchase, asset design and construction - build-own-operate-transfer and lease as acquisition methods and alternatives. Cost versus benefit should be considered when buying movable non-current assets regardless of the method of acquisition chosen.

Asset purchase is when a municipality buys an asset for ownership, while asset design and construction refers to building their own assets. The build-own-operate-transfer option is when the municipality requests a private owner to fund, build assets, rent it and at the end of the project term, transfer ownership to the municipality. The lease option, on the other hand, is when the municipality chooses to defer paying the lump sum for buying an asset. There are two ways in which the municipality can lease movable non-current asset finance and an operating lease.

The municipality must take into consideration the impact (such as costs, rebates and savings) of the choice of acquisition method on capital budgeting decisions. The costs are not only acquisition but the overall expenditure as revealed in the literature review. The asset life cycle approach consolidates the fragmented costs throughout the asset life cycle phases (Schuman and Brent, 2005:02).

### **3.6.2 Establishing Asset Life Cycle Costs**

Asset management is best when approached on a life cycle basis. The same principle is suggested during the acquisition of assets. Acquisition should be approached using the life cycle approach to save costs (National Treasury, 2003:29). This will assist to establish the feasibility, the potential of service delivery as well as the day-to-day operating and disposal costs that may result from the acquisition of an asset. For example, the actual instalment/lump sum when one purchases a truck should include: the cost to deliver the truck when it is purchased, the operating costs such as repairs/insurance for the refuse truck, additional working capital and the residual value that may reduce the cost.

Next the need for effective asset operation, safekeeping and maintenance of movable non-current assets and its impact to capital budgeting is discussed.

### **3.7 ASSET OPERATION, SAFEGUARDING AND MAINTENANCE**

National Treasury (2003:46) defines an operation and a maintenance plan as established standards for the level of use, condition, maintenance and performance of assets. This is a way in which management can control or ensure that assets are used to provide effective service delivery. Rahim *et al.* (2010:04) recommended the “5 C model” for determining asset integrity. The model includes: competence, compliance, coordination, communication and control as a means through which asset plans can be achieved.

#### **3.7.1 Asset Operation Plans for Movable Assets**

Asset Operation Plans for movable assets (such as a refuse truck, equipment and computers) should take the “5 C’s” into account, namely:

- A plan to hire a qualified employee (Truck Driver).
- Ensure that movable non-current asset procedures are followed to allow access to the movable assets (refuse truck).
- At what time employees (Truck Driver) will be allowed access to the movable assets (truck). Outline periodic maintenance plans. Consider a costing technique to determine what steps to follow if the asset is used by other departments.
- The time schedule and area to be covered by the movable assets (for example, refuse truck). This will help to control how and the extent of the utilisation of the asset.
- All heads of departments should be provided with movable non-current asset management plans in the form of either a soft or hard copy. The Movable Asset Management Policy may be provided to section heads as a means of communicating asset management procedures.

The aforementioned will reasonably ensure that assets perform according to predetermined standards as set by management in order to achieve service delivery objectives at reasonable cost. Also, communication of the procedures will identify assets that qualify for disposal and non-disposables.

Following is a brief asset disposal procedure and how adherence may prevent early disposal or premature replacement of movable non-current assets.

### **3.8 ASSET DISPOSAL**

According to the National Treasury (2003:45), asset disposal ends control of a particular asset and at the same time disposal of movable non-current assets may require an asset replacement



to support service delivery. In order to ensure that asset disposal does not interrupt service delivery, the replacement is accommodated in the capital budget. Furthermore, a regular performance assessment and disposal plan is also necessary.

### **3.8.1 Disposal Plan**

National Treasury (2003:41) urges municipalities to formulate a policy for disposal of movable assets. The movable asset disposal policy should include the basic reason to justify a sale. The method, timing and expected amount from the sale should also be stated. This amount is reviewed to determine whether it meets the realistic market value. According to Firer *et al.* (2012:291), disposal value is classified as a "...relevant cash flow that is a direct consequence of taking a project". This implies that disposal value affects net present value which is the preferred and favourite decision rule when evaluating capital budget proposals.

Fourie and Opperman (2007:72) state that for the disposal of assets, the municipal council's approval should be obtained. Similarly to immovable assets, movable non-current asset disposal should be authorised by the municipal council. Following is an overall summary of asset management and budgeting framework and how adherence can improve asset management processes and budgeting for procurement of movable non-current assets.

## **3.9 SUMMARY**

A plan without a budget is considered a wish list, and in order to achieve the municipal objectives, it is advisable that a budget should be part of the plan. The literature revealed that the budget is perceived less important on its own. It was suggested that a SDBIP be used to achieve the municipal objectives. Asset management, IDP and measuring asset performance are approaches the municipality can utilise to achieve municipal objectives. It is recommended that asset management be integrated to asset planning where all the life cycle phases are considered and planned for.

The asset management process includes implementation of developed policies and procedures for buying, receiving, recording, safeguarding as well as disposal and replacement of assets. This process is similar to that of decisions made by the financial manager which includes: deciding on suitable capital assets for the business and the best finance options to finance capital assets. For capital investments to generate cash flow or provide service, capital assets and the day-to-day operations should also receive an equal consideration.

The consideration that is given to planning, acquisition, operation and maintenance of movable non-current assets help the municipality to secure goods and services that provide value for money. For example, the considerations to acquire a pick-up truck maybe a waste of money without operational plans for qualified drivers and availability of operational costs like petrol and maintenance. The latter example may not materialise if a realistic financial plan has not been considered. Moreover, the truck itself would not be an asset if one considers the definition highlighted at the beginning of this chapter that an asset should provide service potential or generate cash flow to qualify as such.

The risks are high for movable non-current assets because failure to manage or control the use of assets or asset information maximises the risk of theft, misuse or loss of movable non-current assets. Poor movable non-current asset controls can result in the municipality spending without any benefits. As additional measures to minimise risk associated with movable assets, the FAR has been recommended to assist with recording asset information. Certain authors hold that asset information is more important, while others assert that managing assets throughout their lifetime is best.

The objective of this chapter is to describe the theoretical framework regarding the asset management process, budgeting and capital budgeting as prescribed by MFMA and the National Treasury. Literature suggests that budgeting is a step-by-step process that commences with the strategic planning of the municipality's activities, followed by the IDP and medium term plans that inform annual and capital budgets. The latter budgets should reflect the objectives and the priorities of the community as outlined in the IDP.

Furthermore, there is literary consensus by the RSA (2003) and the National Treasury that asset management serves as the tool that informs the capital budgeting decisions. This implies if the municipality's Asset Managers do not know what assets they have, it will be difficult to determine what to purchase. As previously postulated, without the municipal council approval and confirmation of available funding, the acquisition should not take place. Finally, it is important to determine the details of existing assets since that information is vital to justify new assets. The following chapter outlines and analyses the asset management and budgeting processes at the Mbhashe Local Municipality.

## **CHAPTER FOUR**

### **ANALYSIS OF THE AUDITOR GENERAL SOUTH AFRICA'S REPORTS FOR DEVIATIONS: MOVABLE NON-CURRENT ASSETS AT MBHASHE LOCAL MUNICIPALITY**

#### **4.1 INTRODUCTION**

In this chapter, Mbhashe Local Municipality's movable non-current asset management and capital budgeting policies and procedures will be defined and compared to the municipality's current practise thereof as well as identify any deviations from set policies and procedures. According to Section 16(1) of RSA (2003), only the capital assets included in the capital budget and approved by the municipal council can be purchased. Fourie and Opperman (2007:08) assert that the MFMA has converted a basic policy principle into legislative requirements as well as modernised the way in which municipal funds and assets are managed.

In this chapter, Mbhashe Local Municipality's capital budgeting and asset management policies and procedures will be listed in a tabular format and the practise as reported by AGSA will be compared to identify compliance or non-compliance with policy requirements. Where an approved Movable Non-current Asset Policy was not available, the National Treasury Asset Management Guidelines were utilised. Audit reports for 2012; 2013; 2014 were used to examine the deviation between policies and Mbhashe Local Municipality's practise.

The MFMA (RSA, 2003) has five underlying principles, namely:

- Simplification of roles played by municipal management (such as the municipal council, Mayor, Municipal Manager and the CFO);
- Strategic approach to budgeting;
- Modernisation of financial management;
- Cooperative governance; and
- Promoting sustainable service delivery.

For this chapter, the concept municipal management will be used to collectively refer to the municipal council, Mayor, Municipal Manager and the CFO. The National Treasury

(2003:01) encourages municipal management to provide leadership, set policies and procedures and encourage compliance with those policies while ensuring a life cycle approach to asset management. Table 1 illustrates the municipal management's general responsibilities, their oversight roles and accountability.

## **4.2 ASSET MANAGEMENT POLICY GUIDELINES**

National Treasury (2003) prescribes the asset management principles and activities that serve as guidelines when formulating asset policies and procedures. National Treasury also stipulates the importance of management control for developing policies and procedures which are necessary for making timely and informed management decisions as well as approaching asset management from a life cycle perspective (National Treasury, 2003:02).

### **4.2.1 Movable Non-current Asset Management Control**

Management control comprises the development of policies, procedures and systems for collecting asset information on which timely and informed asset management decisions need to be based (National Treasury, 2003:02). Table 2 compares an Asset Management Policy Guidelines with AGSA reports 2012; 2013; 2014. The Table highlights how poor management control affected asset management, budgeting and procurement of movable non-current assets at Mbhashe Local Municipality.

### **4.2.2 Asset Life cycle Management**

According to National Treasury (2003:06), the physical life cycle of an asset has four distinct phases, namely: planning, acquisition, operation and disposal. This implies that in order to develop adequate asset policies and procedures, these phases need to be considered to ensure that timely and adequate asset information is collected at each phase to enable effective budgeting and informed economic decision-making. Table 3 illustrates the compliance or non-compliance to the guidelines. AGSA reports were compared to the Asset Management Policy Guidelines to determine the impact of ineffective asset management throughout all life cycle phases for 2012; 2013; 2014 financial years at Mbhashe Local Municipality.

## **4.3 ASSET PLANNING (DETERMINING ASSET NEEDS) AND BUDGETING CONTROL**

National Treasury (2003:08) stipulates that asset acquisition, use and disposal of assets should be made within an integrated service and financial planning framework, and in the context of the Government's overall resource allocation policies and priorities. The National

Treasury (2003:03) also recommends that proposals for new assets must be justified by a thorough evaluation of all service delivery options, and, as part of government budgetary process must be subjected to a comprehensive appraisal or investment evaluation.

Moreover, the National Treasury (2003) also recommends adherence with Section 38(1) (iv) of MFMA (RSA. 2003) which requires that all capital projects are evaluated before the final decision is made on the project. In Table 4, the AGSA reports are compared to Asset Management Policy Guidelines to determine how deviation from asset planning and budgeting control affected Mbashe Local Municipality for the financial period 2012; 2013; 2014.

#### **4.4 DEVELOPING AN ASSET STRATEGY**

National Treasury (2003:11) recommends that the systems and processes to support the preparation of the five year forward asset strategies should encompass the following:

- Asset acquisition;
- Safeguarding of movable non-current assets;
- Maintenance and refurbishment of movable non-current assets;
- Redeployment of underutilised movable non-current assets; and
- Disposal of unused movable non-current assets.

The processes for the preparation of the five-year asset strategies should also take into account the capital and operating costs (National Treasury, 2003:11). The integrated strategy towards asset planning enables municipalities or departments to deliver quality basic services efficiently and effectively. Table 5 illustrates how non-compliance with asset management guidelines in developing an asset strategy negatively affected asset management and service delivery as reported by AGSA 2012; 2013; 2014 at Mbashe Local Municipality.

#### **4.5 CAPITAL FUNDING AND BUDGETING**

The budget division requires the municipality to consider asset acquisition and enhancement options effectively in order to establish priorities (National Treasury, 2003:17). The need to carefully evaluate capital acquisitions ensures that the municipality spends money on projects/assets that meet the municipality's objectives as well as projects/assets that add value for money for the government. Table 6 compares AGSA reports with Asset Management

Policy Guidelines to determine how poor analysis of capital funding and budgeting affected Mphashe Local Municipality for the financial period 2012; 2013; 2014.

#### **4.6 ALIGNING ASSETS WITH SERVICE DELIVERY PROGRAMMES**

According to National Treasury (2003:20), it is important for assets to be aligned with the municipality's service delivery programmes to the extent practical. The alignment helps to determine whether the utilisation of the existing assets meet the municipality's service delivery needs and objectives. Table 7 illustrates how deviations from aligning assets with service delivery needs negatively affected asset management and service delivery as reported by AGSA 2012; 2013; 2014 financial period at Mphashe Local Municipality.

#### **4.7 BUDGET POLICY REQUIREMENTS AT MBHASHE LOCAL MUNICIPALITY**

The budget policy objectives of Mphashe Local Municipality's include, amongst others, ensuring that the municipality:

- Follows the budgetary principles in preparing each MTREF budget;
- Outlines the responsibilities of the Mayor, the Municipal Manager, the CFO and other Senior Managers in compiling the budget; and
- Adheres to the municipality's IDP and budgeting processes (Mphashe Local Municipality (2015: 05)).

##### **4.7.1 Principles of budgeting as adopted by Mphashe Local Municipality**

The budget principles represent the budgeting philosophies that should have been followed by Mphashe Local Municipality when preparing both the capital and the annual budgets. Table 8 illustrates the budgeting values that Mphashe Local Municipality should have complied with to achieve a realistic budget that addressed the community service needs.

##### **4.7.2 Budget Preparation Process**

The budget preparation process (*refer to Table 8*) illustrates the steps that Mphashe Local Municipality should have followed when preparing the budget. Table 9 compares the Mphashe Local Municipality budget policy to the AGSA reports to determine compliance to the budget preparation process for the financial period 2012; 2013; 2014.

## **4.8 CAPITAL BUDGET**

Mbhashe Local Municipality's budget contains concerns that must be considered before capital assets can be purchased. Table 10 briefly outlines the requirements, contents and the process that should be followed before purchasing capital assets.

### **4.8.1 Approval of the Capital Budget**

The municipal council must consider the following concerns before approving the capital budget:

- Total costs for all the financial years until the project is operational.
- Future operational costs and revenues which may arise as a result of the project including the likely future effects on operating budget (property rates and service tariffs).
- Impact on present and future operations of the municipality in relation to finance charges to be incurred on external loans.
- Depreciation of fixed assets.
- Maintenance of fixed assets and other ordinary operational expenses associated with items on the capital budget.
- The Municipal council shall approve the annual or adjustment capital budget only if it has been properly balanced and fully funded from some or all of the funding sources (revenue surplus, external loan, capital replacement reserve and grant funding).

Table 11 illustrates concerns that the municipality must consider before approving the capital budget versus the application at Mbhashe Local Municipality for the period 2012; 2013; 2014 financial period.

**TABLE 1: Financial Governance Framework Recommended for Municipalities**

Audit report and the financial report for financial year				2012	2013	2014
Capital budget versus actual spending				Under-spending	Under-spending	Under-spending
Manager	Responsibility	Oversight over	Answerable to	Status of appointment	Status of appointment	Status of appointment
Municipal council	Approves asset management policies and budget policies.	Mayor	Community	Municipal council was replaced (AGSA, 2012)	Municipal council was replaced (AGSA, 2013)	Municipal council was stable (AGSA, 2014)
Mayor	Develops asset management policy, budget policy, outcomes, implementation strategy and has oversight over the municipal manager.	Municipal Manager	Municipal council and the public	Municipal council was replaced	Municipal council was replaced	Municipal council was stable
Municipal Manager	Outputs and ensures implementation of policies and procedures as set by the municipal council.	Administratively appointed and also provides administrative guidance to political structures.	Mayor, municipal council and the public	Acting	Acting	Acting



Chief Financial Officer	Develops financial plans and Outputs.	Implements financial management plans and ensures preparation of budgets and financial statements according to accounting and MFMA framework.	Municipal Manager	Acting	Permanent	Permanent
-------------------------	---------------------------------------	---	-------------------	--------	-----------	-----------

Source: Fourie and Opperman (2007:08)

**TABLE 2: Comparison of Policy and Application as Outlined in the AGSA Reports from 2012 to 2014**

Mbhashe Municipality audit report qualified issues for the financial year 2011/12. <b>Audit opinion: Qualified (AGSA: 2012)</b>	Mbhashe Municipality audit report qualified issues for the financial year 2012/13. <b>Audit opinion: Qualified (AGSA: 2013)</b>	Mbhashe Municipality audit report qualified issues for the financial year 2013/14. <b>Audit opinion: Qualified (AGSA: 2014)</b>
<ul style="list-style-type: none"> <li>The municipal management must set movable non-current asset policy and procedures to ensure complete records and management of assets (National Treasury, 2003PN006:1.1).</li> </ul>		
Par.55 The municipality experienced leadership challenges and instability due to political infighting which resulted in suspension and appointment of acting personnel in senior positions. Par.56 The municipality had not developed,	Par.41 Mbhashe Local Municipality was not able to achieve leadership stability as a result the executive was replaced, key management personnel were suspended while personnel acted in senior positions. Par. 39 Effective system of internal control was	Par.60 An adequate management, accounting and information system which accounts for assets was not in place as required by MFMA Section 63(2) (a). Par.61 An effective system of internal control for assets (including asset register) was not in

<p>documented and approved internal movable asset management policies and procedures to address collections, recordings, processing, monitoring and reporting on predetermined standards.</p>	<p>unconfirmed as required by MFMA Section 63 (2) (c).</p> <p>Par.42 The municipality had not developed adequate policies and procedures to address the collection, recording, processing, monitoring and reporting on predetermined movable non-current asset objectives.</p> <p>Par. 45 Inadequate processes and assignment of responsibilities to ensure compliance with applicable laws and regulations.</p> <p>Par. 47 Although the internal audit committee met regularly they were not effectively strengthening the control environment as material misstatements continued to show in the Annual Financial Statements (AFS).</p>	<p>place, as required by MFMA Section 63(2) (c).</p> <p>Par.67 The lack of approved policies contributed to non-compliance with legislation and inadequate controls.</p>
<ul style="list-style-type: none"> <li>• Ensure that asset information systems are in place such as developing a GRAP compliant FAR. The FAR should be reviewed periodically to facilitate better financial reporting, reliable operations and effective movable asset management (National Treasury, 2003PN006:1.2).</li> </ul>		
<p>Par.57 The municipality did not have a</p>	<p>Par.6 There was no evidence about</p>	<p>Par.7 Depreciation methods and residual values</p>

<p>complete and accurate Property Plant and Equipment (PPE) and FAR was not reconciled with the amounts reported in the financial statements.</p>	<p>completeness of PPE as the adjustments relating to movable tangible assets could not be justified.</p>	<p>were not reassessed during the year, also the depreciation expense was not calculated in accordance with the accounting policy. Consequently, PPE is overstated and an accumulated surplus is disclosed in the statement of financial position.</p> <p>Par.8 Amounts of assets in the FAR did not agree with amounts in the financial statements (AFS).</p> <p>Par.9 Movable assets could not be physically located during the audit and those identified could not be traced back to the FAR. The right of ownership determined and also the municipality did not account for Property Plant and Equipment (PPE) in compliance with Generally Recognised Accounting Principles (GRAP).</p>
---	---	--

**Source: National Treasury (2003:01)**

**TABLE 3: Asset Life cycle Phases**

<p><b>a) Identification of the need or asset planning phase.</b></p> <p>Based on the municipality’s scope and strategic service delivery programme movable non-current asset needs are identified, defined and evaluated. An asset strategy is developed, capital funding and budgeting options are considered and assets are aligned with programmes. During asset planning all the processes should be considered taking into account financial, economic and environmental benefits to the community and the municipality (National Treasury, 2003:PN006:2.1).</p>		
<p>Par.6 FAR was overstated compared to the financial statements because of capitalisation of value added tax. Non-compliance with GRAP 17 and Directive 7 and the systems to maintain PPE were inadequate.</p>	<p>Par.23 The municipality did not establish mechanism to monitor and review its performance management system for their assets like movable non-current assets as required by MSA Section 40.</p> <p>Par.24 They also did not have or uphold an effective, efficient and transparent system of financial, risk management and internal control systems for their movable non-current assets as required by MFMA Section 62(1) (c) (i).</p>	<p>Par.9 The municipality incorrectly classified PPE as investment even though the assets were held for use in production or for supply of goods or services, for rental to others or administrative purposes. The municipality did not account for Property Plant and Equipment (PPE) in compliance with Generally Recognised Accounting Principles (GRAP17).</p>
<p><b>b) Asset acquisition phase.</b></p> <p>Municipal management should apply the necessary procurement policies and procedures during procurement of movable non-current assets. The municipal management must ensure that internal and external users of assets are involved to ensure that suitable assets are bought using the appropriate funding methods. (National Treasury, 2003PN006:2.2) recommends compliance with Section 38(1)(a)(iv) of PFMA, where the Municipal Manager is responsible for an appropriate procurement and provisioning system which is fair, equitable, transparent and cost effective.</p>		

<p>Par.41 Goods and services with a value between R10 000 and R200 000 were procured without obtaining three different potential service providers as per SCM regulation Section (17) (a) (c).</p> <p>Par.42 Unregistered prospective service provider's quotations were accepted even though they did not meet the SCM listing requirements which was in contravention of SCM Section 16(b) and 17(b).</p> <p>Par.43 Preferential Procurement Policy Framework (PPPF) point system was not applied in all procurement of goods and services above R30 000 as required by Section 2(a) of PPPFA and SCM Section (28) (1) (a).</p> <p>Par.45 Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM</p>	<p>Par.31 The municipality awarded contract and quotations to suppliers who did not submit a declaration on whether they were or not employed by government or not connected to any person employed by the state as required by SCM regulation Section 13(c).</p> <p>Par.46 The systems underlying procurement were inadequate to prevent, detect irregular expenditure on contracts entered into resulting to irregular expenditure disclosed in the municipality's accounting records.</p>	<p>Par.31 Sufficient audit evidence could not be obtained that PPPF point system was applied when awarding contracts to suppliers.</p> <p>Par.32 Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are government employees or are connected to any employees of government, as required by SCM regulation Section 13(c).</p> <p>Par.33 Appropriate evidence could not be gathered that all extensions or modification of contracts were approved by the delegated officials in accordance with SCM Regulation Section 5.</p> <p>Par.37 Contracts were awarded to providers who are in service with other government institutions or whose directors are in the service of other government institution in contravention with the MFMA Section 112(j) and SCM regulation Section 38(1). Similar awards were made in the previous years and no effective steps were taken prevent the abuse SCM</p>
--	--	--

<p>Regulation Section 13(c).</p> <p>Par.46 Contracts were awarded to service providers who were in the service of other state institutions, in contravention of SCM regulation Section 44. Similar awards were in the previous year were identified and no action was taken to prevent this as required by SCM regulation Section 38(1).</p>		<p>process as required by SCM Section 38(1).</p> <p>Par.38 The local community was not consulted by means of a municipal wide structure for community participation in drafting and implementing an IDP as required by MSA Section 28.</p> <p>Par.41 The local community was not afforded an opportunity to comment on the final draft of the IDP before adoption which is in contravention of MSA Section 41(1) (b).</p>
<p><b>c) Operation and Maintenance phase.</b></p> <p>National Treasury (2003:PN006:2.3) recommends compliance with PFMA Section 38(1) (b) where the Municipal Manager is responsible for effective, efficient, economical and transparent use of resources of the municipality. The asset management guideline also recommend that effective accountability frameworks should identify those responsible for assets in order to establish ownership, control and responsibility for use, security, condition and performance of assets. This means the municipality must ensure that based on operational and maintenance policy, procedures and plans are developed and implemented and that operational, performance and maintenance standards and controls are defined, measured and implemented (the users and authorisation process is defined as well as maintenance intervals of assets).</p>		

<p>Par.36 Performance report does not include comparison with set standards as required by MSA Section 46(1) (a) (b) and (c).</p> <p>Par.52 An adequate management, accounting and information system which accounts for assets was not in place as required by MFMA Section 32 (a).</p> <p>Par.53 An effective system of internal control for assets was not in place as required by MFMA Section 63(2) (c).</p>	<p>Par.42 The municipality had not developed adequate policies and procedures to address the collection, recording, processing, monitoring and reporting on predetermined objectives (such as movable non-current asset) .</p> <p>Par.23 The municipality did not establish mechanism to monitor and review its performance management system for their assets like movable non-current assets as required by MSA Section 40.</p> <p>Par.24 They also did not have or uphold an effective, efficient and transparent system of financial, risk management and internal control systems for their movable non-current assets as required by MFMA Section 62(1) (c) (i).</p> <p>Par.29 The Internal audit did not audit the results of performance measurement as required by MSA Section 45 (1) (a).</p> <p>Par.30 Quarterly performance measurement reports were not submitted to the Municipal Manger and performance audit committee as</p>	<p>Par.38 The local community was not consulted by means of a municipal wide structure for community participation or through a forum that encourages community participation in drafting and implementation of the IDP as required by MSA Section 28.</p> <p>Par.40 Measurable performance targets with regard to each of the developmental priorities or objectives and key performance indicators were not set in the IDP, as required by MSA Section 41(1) (b).</p> <p>Par.39 There were no strategic control and performance management systems in place, such as performance planning, monitoring, measurement, review and improvement as well as how it was conducted, organised and managed. The strategic control includes the clear segregation and definition of roles and role players as required by MSA Section 38.</p> <p>Par.25 Lack of standard operating procedures makes it difficult to measure performance of</p>
---	---	--

	<p>required because the reports were not prepared in all quarters during this financial year.</p> <p>Par.43 The municipality did not keep asset systems up to date and the systems were not verified during the year and had to be corrected during the audit process.</p>	<p>assets (movable non-current assets) and its costs.</p> <p>Par.67 The municipality did not apply the best practise in its daily and monthly control activities and there was inadequate oversight by the municipality leadership.</p>
<p><b>d) Disposal Phase(PN006:2.4)</b></p> <p>A detailed disposal policy and procedures defined. A disposal plan is outlined which includes analysis and financial assessment, reasons for disposal and alternative to movable non-current asset disposal as well as the disposal approval process where required. According to National Treasury (2003:44), effective asset disposal frameworks incorporate consideration of alternatives for the disposal surplus, obsolete, underperforming or unserviceable assets. National Treasury also suggests that the alternatives should be evaluated in cost benefit terms.</p>		



<p>Par.29 The municipality did not monitor, measure and review performance of movable non-current assets.</p> <p>Par.58 Poor information systems for verification, storing and reporting actual performance.</p>	<p>Par.23 The municipality did not establish mechanism to monitor and review its performance management system for their assets like movable non-current assets as required by MSA Section 40.</p> <p>Par.24 The municipality also did not have or uphold an effective, efficient and transparent system of financial, risk management and internal control systems for their movable non-current assets as required by MFMA Section 62(1) (c) (i).</p> <p>Par.42 The municipality had not developed adequate policies and procedures to address the collection, recording, processing, monitoring and reporting on predetermined objectives (such as objectives of movable non-current asset).</p>	<p>Par.8 There was insufficient evidence provided for assets disposed during the year.</p> <p>Par.63 Capital assets that were needed for providing the minimum level of basic municipal services were sold, transferred or permanently disposed in contravention of MFMA Section 14(1).</p> <p>Par.64 Capital assets that were required to provide basic services were disposed without the approval of the municipal council or the Municipal Manager as required by MFMA Section 14(2).</p>
--	---	---

**Source: National Treasury (2003:18-44)**

**TABLE 4: Asset Planning and Budgeting Control**

<ul style="list-style-type: none"> <li>According to National Treasury (2003:PN0006: 2.1.1 &amp; 2.1.2) of the National Treasury guidelines for effective asset management the municipality management should ensure that: The service area is defined, suitable movable non-current assets are bought and also there is periodic evaluation of physical condition, functionality, utilisation and financial performance to provide performance report of existing assets.</li> </ul>		
<p>Par.30 The municipality did not monitor and measure the performance against the set priorities, standards and key performance indicators in order to implement the improvement action where the targets are not met as required by MSA Section 41.</p>	<p>Par.23 The municipality did not establish mechanism to monitor and review its performance management system for their assets such as movable non-current assets as required by MSA Section 40.</p> <p>Par.24 They also did not have or uphold an effective, efficient and transparent system of financial, risk management and internal control systems for their movable non-current assets as required by MFMA Section 62(1) (c) (i).</p>	<p>Par.38 The local community was not consulted by means of a municipal wide structure for community participation or through a forum that encourages community participation in drafting and implementation of the IDP as required by MSA Section 28.</p> <p>Par.42 The municipality did not establish mechanisms to monitor and evaluate its performance management system, as required by MSA Section 40.</p> <p>Par.23 The total of 100% reported objectives were not consistent with the approved IDP.</p> <p>Par.25 The measurability of planned targets could not be assessed due to lack of proper systems and formal standard operating procedures and documented system</p>

		descriptions.
--	--	---------------

**Source: National Treasury (2003:08)**

**TABLE 5: Developing the Asset Strategy**

<ul style="list-style-type: none"> <li>According to the National Treasury (2003:PN0006: 2.1.3) the asset strategy should address the changing service delivery requirements in order to address the current service delivery plans. It should also explore different methods or alternatives of service delivery, address technological developments as well as identify solutions to deal with idle assets. The strategy should also be supported by the service delivery budget and implementation plan to make the IDP and the municipality budget practical (National Treasury 2003:11).</li> </ul>		
<p>Par.36 The performance report does not include a comparison with performance standards/targets or with previous financial years and measures that were taken to improve performance, as required by Section 46(1) (a) (b) (c) of the MSA.</p> <p>Par.38 The municipality did not audit the results of performance measurement, as required by Section 45(1) (a) of the MSA.</p> <p>Par.40 The internal audit did not audit the performance measurements on a continuous basis and submit quarterly reports to the</p>	<p>Par.23 The municipality did not establish mechanism to monitor and review its performance management system for their assets such as movable non-current assets as required by MSA Section 40.</p> <p>Par.24 They also did not have or uphold an effective, efficient and transparent system of financial, risk management and internal control systems for their movable non-current assets as required by MFMA Section 62(1) (c) (i).</p>	<p>Par.39 The performance management system and related controls were not in place as the processes of performance planning, monitoring, measurement, review, reporting and implementation were not described and explained how they should be conducted, organised and managed including the roles of different role players.</p> <p>Par.60 An adequate management, accounting and information system which accounts for assets was not in place as per MFMA Section 63(2) (a).</p>

<p>Municipal Manager and performance committee, as required by Municipality Planning and Performance Management Regulation Section 14(1) (c).</p>		<p>Par.61 An effective system of internal control for assets, including an asset register was not in place, as required by MFMA Section 63(2) (c).</p> <p>Par.38 The municipality did not involve the community when drafting and implementation of the IDP.</p> <p>Par.41 The community was not afforded an opportunity to comment on the final draft if IDP in order to inform the municipality about the current needs of the community.</p> <p>Par.23 The total of 100% reported objectives were not consistent with the approved IDP. There was not alignment between objective, indicators and targets between planning and reporting documents.</p>
<ul style="list-style-type: none"> <li>• Forward-looking asset strategies are required, such as the development of a GRAP compliant asset register in order to identify and collect information regarding existing movable non-current assets that are capable of providing programme delivery needs as well as those existing assets that are below the standard and need refurbishment to meet programme delivery needs. The forward looking strategies will also help to identify assets that are in excess to programme delivery needs so that they can be disposed or to identify assets that must be acquired to meet programme delivery needs (National Treasury 2003:12).</li> </ul>		

<p>Par.6 FAR was overstated compared to financial statements as result of capitalised VAT.</p> <p>Par. 7 Sufficient evidence was not available to confirm assets that were disclosed as PPE.</p> <p>Par.52 An adequate management, accounting and information system which accounts for assets was not in place, as required by MFMA Section 63(2) (a).</p> <p>Par.53 An effective system of internal control for assets was not in place as required by MFMA Section 63(2) (c).</p>	<p>Par.6 There was no evidence about completeness of PPE as the adjustments relating to movable tangible assets could not be justified.</p> <p>Par.39 Effective internal control system for assets was not in place, as required by MFMA Section 63(2) (c).</p> <p>Par.43 The systems for assets was not kept up to date and verified during the year and had to be corrected during the audit process.</p>	<p>Par.8 Amounts of assets in the FAR did not agree with amounts in the financial statements (AFS).</p> <p>Par.9 Movable assets could not be physically located during the audit and those identified could not be traced back to the FAR. The right of ownership determined and also the municipality did not account for Property Plant and Equipment (PPE) in compliance with Generally Recognised Accounting Principles (GRAP).</p> <p>Par.8 No sufficient evidence was provided to justify disposals during the year.</p> <p>Par. 7 The residual value was not reassessed during the year. Depreciation was not calculated according to accounting policy.</p> <p>Par.60 An adequate management, accounting and information system which accounts for assets was not in place, as required by MFMA Section 63(2) (a).</p> <p>Par.61 An effective system of internal control</p>
--	---	--

		<p>for assets (including FAR) was not in place as required by MFMA Section 63(2) (c).</p> <p>Par.63 Capital assets were sold that were required to provide the minimum level of basic municipal service, in contravention with MFMA Section 14(1).</p>
--	--	--

**Source: National Treasury (2003:11-12)**

**TABLE 6: Capital Funding and Budgeting**

<ul style="list-style-type: none"> <li>According to the National Treasury (2003:PN0006: 2.1.4), Capital funding and budgeting should be based on the municipality’s objectives and priorities as outlined in the IDP and MTEF when considering suitable capital funding and budget to finance movable non-current assets, there are two financing options for municipality expenditure; capital budget for movable and immovable assets (funded from state dedicated funds and annual capital works allocation) and operational budget for operational costs (National Treasury 2003:18).</li> </ul>		
<p>Par.29 The municipality did not align its operations with IDP as required by MSA Section 36.</p> <p>Par.31 Municipal Manager did not submit the monthly budget which outlines expected revenues and expenditures as required</p>	<p>Par.19 The information presented with respect to development priority, basic service delivery and investment was not reliable when compared to evidence provided. The municipality lacks standard operating procedures for accurate recording of</p>	<p>Par.26 Usefulness and reliability of information reported was questionable as the IDP, performance indicators could not be assessed due to lack of corroborative supporting evidence to verify management’s explanation why the indicators were considered important</p>

<p>MFMA Section 71 (1)</p> <p>Par.32 Municipal Manager did not assess the first half of the municipality's performance as required by MFMA Section 72(1) (a) (ii).</p>	<p>achievements and lack of review of the validity of reported achievements against source documents.</p>	<p>to the realisation of strategic goals and objectives.</p> <p>Par.23 Mphashe was reported to have been operating without an adopted reviewed framework as a result a total of 100% reported objectives, indicators and targets were not consistent with those in the IDP.</p> <p>Par.25 The measurability of planned targets could not be assessed due to lack of proper systems and formal standard operating procedures and documented system descriptions.</p>
--	---	---

**Source: National Treasury (2003:18)**

**TABLE 7: Aligning Assets with Service Delivery Programmes**

<ul style="list-style-type: none"> <li>According to National Treasury (2003:PN0006: 2.1.5), the municipal management should compare the service delivery movable assets if they are operational as intended to determine under-utilisation or to identify any damaged assets. The comparison helps to identify assets that do not meet the appropriate capacity to adequately address the service delivery standards or assets that are underutilised or that do not support the municipality objectives (National Treasury 2003:21).</li> </ul>		
<p>Par.30 The municipality did not monitor, measure and review performance of movable non-current assets with regard to each of the development priorities and objectives where performance standards were not met MSA Section 41.</p>	<p>Par.23 The municipality did not establish mechanisms to monitor and review its performance management system as required by MSA Section 40.</p> <p>Par.21 The municipality did not achieve 47% of its target plans for the year. This is because of inadequate performance management systems that are in place as well as lack of capacity within the municipality.</p> <p>Par.39 An effective system of internal control for assets was not in place, as required by MFMA Section 63 (2) (c).</p> <p>Par.19 The information presented with respect to development priority, basic service delivery and investment was not reliable when compared to evidence provided. The</p>	<p>Par.38 The local community was not consulted by means of a forum that enhances community participation in drafting and implementation of the IDP as required MSA Section 28.</p> <p>Par.39 Performance management systems and controls were not in place to describe the present processes or to establish standards against which the municipality can measure future performance and report improvements as required by MSA Section 38.</p> <p>Par.41 The local community was not afforded the opportunity to comment on the final draft of the IDP, as required by MSA Section 42.</p>



	<p>municipality lacks standard operating procedures for accurate recording of achievements and lack of review of the validity of reported achievements against source documents.</p>	
<ul style="list-style-type: none"> <li>The municipal management should ensure that a cost effective method (purchase, design or finance lease) was used to procure movable non-current assets, exposure to risk is minimised (thorough economic appraisal is conducted) and that purchasing ethics and principles are followed (National Treasury 2003:22).</li> </ul>		
<p>Par.41 Goods with transaction values between R10 000 and R200 000 were procured without written quotations from three different suppliers as required in the SCM policy.</p> <p>Par.42 Unregistered Prospective service providers were allowed to submit quotations in contravention of the SCM policy.</p> <p>Par.43 There was no evidence that a PPPF point system was used.</p> <p>Par.45 The Bidders that did not submit a declaration that they were not government employees. There were tenders that were</p>	<p>Par.31 The municipality did not require the supplier to submit a declaration on whether they were or not employed by government or not connected to any person employed by the state as required by SCM Section 13(c).</p> <p>Par.46 The system underlying procurement processes at the municipality were inadequate to prevent and detect irregular expenditure on contracts entered into. Also, the municipality did not take any action towards officials who permitted unauthorised, irregular, wasteful expenditure.</p>	<p>Par.31 Sufficient evidence was not obtained that contracts were awarded in compliance of SCM policy and PPPF point system was used to calculate and allocate points during the procurement of goods and supplies.</p> <p>Par.32 Contracts were awarded to bidders who did not submit a declaration on whether they were employed by government or were connected to any government employees or not.</p> <p>Par.37 Contracts were awarded to service providers that were in the service of other state institution or whose directors are in the service of other state institution, in contravention of</p>

awarded to state employees which are in contravention with the SCM policy.		MFMA Section 112(j) and SCM regulation Section 44.
<ul style="list-style-type: none"> <li>• Should also ensure that movable non-current asset life cycle costs are taken into account at procurement stage of assets. According to National Treasury (2003:28), establishing life cycle costs during procurement provides the baseline to estimate costs for future acquisition projects or assets as well as provide the basis of analysing the performance of existing assets against predicted life cycle costs.</li> </ul>		
Par.30 The municipality did not monitor, measure and review performance with respect to each of development priorities and objectives and against key performance indicators and set targets in order to take action where there is need for improvement.	<p>Par.23 The municipality did not establish mechanism to monitor and review its performance management system for their assets (such as movable non-current assets) as required by MSA Section 40.</p> <p>Par.24 They also did not have or uphold an effective, efficient and transparent system of financial, risk management and internal control systems for their movable non-current assets as required by MFMA Section 62(1) (c) (i).</p>	Par.39 The performance management system and related controls were not in place as it did not describe and represent the processes of performance planning, monitoring, measurement, review, reporting and improvement and how it is conducted, organised and managed including clear definition of roles and role players.

**Source: National Treasury (2003:21-28)**

**TABLE 8: Principles of Budgeting**

<p><b>Mbhashe Local Municipality audit report qualified issues for the financial year 2012.</b></p> <p><b>Audit opinion: Qualified(AGSA: 2012)</b></p>	<p><b>Mbhashe Local Municipality audit report qualified issues for the financial year 2013.</b></p> <p><b>Audit opinion: Qualified(AGSA: 2013)</b></p>	<p><b>Mbhashe Local Municipality audit report qualified issues for the financial year 2013.</b></p> <p><b>Audit opinion: Qualified(AGSA: 2014)</b></p>
<ul style="list-style-type: none"> <li>• Realistic budgeting that considers actual revenue collections not deficit (Mbhashe Local Municipality, 2015)</li> </ul>		
<p>Par.50 Interest was not charged on all outstanding accounts as required by MFMA Section 64(2) (g).</p> <p>Par.51 Revenue was not always reconciled on a weekly basis as require by MFMA Section 64 (2) (h).</p> <p>Par.22 All the targets were not specific in clearly specifying the nature and the required level of performance.</p> <p>Par.25 The municipality did not have the appropriate system for identifying, collection, recording, processing, monitoring and storing of information. The actual reported performance for the selected objectives was not completely recorded.</p>	<p>Par.38 Interest was not charged on all accounts in areas, as required by MFMA Section 64 (2) (g).</p> <p>Par.19 The municipality did not have an appropriate system to collect, collate, verify and store performance information to ensure valid, accurate and complete recording of actual achievement against planned objectives, indicators and targets(of revenue).</p>	<p>Par.55 A tariff policy was not adopted and implemented for the levying of fees for provision of municipal services, as required by MSA Section 74(1).</p> <p>Par.56 A credit policy for credit customers was not maintained and implemented as required by Property Rates Act s3(1) or the MFMA Section 62(1)(f)(iii).</p> <p>Par.58 An effective debtors and revenue internal control system was not in place as required by MFMA Section 64(2) (f). Par. 59 Interest was not charged on all accounts in arrears.</p>

<ul style="list-style-type: none"> <li>Expenses are incurred in terms of the approved annual budget or adjustment budget and within approved amounts of appropriated amounts for each vote (Mbhashe Local Municipality, 2015).</li> </ul>		
<p>Par.32 The Municipal Manager did not assess the first half of the financial performance as required by Section 72(1) (a) (ii) of the MFMA.</p> <p>Par.42 The municipality had not developed adequate policies and procedures to address the collection, recording, processing, monitoring and reporting on predetermined revenue objectives.</p>	<p>Par.43 The municipality did not have a proper record management system that provides for the maintenance of information that supports the reported information as contained in the annual performance report. This includes information relating to the collection, collation, verification, storing and reporting of actual performance information.</p>	<p>Par.23 The municipality operated without an adopted and reviewed framework resulting in 100% of reported objectives, indicators and targets that were not consistent with those approved in the IDP.</p>
<ul style="list-style-type: none"> <li>A three year budget (MTREF) is prepared and reviewed annually and approved by the Municipal Council (Mbhashe Local Municipality, 2015)l</li> </ul>		
<p>Par.29 The municipality did not conduct its affairs consistent with its IDP (which is the foundation of MTREF) as required by MSA Section 36.</p> <p>Par.41 Mbhashe was unable to achieve leadership stability as a result the executive was replaced, key management personnel were suspended and personnel were acting</p>	<p>Par.45 The municipality did not have adequate processes and assignment of responsibilities to ensure compliance with all the applicable laws and regulations. As a result there were instances of non-compliance with MFMA and DoRA.</p>	<p>Par.23 The municipality operated without an adopted and reviewed framework resulting in 100% of reported objectives, indicators and targets that were not consistent with those approved in the IDP.</p>

<p>in senior positions.</p> <p>Par.42 The municipality had not developed adequate policies and procedures to address the collection, recording, processing, monitoring and reporting on predetermined revenue objectives.</p>		
<ul style="list-style-type: none"> <li>• The budget at all times should be within the framework of the IDP (Mbhashe Local Municipality, 2015)</li> </ul>		
<p>Par.29 The municipality did not conduct its affairs consistent with its IDP (which is the foundation of MTREF) as required by MSA Section 36.</p> <p>Par.55 Mbhashe Local Municipality was unable to achieve leadership stability as a result the executive was replaced, key management personnel were suspended and personnel were acting in senior positions.</p> <p>Par.56 The municipality had not developed and approved adequate policies and procedures to address the collection, recording, processing, monitoring and reporting on predetermined revenue</p>	<p>Par.41 The municipality was not able to achieve leadership stability during the year as a result the municipal executive was replaced, key management suspended and personnel were acting in senior positions.</p> <p>Par.42 The municipality’s reliance on both the consultants and the audit process to achieve fair presentation did not create a sustainable platform for achieving clean administration.</p> <p>Par.19 The information presented with respect to development priority, basic service delivery and infrastructure investment was unreliable when compared to the source information and evidence provided.</p>	<p>Par.23 The municipality operated without an adopted and reviewed framework resulting in 100% of reported objectives, indicators and targets that were not consistent with those approved in the IDP.</p>

<p>objectives.</p> <p>Par.59 The municipality had inadequately assigned responsibility and implemented processes to monitor compliance with the approved budget and ensure adherence with the applicable laws and regulations.</p>		
--	--	--

**Source: Mbhashe Local Municipality Budget Policy (2015)**

**TABLE 9: Budget Preparation Process**

<p><b>7.1 Formulation of the budgeting process.</b></p> <ul style="list-style-type: none"> <li>Municipal Manager with assistance of the CFO and the director for IDP shall draft the IDP process and schedule for the municipality (Mbhashe Local Municipality, 2015:7.1).</li> </ul>		
<p>Par.59 The municipality did not assign responsibility and implement processes to adequately monitor compliance with the approved budget and ensure adherence with the applicable laws and regulations.</p>	<p>Par.43 The dependence on both consultants and the audit process to attain fair presentation did not create a sustainable platform for clean administration.</p>	<p>Par.25 The measurability of planned targets could not be assessed due to lack of processes and formal standard operating procedures and documented systems descriptions.</p>
<ul style="list-style-type: none"> <li>The Mayor shall table the IDP process plan and schedule to the municipal council by the 31 December each year (10 months before the start of the next budget year) (Mbhashe Local Municipality, 2015).</li> </ul>		
<p>Par.55 Mbhashe Local Municipality unable to achieve leadership stability as a result the</p>	<p>Par.41 The municipality was unable to achieve leadership stability during the year as a result</p>	<p>Par.67 The lack of accountability resulted in actions to address audit findings relating to laws</p>

<p>executive was replaced, key management personnel were suspended and personnel were acting in senior positions.</p> <p>Par.29 The municipality did not conduct its affairs consistent with its IDP as required by MSA Section 36.</p>	<p>the municipal executive was replaced, key management suspended and personnel were acting in senior positions.</p>	<p>and regulations and predetermined objectives not being implemented adequately. For example, there was inadequate oversight by leadership and slow response to key messages.</p>
<ul style="list-style-type: none"> <li>Key deadlines for the IDP and MTERF reviews and the revision of the annual budget should be indicated (Mbhashe Local Municipality, 2015).</li> </ul>		
<p>Par.59 The municipality did not assign responsibility and implementation processes adequately to monitor compliance with the approved budget and applicable laws and regulation.</p>	<p>Par.45 The municipality did not have adequate processes and assignment of responsibility to ensure compliance with all applicable laws and regulations.</p>	<p>Par.69 The municipality did not have systems in place to monitor compliance and prevent non-compliance with all applicable legislation.</p> <p>This could have been prevented had compliance been properly reviewed and monitored.</p>
<ul style="list-style-type: none"> <li>Strategic workshop to discuss IDP priorities should be held for senior management and the Mayoral committee. This discussion of priorities forms the basis for the MTERF budget taking into account the financial and political pressures facing the municipality (Mbhashe Local Municipality, 2015).</li> </ul>		
<p>Par.55 Mbhashe Local Municipality was unable to achieve leadership stability as a result the executive was replaced, key management personnel were suspended and</p>	<p>Par.41 The municipality was unable to provide leadership stability during the year as a result the municipal executive was replaced, key management suspended and personnel were</p>	<p>Par.23 The municipality operated without an adopted and reviewed framework. The MSA Section 41 requires that the municipality uses the IDP as a basis for annual reports and therefore</p>

<p>personnel were acting in senior positions (for example Municipal Manager who is responsible to provide administrative guidance to the political structure).</p>	<p>acting in senior positions. Par.23 The municipality did not establish mechanisms to monitor and review its performance management system as required by MSA Section 40.</p>	<p>requiring consistency between planning and reporting documents. Par.67 The lack of accountability resulted in actions to address audit findings relating to laws and regulations and predetermined objectives not being implemented adequately. For example, there has been inadequate oversight by leadership and slow response to key messages.</p>
<ul style="list-style-type: none"> <li>By the 31 March MTERF, IDP and the draft budget must be presented together with draft resolutions and budget related policies (such as tariff settings and credit control guidelines) (Mbhashe Local Municipality, 2015).</li> </ul>		
<p>Par.23 The required performance could not be measured for all the targets. Par. 30 The municipality did not conduct its affairs consistent with its IDP as required by MSA Section 36</p>	<p>Par.41 Mbhashe Local Municipality was unable to achieve leadership stability as a result the executive was replaced, key management personnel were suspended and personnel were acting in senior positions (i.e. the Municipal Manager who is responsible to provide administrative guidance to the political structure).</p>	<p>Par.23 The municipality operated without an adopted and reviewed framework. The MSA Section41 requires that the municipality uses the IDP as a basis for annual reports and therefore requiring consistency between planning and reporting documents.</p>
<ul style="list-style-type: none"> <li>The CFO and the senior managers undertake the technical preparation of the budget and the budget must be in prescribed format and divided into capital and operating budget (Mbhashe Local Municipality, 2015).</li> </ul>		
<p>Par.55 Mbhashe Local Municipality was</p>	<p>Par.43 Reliance on both consultants and the</p>	<p>Par.67 The lack of accountability resulted in</p>



<p>unable to achieve leadership stability as a result the executive was replaced, key management personnel were suspended and personnel were acting in senior positions (for example the municipality executive is responsible for approving the draft resolutions and hold public hearings).</p> <p>Par.59 The municipality did not assign responsibility and implementation processes to adequately monitor compliance with the approved budget and applicable laws and regulation.</p>	<p>audit process to achieve fair presentation did not create a sustainable platform for achieving clean administration.</p>	<p>actions to address audit findings relating to laws and regulations and predetermined objectives not being implemented adequately. For example, there has been inadequate oversight by leadership and slow response to key messages.</p>
<ul style="list-style-type: none"> <li>The budget must reflect realistic revenue and expenses that are divided into votes (Mbhashe Local Municipality, 2015).</li> </ul>		
<p>Par.50 Interest was not charged on all outstanding accounts as required by MFMA Section 64(2) (g).</p> <p>Par.51 Revenue was not always reconciled on a weekly basis as require by MFMA Section 64(2) (h).</p> <p>Par.29 The municipality did not conduct its affairs consistent with its IDP as required by</p>	<p>Par.38 Interest was not charged on all accounts in arrears, as required by MFMA Section 64(2) (g).</p> <p>Par.23 The municipality did not establish mechanisms to monitor and review its performance management system as required by MSA Section 40. There were no performance assessments conducted to check</p>	<p>Par.54 The tariff policy was not adopted and implemented for the levying fees for provision of municipal services as required by MSA Section 71(1).</p> <p>Par.56 A credit control and debt collection policy was not maintained and implemented as required by MSA Section 96(b).</p> <p>Par.58 An effective debtors and revenue system</p>

<p>MSA Section 36. The IDP is the basis of the three year plan.</p> <p>Par.21 Due to lack of review, monitoring and standard operating procedures that were not in place 51% of reported objectives, 84% performance indicators and all the reported targets were not consistent with the IDP objectives, targets and performance indicators.</p> <p>Par.24 All the actual reported performance relevant to the selected objectives was not valid and accurate when compared to evidence provided.</p> <p>Par.44 The municipality did not have a proper system of record management that supports information reported in the annual performance report. This includes information which relates to collection, collation, verification, storing and reporting of actual performance information.</p>	<p>actual performance against plans.</p> <p>Par.41 Mbhashe was not able to achieve leadership stability as a result the executive was replaced, key management personnel were suspended and personnel were acting in senior positions.</p> <p>Par.26 An oversight report containing comments on the annual report was not adopted by the municipality council within two months from the date it was tabled as required by MFMA Section 129(1).</p>	<p>was not in place, as required by MFMA Section 97(i).</p> <p>Par.59 Interest was not charged on all accounts in arrears as required by MFMA Section 64(2) (g).</p> <p>Par.23 The municipality operated without an adopted and reviewed framework. The MSA Section41 requires that the municipality uses the IDP as a basis for annual reports and therefore requiring consistency between planning and reporting documents.</p>
---	---	---

<p><b>7.2 Public participation process</b></p> <ul style="list-style-type: none"> <li>Just after the tabling of the draft of the annual budget the municipality must convene hearings on draft budget in April and then make representation at the municipal council hearing and submit comments in response of the draft (Mbhashe Local Municipality, 2015:7.2).</li> </ul>		
<p>Par.55 Mbhashe was not able to achieve leadership stability as a result the executive was replaced, key management personnel were suspended and personnel were acting in senior positions (for example the municipality executive that is responsible for holding public hearings was replaced).</p> <p>Par.59 The municipality did not assign responsibility and implementation processes adequately to monitor compliance with the approved budget and applicable laws and regulation.</p>	<p>Par.41 Mbhashe was unable to achieve leadership stability as a result the executive was replaced, key management personnel were suspended and personnel were acting in senior positions.</p> <p>Par.45 The municipality did not have adequate processes and assignment of responsibilities to ensure compliance with all the applicable laws and regulations.</p>	<p>Par.67 There has been lack inadequate oversight by leadership and slow response to key messages.</p> <p>Par.38 The local community was not consulted through a forum that enhances community participation in drafting and implementation of the IDP as required by MSA Section28.</p> <p>Par.41 The local community was not afforded the opportunity to comment on the final draft of the IDP as required by MSA Section 42.</p>
<p><b>7.3 Approval of the budget</b></p> <ul style="list-style-type: none"> <li>Municipal council must consider MTERF budget for approval 30 days before the beginning of the budget year. Municipal council resolution should contain the budget policies and performance measures to be adopted (Mbhashe Local Municipality, 2015:7.3).</li> </ul>		
<p>Par.55 Mbhashe was unable to achieve leadership stability as a result the executive was replaced, key management personnel</p>	<p>Par.41 Mbhashe was unable to achieve leadership stability as a result the executive was replaced, key management personnel were</p>	<p>Par.67 There has been inadequate oversight by leadership and slow response to key messages.</p> <p>Par.25 The measurability of planned targets and</p>

<p>were suspended and personnel were acting in senior positions (for example the municipality executive is responsible for holding public hearings was replaced).</p>	<p>suspended and personnel were acting in senior positions.</p>	<p>indicators could not be assessed due to lack of suitable systems and processes, formal standard operating procedures and documented system descriptions.</p>
<ul style="list-style-type: none"> <li>• If the municipal council fails to approve the budget before the start of the budget year, the Mayor must inform the Finance MEC that the budget has not been approved and must comply with 25, 26 and 55 of MFMA (Mbhashe Local Municipality, 2015).</li> </ul>		
<p>Par.31 Monthly budgets were not submitted timely to the relevant provincial treasury as required by MFMA Section 71(1).</p> <p>Par.59 The municipality did not assign responsibility and implementation processes adequately to monitor compliance with the approved budget and applicable laws and regulation.</p> <p>Par.21 Due to lack of review, monitoring and standard operating procedures that were not in place, 51% of reported objectives, 84% performance indicators and all the reported targets were not consistent with the IDP objectives, targets and per performance</p>	<p>Par.26 An oversight report containing comments on the annual report was not adopted by the municipality council within two months from the date it was tabled as required by MFMA Section 129(1).</p> <p>Par.27 the municipal council's over site report on the annual report was not made public within seven days of its adoption as required by MFMA Section 129(3).</p>	<p>Par.61 An effective internal control system for assets was not in place as required by MFMA Section 63(2) (c).</p>

indicators.		
<ul style="list-style-type: none"> <li>The budget with draft resolution approving budget, property rates, taxes and tariffs must be tabled to the municipal council for approval. Draft resolutions of measurable performance objectives for each budget vote must be aligned to IDP of the municipality (Mbhashe Local Municipality, 2015).</li> </ul>		
<p>Par. 29 The Municipality did not conduct its activities in line with the IDP as required by MSA Section 36.</p> <p>Par. 30 The municipality did not monitor and review performance regarding each of the developed priorities and objectives in order to take corrective action to improve performance.</p>	<p>Par. 23 The municipality did not establish mechanisms to monitor and review its performance management system as required by MSA Section 40. There were no performance assessments conducted to check actual performance against plans.</p>	<p>Par. 55 A tariff policy was not adopted and implemented for the levying of fees for provision of municipal services as required by MSA Section 74(1).</p> <p>Par. 25 The measurability of planned targets and indicators could not be assessed due to lack of suitable systems and processes, formal standard operating procedures and documented system descriptions.</p> <p>Par. 57 The policy for the levying of rates on rateable property was not adopted and implemented as required by MFMA Section 62 (1) (f) (ii).</p>
<ul style="list-style-type: none"> <li>The budget should also include projected cash flows for the financial year by revenue sources and expenditure votes (Mbhashe Local Municipality, 2015).</li> </ul>		
<p>Par.50 Interest was not charged on all outstanding accounts as required by MFMA</p>	<p>Par.8 Non-cash items included in the cash flow statement were not unsubstantiated.</p>	<p>Par.8 AGSA was unable to substantiate the accuracy of non-cash items in the prior cash flow</p>

<p>Section 64 (2) (g). Par.51 Revenue was not always reconciled on a weekly basis as require by MFMA Section 64 (2) (h).</p>	<p>Par.38 Interest was not charged on all accounts in arrears, as it is required by MFMA Section 64(2) (g).</p>	<p>statement.</p>
<ul style="list-style-type: none"> <li>The budget must also include proposed amendments to the municipality’s IDP and to the budget related policies (Mbhashe Local Municipality, 2015).</li> </ul>		
<p>Par.24 All the actual reported performance relevant to the selected objectives was not valid and accurate when compared to evidence provided. Par.21 Due to lack of review, monitoring and standard operating procedures that were not in place 51% of reported objectives, 84% performance indicators and all the reported targets were not consistent with the IDP objectives, targets and performance indicators. Par.29 The municipality did not conduct its affairs consistent with its IDP as required by MSA Section 36.</p>	<p>Par.23 The municipality did not establish mechanisms to monitor and review its performance management system as required by MSA Section 40. There were no performance assessments conducted to check actual performance against plans.</p>	<p>Par.67 There has been inadequate oversight by leadership and slow response to key messages. Par.38 The local community was not consulted through a forum that enhances community participation in drafting and implementation of the IDP as required by MSA Section28. Par.41 The local community was not afforded the opportunity to comment on the final draft of the IDP as required by MSA Section42.</p>
<ul style="list-style-type: none"> <li>The municipality’s costs such as salaries, allowances and the other benefits of office bearers, municipal council, the Accounting Officer, CFO</li> </ul>		

and others senior managers; Particulars of other proposed municipal entities and external parties assisting the municipality in service delivery; Particulars of the municipal investments and various information regarding municipal entities under the shared or sole control of the municipality (Mbhashe Local Municipality, 2015).

<p>Par.44 The municipality did not have a proper record management system that supports information reported in the annual performance report. This includes information which relates to collection, collation, verification, storing and reporting of actual performance information.</p> <p>Par.12 Provisions made in the financial statements were not justified.</p>	<p>Par.32 The competencies of financial and supply chain management officials were not assessed to identify possible gaps in competence levels as required by Municipal Regulations on Minimum Competency Levels regulation Section 13.</p> <p>Par.34 Senior officials were appointed for more than six months in contravention of MSA Section 67(d).</p> <p>Par.36 The senior managers directly accountable to the municipal manager did not sign performance agreements as required by MSA Section 57(2) (a).</p>	<p>Par.47 An Acting Municipal Manager was appointed for more than six months in contravention of the MSA Section 54A (2A).</p> <p>Par.50 The financial officials competencies were not assessed timely to identify and address gaps in competency levels as required by Municipal Regulations on Minimum competency Levels Regulations Section 14(2) (a).</p>
---	---	---

**7.4 Publication of the budget**

- Within 14 days an annual draft budget must be tabled before the municipal council for approval. The Director of corporate services must post the final draft and the other related documents onto the municipality’s website for public access and also send a hard copy to the National Treasury and provincial Treasury. The CFO must submit the approved budget within 14 days in both printed and the soft copy to the National and Provincial Treasury and must be posted on the municipality’s website (Mbhashe Local Municipality, 2015:7.4).

Par.59 The municipality did not assign responsibility and implementation processes adequately to monitor compliance with the approved budget and applicable laws and regulation.

Par.31 Monthly budget statements were not submitted timely to the relevant Provincial Treasury as required by Section 7(1) of MFMA.

Par.32 The Municipal Manager did not assess the first half of the municipality’s performance.

Par.41 The municipality was unable to achieve leadership stability as the executive was replaced, key management suspended and the personnel were acting in senior positions.

Par.67 There has been inadequate oversight by leadership and slow response to key messages. Improvement is dependent on proper execution of action plans drafted, which were not fully implemented during the year.



**7.5 Service Delivery Budget Implementation Plan**

Mayor must approve the SDBIP not later than 28 days after approval of the council components of the SDBIP :

- Monthly projections of revenue to be collected for each revenue source (Mbhashe Local Municipality, 2015:7.5).

Par.50 Interest was not charged on all outstanding accounts as required by MFMA Section 64 (2) (g).

Par.51 Revenue was not always reconciled on a weekly basis as require by MFMA Section 64 (2) (h).

Par.38 Interest was not charged on all accounts in arrears, as required by MFMA Section 64(2) (g).

Par.55 A tariff policy was not adopted and implemented for the levying of fees for provision of municipal services, as required by MSA Section 74(1).

Par.56 A credit policy for credit customers was not maintained and implemented as required by Property Rates Act Section 3(1) or the MFMA Section 62(1) (f) (iii).

Par. 58 An effective debtors and revenue internal control system was not in place as required by MFMA Section 64(2) (f).

Par. 59 Interest was not charged on all accounts in arrears.

- Quarterly projections of service delivery targets and performance indicators for each vote. Ward information for expenditure and service delivery. Service delivery monthly projections of expenditure (operational and capital) and revenue for each vote. Detailed capital work plans are broken down by ward over three years (Mbhashe Local Municipality, 2015).

Par.29 The Municipality did not conduct its activities in line with the IDP as required by

Par.23 The municipality did not establish a mechanism to monitor and review its

Par.25 The measurability of planned targets could not be assessed due to lack of processes and

<p>MSA Section 36.</p> <p>Par.30 The municipality did not monitor, measure and review performance with regard to each of the development priorities and objectives where performance targets are not met, as required by MSA Section 41.</p>	<p>performance management system, as required by MSA Section 40.</p> <p>Par.29 The internal audit did not audit the results of performance measurements, as required by MSA Section 45(1) (a).</p> <p>Par.30 The internal audit did not audit the performance measurement continuously in order to submit quarterly reports to the municipal manager, as required by Municipal planning and performance management regulation.</p> <p>Par.19 Due to lack of review, monitoring and standard operating the information presented with respect to development priority, basic service delivery and investment was unreliable when compared to the evidence provided.</p>	<p>formal standard operating procedures and documented systems descriptions.</p> <p>Par.38 The local community was not consulted by means of a forum that enhances community participation in drafting and implementation of the IDP as required MSA Section 28.</p> <p>Par.39 Performance management systems and controls were not in place to describe the present processes or to establish standards against which the municipality can measure future performance and report improvements as required by MSA Section 38.</p> <p>Par.41 The local community was not afforded the opportunity to comment on the final draft of the IDP, as required by MSA Section 42.</p>
--	--	---

**Source: Mbhashe Local Municipality Budget Policy (2015)**

**TABLE 10: Capital Budget**

Only expenditure which meets the definition of an asset and has a value that exceeds R10 000 and has life that is more than one year should be included in the capital budget. Vehicles are dealt with in terms of the municipal council vehicle replacement policy. The budget for vehicles shall separate between replacement and new vehicles. No globular amounts shall be budgeted for vehicles. The municipality may only spend money on capital projects if the money has been appropriated in the capital budget and that envisaged funding sources (such as revenue, external loans, capital replacement reserve and grant funding) must be carefully considered and the municipality council must be assured that the funding is not dedicated for other purposes (Mbhashe Local Municipality, 2015:8).

<p>Par.7 Assets disclosed as PPE in note 9 could not be confirmed.</p> <p>Par.8 Sufficient evidence about completeness of irregular expenditure could not be obtained. According to MFMA and the policy capital budgeting of Mbhashe Local Municipality only capital projects included in the capital budget and approved by the municipal council can be paid or purchased.</p> <p>Par.49 The municipality did not take effective steps to prevent unauthorised, irregular and fruitless and wasteful expenditure as required by MFMA Section 62(1) (d).</p>	<p>Par.6 The adjustments' relating to movable tangible assets was not justified.</p> <p>Par.7 Irregular expenditure amounting to R1, 2 million was not disclosed as required by SCM requirements. According to the Mbhashe Local Municipality policy and MFMA, only capital projects included in the capital budget that is approved by the municipal council can be purchased.</p> <p>Par.37 Reasonable steps were not taken to prevent irregular expenditure as required by MFMA Section 62(1) (d).</p>	<p>Par.7 The municipality incorrectly classified PPE as investment even though the assets were held for use in production or for supply of goods or services, for rental to others or administrative purposes. The municipality did not account for Property Plant and Equipment (PPE) in compliance with Generally Recognised Accounting Principles (GRAP17). The municipality inappropriately classified items of PPE which consequently resulted in overstatement of PPE by accumulated surplus as depreciation and residual values were not reassessed during the year. Also depreciation was incorrectly calculated and items of investments were duplicated in PPE.</p>
---	---	---

		Par.54 Reasonable steps were not taken to prevent irregular expenditure as required by MFMA Section 62(1) (d).
--	--	--

**TABLE 11: Issues that the Municipality Council Should Consider Before the Approval of the Capital Budget**

Total costs and cash flows for all the financial years until the project is operational (Mbhashe Local Municipality, 2015:9).		
<p>Par.6 The municipality did not apply the requirements of GRAP 17 and Directive 7 and did not maintain adequate system of PPE. The asset register was overstated by the amount of VAT that was incorrectly capitalised.</p> <p>Par.7 PPE adjustments were not justified. Depreciation expense is based on values that are disclosed in the PPE.</p> <p>Par.59 The municipality did not assign responsibility and implement the processes to adequately monitor compliance with the approved budget and ensure compliance with laws and regulations</p>	<p>Par.32 The competencies of SCM officials were not assessed in a timely manner in order to address gaps in competency levels as required by Municipal Regulations on Minimum Competency Levels Regulations Section 13.</p> <p>Par.34 The municipality officials were appointed in acting positions for more than 6 months in contravention of MSA Section56 (1) (c).</p> <p>Par.36 The senior managers directly accountable to the municipal manager did not sign performance agreements as required by</p>	<p>Par.10 The municipality did not account for employee costs in accordance with GRAP 25, where the councillor received a payment after the services were terminated. Leave gratuity payments were incorrectly calculated and paid and accrued leave for the year end was not calculated correctly. Employee costs were overstated.</p> <p>Par.55 A tariff policy was not adopted and implemented for the levying of fees for provision of municipal services, as required by MSA Section 74(1).</p> <p>Par.56 A credit policy for credit customers was</p>

	<p>MSA Section 57(2) (a).</p> <p>Par.38 Interest was not charged on all accounts in arrears as required by MFMA Section 64(2) (g).</p> <p>Par.37 Reasonable steps were not taken to prevent irregular expenditure as required by MFMA Section62 (1) (d).</p>	<p>not maintained and implemented as required by Property Rates Act s3(1) or the MFMA Section 62(1) (f) (iii).</p> <p>Par.58 An effective debtors and revenue internal control system was not in place as required by MFMA Section 64(2) (f). Par. 59 Interest was not charged on all accounts in arrears.</p> <p>Par.40 Measurable performance targets with regard to each of the developmental priorities or objectives and key performance indicators were not set in the IDP, as required by MSA Section 41(1) (b).</p>
--	--	---

**Source: Mbashe Local Municipality Budget Policy (2015)**

Section 4.9 next provides a summary of the weaknesses identified in the actual process of asset management, budgeting and capital budgeting at Mbhashe Local Municipality as reported by AGSA audit reports 2012; 2013; 2014 respectively.

#### **4.9 SUMMARY**

In this chapter, movable non-current asset management, budgeting and capital budgeting practise at Mbhashe Local Municipality was compared to policies developed and approved. The Local Municipality had developed and approved a budgeting policy which outlined the objectives and principles of budgeting, budgeting process as well as capital budgeting contents. Although the municipality developed a budgeting policy, there was no evidence that a Movable Non-current Asset Management Policy had been developed. Consequently, Movable Non-current Asset Management Policy was not analysed, whilst National Treasury Guidelines for Effective Asset Management had been analysed.

AGSA audits and State of Local Government Financial Reports for the financial year 2012; 2013; 2014 were used to examine the effectiveness of movable non-current asset management, budgeting and capital budgeting processes and practises at Mbhashe Local Municipality. Amongst other issues that were evident from the AGSA audits and State of Local Government Finances Reports were that; Mbhashe Local Municipality continued to experience challenges in management control or leadership, inadequate strategic controls, information and performance systems. Instability in leadership as per AGSA audit reports implies that the municipality had no effective structure to set values or to model the operational philosophy. Effective leadership is fundamental to develop efficient, effective and economic management of the municipality's operations and to control the use of municipal resources. AGSA audit reports have highlighted that due to instability in leadership, the municipality had not yet developed and implemented important policies, amongst which was the Movable Non-current Asset Management Policy.

Consequently, in Table 2 of Chapter 4 AGSA reported consistent non-compliance with laws and regulations at Mbhashe Local Municipality, lack of monitoring and also unreliable financial and performance reports. Reliable information in general and specifically reliability of asset information is important because it is information that is fundamental when taking economic decisions. For example, incomplete asset information, overstated asset information

and poor review and monitoring are amongst the reasons that resulted in questionable asset information. Apart from ratepayers and consumers who are interested in whether the municipality would be able to provide future basic services, poor asset information systems is also a concern for the management of the municipality who require reliable asset information to assess whether existing movable non-current assets would be able to provide future services for the community.

The analysis in Table 3 revealed that poor asset information systems include, amongst others, deviations in information in the asset register and the physical assets, capitalisation of VAT and failure to periodically review depreciation and residual values. These instances indicate that the information in the financial statements was either over or understated. According to National Treasury's Asset Management Guidelines, assets should be managed throughout all the asset life cycle phases (such as during planning, acquisition, operation and maintenance and disposal phase). This helps the municipality to continuously assess the conditions of their assets and know when to replace or review the lifetime of their assets.

In Table 3, the municipality also did not comply with the necessary procurement policies and procedures when purchasing movable non-current assets. For example, the municipality awarded contracts without obtaining quotations from three different suppliers; not complied with the Preferential Procurement Policy Framework (PPPF) when awarding contracts; awarded contracts without requesting a disclosure of conflict of interest by prospective suppliers as well as suppliers who were working for other government institutions. The flaunting of the procurement processes, Supply Chain Management policies and ignorance of an asset management policy exposed the municipality to financial risk such as buying from suppliers whose prices are inflated. The municipality could also be purchasing sub-standard assets which could require immediate replacement.

In Tables 4 and 5, AGSA audit reports revealed that Mphashe Local Municipality also lacked performance management systems and regular monitoring, which would have helped to ensure that asset operations are controlled and assets are used responsibly. Effective performance management systems and continuous monitoring help to identify any gaps that may exist and suggest areas that need improvement. While, effective systems could simultaneously help to identify assets that are performing below or above set performance standards/capacity. The lack of regular monitoring and inadequate performance systems

could be the reason the municipality procured assets that were not included in the budget or were not approved by the municipal council. For example, effective performance management systems would have helped the municipality to identify assets that needed to be replaced in time in order to include them as priorities in their planning and capital budget. The latter would have assisted the municipality to detect any performance deviations from the set objectives and take the necessary steps to achieve the performance targets within the approved budget. Consequently, the periodic review and monitoring of performance serves as both a planning tool as well as control not to exceed or underspend compared to the budget.

In order to develop an effective plan within the budget that would meet service delivery targets, the National Treasury (2004:28) in Chapter 3 suggests that an integrated asset strategy can achieve service delivery. An integrated asset strategy takes into account any future changes in service delivery and rapid changes in technology because it encompasses the priorities of IDP, asset management and performance management. The AGSA reports in Tables 6 and 7 revealed that the community of Mphashe Local Municipality was not involved in the development and approval of the IDP. This implies that the municipality only addressed what they thought were the needs of the community without confirming the needs of the community. The lack of input by the community during the development of the IDP implies that the municipality was not transparent, which resulted in negative implications such as service delivery protests that took place at Mphashe Local Municipality early during 2015. Gibson (2012:51) in Chapter 2 acknowledged the IDP as means to actively control and manage what external parties dictate to their municipality.

It is evident from the analysis in Table 1 that the municipality's capital spending patterns were below what they had planned for. For example, the financial report revealed throughout the period of the study that the municipality had under-spent compared to their capital budget to purchase capital assets. AGSA (2014) also reported in Tables 6 and 7 that items included in the IDP were not aligned to service delivery programmes as required. This means that the municipality was not able to convert the IDP or the budget to practical documents because of their reported inability to establish the actual needs from the community. According to the literature reviewed, there was criticism of the IDP. It was reported that the latter is merely a wish list and a budget was not as a practical document unless supplemented with the SDBIP.



Although Mphashe Local Municipality prepared the SDBIP without addressing the needs of the Community, the latter does not serve its purpose of making the IDP and the budget practical and implementable document. The literature reviewed also strongly suggests that a municipal structure that does not implement asset management as a fundamental function is incompetent. The argument is that all the departments need effective assets to provide services. However, without a dedicated section to ensure that assets are operational, poor asset management could hamper service delivery.

Tables 8 and 9 revealed that incomplete collection, recording and updating of asset information negatively affected the Mphashe Local Municipality's financial reports. The analysis revealed that without asset management and reliable asset information as tools to plan, information presented in the financial statements may not necessarily be effective (that is, the municipality will not have reliable information on which to support movable asset needs). Moreover, they will not have reliable figures and detail to include in their budgets. The objective of this study was to determine whether budgeting for procurement of movable non-current assets is possible without sound asset management.

According to Mphashe Local Municipality's MFMA and capital budgeting policy, Tables 9, 10 and 11, revealed that only assets included in the budget and approved by the Municipality's Council can be purchased. The inclusion of assets in the budget also requires reasonable estimates and evaluation of relevant cash flow. The evaluation includes the estimation of realistic expected revenues and expenses to purchase movable non-current assets. Mphashe Local Municipality failed to consider the budget as an integrated process that takes into account the priorities from the SDF, IDP and MTREF which are reviewed on an annual basis. The analysis of the AGSA reports in Table 7 also indicated regular reference to deviations of the municipal objectives, performance targets and the IDP. Consequently, AGSA reports revealed that a significant percentage of objectives or performance targets were not achieved.

The budgeting process has five steps: formulating the budget process; public participation; approval of the budget; publication of the budget and service delivery budget implementation plan. The budget implementation plan helps to convert the IDP and MTERF into recognisable and practical documents. Although Mphashe Local Municipality has regularly developed the SDBIP, without effective leadership, alignment of asset and service delivery

plans outlined in the IDP as well as ineffective mechanisms to monitor the municipality's performance, the SDBIP did not serve its purpose (such as realise planning). The AGSA reports in Tables 5 and 6 highlighted the deviations between the municipality's performance standards and objectives including the items included in the IDP. The deviations could be blamed on, amongst other things, the ever-changing leadership and exclusion of the community during the development and approval of the IDP.

Table 1 revealed that Mphashe Local Municipality has not appointed a permanent Municipal Manager throughout the period of this study. Accordingly, the AGSA reports in Tables 2 and 5 reported that the municipality had laboured to establish stability in its leadership. As a result, Internal Audits and Audit Committees were ineffective. For example, the ineffective Internal Audits and Audit Committee structures failed the Mphashe Local Municipality in improving either their financial reports, audits or decision-making. The lack of the aforementioned effective structures to monitor and advise the municipality to improve asset management policies and processes, has caused difficulty for the municipality to develop even capital budgets that are realistic. For example, in Table 5 Mphashe Local Municipality could not justify the adjustments relating to existing assets. However, poor valuation of PPE and the number of assets was consistently overstated. Amongst other reasons that led to overstatement of PPE was the failure to adequately account for PPE (where VAT was capitalised, depreciation and residual values were not re-valued periodically as expected) and no steps were taken throughout the period of the study to prevent irregular expenditure.

As a result of instability in leadership, poor asset information and accounting systems, the municipality did not have reliable information on which to base their capital budgets. Consequently, assets were bought and sold without the approval of the municipal council as stipulated in the MFMA. The Asset Management Framework in Table 7 requires a thorough asset analysis and cost effective method to carefully conduct funding options. The unauthorised purchase and sale of assets are typical examples highlighted in the AGSA reports. Table 5 revealed that Mphashe Local Municipality purchased and sold assets without complying with the budgeting and capital budgeting process. The lack of a Movable Asset Management Policy, incomplete asset information and inadequate performance system resulted in questionable information that was reported and utilised to take crucial decisions. In order to buy new or dispose existing assets, it requires the management of existing assets throughout the phases of the asset life cycle.

The following chapter briefly outlines the summary of findings and recommendations to improve asset management and budgeting for procurement of movable non-current assets at Mbhashe Local Municipality.

## **CHAPTER 5**

### **SUMMARY OF FINDINGS AND RECOMMENDATIONS**

#### **5.1 INTRODUCTION**

The MFMA principles include, amongst others, strategic approach to budgeting, innovative financial management and compliant governance which promotes communities with effective service delivery. Effective service delivery to communities depends on the availability of movable non-current assets. However, procurement of movable non-current assets should be justified. Qualitative evidence of what policies and procedures to follow for both budgeting and asset management was discussed and compared against the practical evidence published in the AGSA audit reports 2012; 2013; 2014. In this chapter a summary of the findings of asset management and budgeting at Mbhashe Local Municipality is provided including recommendations on how the practise can be improved. This chapter will expound on the following:

- Summary of all the chapters;
- Brief discussion of the findings;
- Recommendations of how asset management and budgeting practises can be improved;
- Possible research areas and
- Summary of the chapter.

This chapter will begin by providing an overall summary of Chapters 1 to 4. The summary will provide the basis for the final conclusion and recommendations on how Mbhashe Local Municipality can improve the asset management processes as well as capital budgeting for procurement of movable non-current assets.

#### **5.2 SUMMARY OF THE STUDY**

In Chapter 1, the primary objective of the study was to determine whether ineffective non-current asset management negatively affected capital budgeting for the procurement of movable non-current assets at Mbhashe Local Municipality. In order to give effect to the primary objective, the secondary objectives were formulated whereby the literature of other

scholars, AGSA reports and the theoretical framework of asset management, capital budgeting and budgeting processes as prescribed by MFMA and the National Treasury were analysed. The objectives set from the beginning of the study were achieved, because the qualitative evidence collected using desktop research method in Chapters 2, 3 and 4 suggests that poor asset management negatively impacted capital budgeting decisions taken and procurement of movable non-current assets at Mbhashe Local Municipality for the period of the study 2012; 2013; 2014 financial year.

In order to achieve the objectives, in Chapter 2 an extensive literature review was undertaken of asset management and the budgeting process as well as municipal policies and procedures as prescribed in the MFMA. The importance of adherence to asset management, capital budgeting and the budgeting process was explored in detail. The focus in Chapter 2 was to explore various scholars' view of the impact of asset management on budgeting in general as well as procurement of movable non-current assets in particular.

In Chapter 3, the asset management guidelines and Mbhashe Local Municipality's budgeting policy and process was outlined and explained. The latter discussion served as the foundation for the analysis of Mbhashe Local Municipal asset management, budgeting and procurement practises in Chapter 4. In the latter chapter, the asset management and budgeting policies, procedures and practises for procurement of movable non-current assets was compared with the literature and set policies and procedures in Chapters 2 and 3 respectively. The focus in Chapter 4 was primarily on analysing Mbhashe Local Municipality's asset management and budgeting practises as reported in the AGSA audit reports and the State of Financial Local Government Finances Reports 2012; 2013; 2014 financial years.

The analysis focused on whether the municipality adhered to asset management policies throughout all asset life cycle phases, budgeting and procurement policies as prescribed by the municipality's policies and/or the National Treasury. The AGSA audit and State of Local Government Finances Reports provided evidence of the areas of non-compliance as well as the impact as a result of non-compliance. A summary was provided of the primary areas of non-compliance and the weaknesses that Mbhashe Local Municipality faced during the period of the study, namely: instability in leadership or lack of management control and under-spending compared to the capital budget. However, there was also evidence that,

amongst others, poor budgeting practices was the reason the municipality was underspending. Consequently, unauthorised expenditure was repeatedly highlighted as one of the qualifying audit queries by AGSA throughout the period of the study.

A brief discussion of the findings and recommendations follows, starting with the discussion of management control as an approach that could improve asset management.

### **5.3 MANAGEMENT CONTROL: MOVABLE NON-CURRENT ASSETS**

AGSA reported throughout the period of the study instability of leadership, inadequate monitoring and periodic review of physical assets against theoretical assets. Poor budgeting, lack of appraisal of the competencies of employees in the finance and supply chain management departments were listed as some of the weaknesses that Mphashe Local Municipality needed to address. In Chapter 4, Fourie and Opperman (2007:08) the duties of the Municipal Manager were defined as that which involves ensuring the implementation of policies and procedures. However, the State of Local Government Finances Reports 2012; 2013; 2014 revealed that the Municipal Manager occupied an acting position throughout the period of the study.

The temporary appointment of an acting Municipal Manager revealed that the municipality was unable to ensure the proper implementation of policies and procedures. For example, instability in leadership implied that the municipality's movable non-current asset policies had not been approved in the 2013/14 financial year. Consequently, the municipality continued to face challenges of non-compliance with legislation and inadequate controls of asset management, accounting and asset information system. The following recommendations were made in order to improve stability in management control and thereby improve information fundamental for capital budgeting decisions.

#### **5.3.1 Recommendations: Improve Management Control**

The following is recommended to improve management control at Mphashe Local Municipality:

- The National Government should be decisive about the level of political influence allowed in the administrative running of the municipality. For example, non-

interference of politicians in the appointment of skilled employees should be enforced.

- The instability in management as a result of political infighting should be addressed by creating a supportive structure comprising an equal number of administrators and politicians to continue the work in the absence of politicians.
- The municipality should evaluate the competencies of employees in the finance and supply chain departments to identify and address lack of skill thereof.
- In the absence of approved policies, the National Treasury Guidelines should serve as procedures to guide operations.
- The Municipal Manager should ensure that compliance with legislation and adequate controls of asset management, accounting and asset information systems are implemented.

Evaluating competencies would identify and address any lack of skills in the Finance and Supply Chain Section and the neutralisation of political interference will ensure that municipal operations continue even during political instability. The literature reviewed in Chapter 2 has also cited that political interference is amongst one of many challenges that results in the lack of capacity within municipalities.

Ajam (2008:45) though appreciative of the unique contradiction that emanates from the political element in managing municipalities acknowledges the lack of skills as a result of the two centres of power and affirms that there is a possibility to create culture by having the politicians work with administrators. The politicians are primarily responsible for the development of strategic policies and procedures for operations of the municipality. The creation of the supportive structure will ensure that administrators assist to execute the work using the National Treasury Guidelines and developed policies and procedures where there are concerns that the politicians are attempting to resolve.

The analysis of budgeting policy and the AGSA reports of actual processes at Mbhashe Local Municipality in Chapter 4 revealed that there were challenges regarding realistic budgeting. Following, the need for realistic budgeting is discussed and how honest budgeting could improve decisions for procurement of movable non-current assets.

## 5.4 REALISTIC BUDGETING

The presence of both underspending compared to capital budget and unauthorised expenditure as per AGSA audit reports at the municipality is indicative that budgeted capital funds were not spent and yet unauthorised capital purchases transpired in contravention of the MFMA. AGSA audit reports also made reference to the lack of approved policies and an exclusion of key stakeholders such as the community during the drafting and presentation of the IDP. Community involvement during the drafting and presentation of the IDP is imperative in order to identify the needs of the community as well as share information of what assets should be included during the IDP and the budgeting process. The identification of community needs is crucial to determine capital investments required to support service delivery.

In Chapter 2, Ajam and Mkhize (2006:764) support the view that understanding service delivery needs reduces unnecessary capital spending. Gibson (2012:51) in Chapter 2 suggests that the IDP informs the capital and operational budget of the municipality. According to AGSA, Mbashe Local Municipality's negligence to include external views during the assessment of capital needs and the lack of monitoring and performance evaluation of movable non-current assets led to "unrealistic budgeting" at the municipality. Moreover, throughout the period of the study, the objectives of the municipality differed, especially with the priorities outlined in the IDP. This implies that the municipality's planning process was not aligned with the municipality's strategic plans as outlined in the IDP.

Ineffective asset management, weak asset accounting and asset information systems including the lack of approved policies and procedures as well as unreliable information resulted in the municipality being unable to take capital budgeting decisions. The municipality lacked information to justify their need for assets. According to AGSA reports 2011/12, 2012/13 and 2013/14 Mbashe Local Municipality's financial reports presented incorrect asset figures because the stated assets could not be physically located. Furthermore, the physical assets had not been recorded.

Moreover, the reported instability in leadership did not only lead to financial misrepresentation but it also affected the capital spending patterns. The municipality had repeatedly reported under-spending compared to their capital budget. AGSA also reported that the municipality's performance management system had not been implemented, which



implied that the municipality had neither set performance standards nor reviewed actual performance against set standards.

The periodic review of movable and physical non-current assets against the asset records does not only help to evaluate the condition of assets but also to identify the availability and the value thereof. Movable non-current assets by their nature are mobile and this exposes them to misplacement, misuse and theft. The differences between the physical and theoretical asset records also affected the municipality's financial reports. The lack of approved movable non-current asset policies and procedures did not assist the asset financial reports which were overstated because there were neither approved municipal guidelines nor information systems to manage and accurately report movable non-current assets. Capital budgeting decisions are based on the latter financial reports, which imply that effective asset management, controls and information systems is fundamental to making informed capital budgeting decisions.

#### **5.4.1 Recommendations: Achieve Realistic Budgeting**

In order to achieve realistic budgeting for the procurement of movable non-current assets at Mbhashe Local Municipality, the following is recommended:

- Asset policies and procedures are developed and strictly adhered to.
- The Municipal Manager should ensure that movable non-current asset management policies and procedures are implemented.
- The performance standards for movable non-current assets are set and reviewed periodically as stipulated in the MFMA.
- The Municipal Manager should ensure that the acquisition policies and procedures are strictly adhered to.
- The Internal Audit should ensure that the Finance and Supply Chain Management Section employee competencies are assessed regularly to determine any lack of skills as well as recommend skills development where necessary (such as the development and completion of the GRAP compliant asset register).
- The Municipal Manager should ensure that asset information, controls and accounting systems are adhered to. Adherence to the latter would ensure that reliable asset information is presented as and when required.

- The Municipal Manager, with the help of the Internal Audit should regularly review movable non-current asset systems to ensure its effectiveness as well as establish whether the reported movable non-current assets are operational as expected.
- The Municipal Manager with the help of the Facilities Section should also ensure that all the offices are lockable in order to avoid removal of furniture without authorisation.
- The Municipal Manager, assisted by the Internal Audit and the Asset Manager should ensure that all receipts or removal of movable non-current assets are recorded and updated properly in the necessary documents. They should also ensure that all municipal assets are bar-coded and every office has a list of its movable non-current assets.
- All the offices are not occupied by Asset Managers. Therefore, it is important that asset policies and processes are not only given to departments but simplified for everyone within the municipality.
- The Municipal Manager should ensure that the municipality implements the GRAP compliant principles for recording and accounting for movable non-current assets.

As explained in Chapter 1, GRAP 17 is a general accounting principle which guides how assets should be recognised, measured, recorded and disposed. Compliance with GRAP 17 will ensure that the information on which capital budgeting decisions is based is reasonable and reliable.

Following an impact of asset lifecycle management is discussed to determine the effects of general asset management and budgeting for procurement of movable non-current assets at Mbhashe Local Municipality.

## **5.5 ASSET LIFE CYCLE MANAGEMENT**

In Chapters 3 and 4 the National Treasury (2003:07 & 18) suggests that assets should be approached from a life cycle perspective and the planning processes should take into account financial, economic and environmental benefits of the community and the municipality. The following asset life cycle phases should be controlled in order to produce what is termed a “realistic budget”.

### **5.5.1 (a) Planning Phase**

According to AGSA 2011/12, 2012/13 and 2013/14, Mbhashe Local Municipality did not involve the Community during the planning stage. Moreover, there was inadequate adherence to policies and procedures as prescribed by legislation. AGSA also reported that Mbhashe Local Municipality overstated their assets as a result of capitalisation of VAT in the municipality's financial statements as well as classified PPE incorrectly as investments. Furthermore, the municipality did not establish mechanisms to monitor and review their performance management systems as required by the MSA. Consequently, assets were overstated.

Overstating assets in the balance sheet and incorrect classification of PPE distorted its value and the financial information on which to make capital budgeting decisions. The poor performance evaluation also affirms that the municipality did not have reliable information of the availability and condition of existing assets. This is confirmed in the AGSA reports that the recorded asset values differed from the physical assets of the municipality. The presentation of incorrect values and condition of existing assets makes it difficult, if not impossible to have a decisive plan of the municipality's asset requirements. Misinformation of the value of assets affects financial statements, the production levels and the environment at large. For example, a computer that performs below expected capacity delays service delivery while a car that is deteriorated may be a danger to the community and municipality employees and thereby a financial risk to the municipality.

The following are recommendations suggested that could improve movable non-current asset planning at Mbhashe Local Municipality.

### **5.5.1 (b) Recommendations: Improve Movable Non-current Asset Planning**

Chapter 4, Fourie and Opperman (2007:08) posit that the CFO develops financial plans and outputs such as budgets, financial statements in compliance with GRAP and MFMA. AGSA reported that the municipality neither complied with GRAP nor MFMA in valuing, recording, classifying and assessment of the performance of its assets. Mbhashe Local Municipality could adopt the following recommendations in order to ensure effective movable non-current asset planning:

- A GRAP compliant asset register is maintained and periodically reviewed to update and confirm the correctness of the values presented in the financial statements.

- A performance evaluation system must be developed and maintained to periodically assess the physical condition of existing assets and to determine movable non-current assets existence.
- GRAP 17 is adhered to when recording, measuring and reporting the value of PPE.
- Realistic financial plans should be developed in compliance with the MFMA. Realistic financial plans include approved capital and operational expenditure that is informed by reliable performance reports and asset information.

The GRAP compliant and updated FAR would ensure that the asset information is current and reliable to take capital and operational decisions. The periodic evaluation of asset performance would assist the municipality to ascertain the municipality's asset needs and thereby inform future planning.

### **5.5.2 (a) Acquisition Phase**

Section 38(1)(a)(iv) of the MFMA (RSA, 2003) recommends that the Municipal Manager must ensure that appropriate procurement, provisioning systems and procedures are fair, equitable, transparent and cost effective. AGSA audits throughout the period of the study reported that Mbashe Local Municipality did not adhere to the acquisition and provisioning procedures. The deviation from procurement and provisioning procedures could result in purchasing sub-standard movable non-current assets. Moreover, overstatement of PPE could result in untimely replacement of movable non-current assets. For example, purchasing from just one supplier implies that the municipality did not afford all suppliers an equal opportunity to compete for reasonable prices.

The following are recommendations that could improve movable non-current asset acquisition at Mbashe Local Municipality.

### **5.5.2 (b) Recommendations: Acquisition of Movable Non-current Assets is Fair, Equitable, Transparent and Cost Effective**

- The Municipal Manager should ensure that Supply Chain Management principles are adhered during the procurement of movable non-current assets.
- The municipality must ensure that all employees declare any conflict of interest before they are employed.

Adherence to Supply Chain Management would ensure that movable non-current assets are acquired from the selected three prospective suppliers using the PPPF point system where

necessary. Also, compliance with Supply Chain Management principles would ensure that contracts are awarded to movable non-current asset suppliers who are registered and have fully disclosed any possible conflict of interest.

### **5.5.3 (a) Operation and Maintenance Phase**

National Treasury (2003:32) states that the Municipal Manager is responsible to ensure effective, efficient, economic and transparent use of municipal resources. Mbhashe Local Municipality's performance reports did not include a comparison with the set standards as required by MSA. The municipality's oversight to compare actual with set standards and the lack of approved policies and procedures to collect, record, process, monitor and report on predetermined objectives has negatively affected Mbhashe Local Municipality's potential to meet its targets. The AGSA audit reports revealed that missing targets was as a result of the lack of and inadequate internal controls, accounting, management and information systems. When movable non-current assets are unaccounted or there is lack of movable non-current asset management and information systems, the municipality is neither in a position to determine nor reliably forecast the operational and maintenance costs to maintain the productivity of existing assets or determine their replacement timing.

As a result of the lack of performance systems, the municipality's performance targets were not met and certain physical assets could not be located. The municipality could not establish the number of assets they had and whether these assets were available to operate as per set standards. Following are recommendations to improve movable non-current asset operation and maintenance at Mbhashe Local Municipality.

### **5.5.3 (b) Recommendations: Improve Movable Non-current Asset Operations and Maintenance**

Mbhashe Local Municipality could adopt the following recommendations to improve movable non-current asset operations and maintenance:

- The Municipal Manager should ensure that there are effective internal controls to safeguard movable non-current assets from theft or unauthorised use. Movable non-current assets are physical and movable, making them vulnerable to unauthorised use, damage and theft.
- The internal controls should include physical controls such as lockable doors in the offices, security personnel at every entrance of the municipality's buildings or at the

gate. The physical access controls will reduce unauthorised use or theft of movable non-current assets.

- The security must ensure that all cars coming in and out are searched. This will prevent, detect and intercept unauthorised use of assets.
- The standard operating procedures and performance targets for movable non-current assets must be set. Availability of standard operating procedures and operating targets will serve as a yardstick to measure performance of movable non-current assets and determine the timing of maintenance intervals as and when required.
- The condition and capacity of movable non-current assets must be periodically reviewed and a movable non-current asset register be updated with current information.
- The users of movable non-current assets should be briefed to keep their offices locked or consult Asset Managers or the Facilities Section about the removal of assets in their offices.
- The municipality should establish an Asset Management Section so that assets are operational as and when required. This will help to reduce either the misuse and/or theft of movable non-current assets.

All the measures listed above will ensure that movable non-current assets remain operational and available as and when required. It will also reasonably eliminate the premature disposal and replacement of existing assets that was reported in Chapter 4 in AGSA audit reports. Moreover, compliance with operational and maintenance controls will delay any unplanned and unauthorised capital outlays that may be incurred by the municipality. In Chapter 2, Joubert *et al.* (2014:34), asserts that capital budgeting starts with existing assets and the effective management of existing assets reduces capital outlays or money spent on buying non-current assets.

#### **5.5.4 (a) Disposal Phase**

National Treasury (2003:44) recommends that effective asset disposal framework takes into account alternative reasons for the disposal of assets. The elements that should be considered in the disposal guidelines include, amongst others, surplus, obsolescence, performance and unserviceable assets. AGSA in Chapter 4, Table 3 reported that Mbhashe Local Municipality AGSA lacked monitoring, measuring and reviewing of asset performance throughout the period of the study. As a result, there was inadequate evidence to justify the disposal of

assets during 2013/14. Assets that were required to provide minimum level of basic municipal services were sold or permanently transferred in contravention of MFMA.

The ineffective, inefficient and lack of transparency in the financial systems, risk management and lack of internal controls of movable non-current assets does not end with premature disposal of movable non-current assets but raises the need for replacement of the asset disposed. The untimely and occasional unauthorised purchase of movable non-current asset could have been avoided if the municipality had clear and effective policies and procedures in order to reach a disposal decision.

The following are recommendations to delay untimely disposal of movable non-current assets at Mbhashe Local Municipality.

#### **5.5.4 (b) Recommendations: Ensure Adherence to Asset Disposal Process**

Mbhashe Local Municipality could avoid untimely disposal of movable non-current assets by adhering to the following recommendations:

- The municipality should develop and approve a policy and procedure of movable non-current assets which clearly specifies the expected performance standards.
- The municipality should encourage the development and regular review of actual performance of movable non-current asset against predetermined standards and evaluate significant variances.
- The disposal policy should specify the criterion that qualifies an asset for disposal. Also, the criteria must be implemented adequately.
- The municipality should ensure that effective financial, risk management and internal control systems for movable non-current assets is developed and maintained.
- The internal audit should evaluate the effectiveness of the performance management system. The measurement of asset performance will detect possible movable non-current asset risks and the means to prevent and correct any errors as and when they occur.
- The internal audit should assist the municipality to assess whether the asset disposal policy and procedures are implemented accordingly and operational as intended.
- The municipality should utilise an independent audit committee that would assist with the internal audit function to implement the proposed recommendations by AGSA.

Setting performance standards and assessment of the asset disposal policy will prevent disposal of assets that have not met the disposal criteria. Compliance with the asset disposal policies will prevent the premature selling of movable non-current assets which could lead to untimely or even unauthorised capital expenditure to replace sold assets. Most importantly, regular review and monitoring of performance management systems will help to detect movable non-current assets that are underutilised or in poor operational condition of whether to exchange, replace, dispose or repair.

Over and above setting performance standards to detect whether assets are under or over utilised, below the need for asset planning and budgeting control is summarised and the recommendations for effective asset planning and budgeting control are suggested.

## **5.6 ASSET PLANNING AND BUDGETING CONTROL**

The National Treasury (2003:08) asset management guidelines states that service areas must be defined in order to procure suitable assets. National Treasury also stipulates that the assets purchased should be periodically evaluated for physical condition, functionality, utilisation and financial performance. The periodic evaluation is expected to provide a detailed report of the condition and value of existing assets. These movable asset variables are important to determine the depreciation and evaluation of future projects or assets. AGSA audit reports in Chapter 4 Table 3 also reported that Mbhashe Local Municipality did not consult the community during the drafting as well as implementation of the IDP.

The lack of performance measurement against set standards as well as the poor monitoring or review of performance were amongst the challenges faced by Mbhashe Local Municipality. The lack of a performance evaluation system, community consultation and participation during the drafting and implementation of the IDP leads to poor control of the community's needs and thereby lack of budgetary control. The municipality neglected to include the needs of the consumers during the drafting of the budget plans. The lack of community consultation could be blamed for service delivery protests.

AGSA audit reports stated that the municipality had been under-spending habitually. This was irrespective of the reported consistent irregular, unauthorised and wasteful expenditure. This contradiction can be interpreted as evidence of poor budgeting or planning. Failure to



spend the capital budget was also reported which was compounded by unauthorised expenditure which is in direct contravention of the MFMA. According to AGSA audit reports, the municipality's objectives were in total contravention of what was included in the IDP. This was further evidence that the IDP was not necessarily addressing the Community's needs. Gibson (2012) refers to an IDP that cannot be translated into MTERF or annual budget as a wish list and not a practical plan. This implies that a budget should reflect the municipality's IDP, MTERF, strategic plans and objectives.

### **5.6.1 Recommendations: Ensure Realistic Planning and Budgeting Control**

To achieve realistic planning and budgeting control, the Mbhashe Local Municipality could benefit by adhering to the following recommendations:

- Align IDP with the municipality's objectives.
- The municipality should ensure that the Community is involved from the drafting to the implementation stage of the IDP. Regular consultation and community participation could avoid any surprises or service delivery protests.
- The municipality should ensure periodic performance measurements, monitoring and value of movable non-current assets.
- Avoid creating unrealistic expectations which the municipality does not have a budget to finance.

The definition of service delivery areas, the periodic evaluation and measurement of movable non-current asset performance and "participatory budgeting" will ensure that suitable assets are budgeted for and the needs of the community are not only managed but addressed effectively. In order to ensure that suitable assets are acquired and effectively controlled the municipality should develop an asset strategy to prevent all possible risks that might occur.

Below the need for developing an asset strategy is summarised and recommendations to improve the effectiveness of asset strategy are suggested.

## **5.7 DEVELOPING AN ASSET STRATEGY**

National Treasury (2003:11) states that an asset strategy that addresses the changing service delivery needs must be devised to meet service delivery plans. When developing an asset strategy, National Treasury also advises that asset management functions are incorporated in the IDP and performance management plan. At Mbhashe Local Municipality, leadership

instability was reported as a constant challenge. The instability in leadership implies that the municipality has not had time to develop and approve asset policies and procedures. As a result, AGSA reported weaknesses in the municipality's financial, risk management and internal control systems for assets.

During the strategic planning stage, the municipality did not consult the community. According to Gibson (2012:53), an effective asset strategy takes into account the IDP. Mbhashe Local Municipality's AGSA report revealed that the objectives of the municipality did not conform to the approved IDP. The municipality was also reported to have sold strategic assets that were required to provide basic services without the approval of the municipal council. The sale of strategic assets and ineffective strategic plans implied that the municipality's asset strategy was ineffective.

#### **5.7.1 Recommendations: Develop an Effective Asset Strategy**

The following recommendations could improve the effectiveness of the Mbhashe Local Municipality's movable non-current asset strategy:

- The municipality should ensure that service delivery and technological changes are taken into account when crafting a movable non-current asset strategy.
- The asset strategy should also cover all the asset management functions (for example, planning, acquiring, operation, maintenance and disposal) and the performance measurement strategy of the municipality.
- The municipality is a community institution therefore; community consultation is necessary to accomplish an effective asset strategy.
- The municipality should ensure that their asset strategy is practical and structured.
- The municipality and Facilities Department should ensure that offices are lockable and there is a security guard at every entry and exit point.
- Ensure that effective asset information systems are developed to ensure that all movable non-current assets are accounted for.
- Encourage the Internal Audit Function to review performance measurement procedures which would help identify under-performing movable non-current assets or assets that require maintenance, replacement or disposal.
- The municipality's approved IDP must be aligned with the objectives of the municipality.

The structured asset strategy helps the municipality to form a practical budget which is not just a wish list. Gibson (2012:53) suggests that a structured asset strategy can save the municipality money. An advanced asset strategy will ensure that underperforming or obsolete movable non-current assets are managed and asset replacement and disposal be factored in the capital budget.

Below the need for capital funding and budgeting is summarised and recommendations on selecting cost effective funding are suggested.

## **5.8 CAPITAL FUNDING AND BUDGETING**

The State of Local Government Finances 2012, 2013 and 2014 reported that Mbhashe Local Municipality had consistently under-spent compared to their capital budget. The National Treasury (2003:18) states that the municipality's objectives and priorities should be outlined on the IDP, carried forward to the MTREF and annual budget. Gibson (2012:50) refers to this type of planning as a multi-layered approach where priorities are evaluated annually and form part of the annual plans. It is also important that these annual plans are measured in order to decide on which financing options are necessary. For example, long term assets are financed using the capital budget while operational expenses such as maintenance costs are financed using the operational budget.

Fourie and Opperman (2008:335) also suggest that even operational costs resulting from the purchase of capital assets should be carefully measured and communicated with the municipal council for approval. The communication and approval of both capital and operational expenditure is important because the MFMA condemns unauthorised purchases. Mbhashe Local Municipality did not align their operations with the IDP. The municipality also lacked standard operating procedures and did not review reported achievements against source documents for recording asset achievements. As a result of the lack of systems, the measurability of planned targets could not be assessed. Consequently, the municipality's objectives, indicators and targets differed from the IDP.

### **5.8.1 Recommendations: Secure Cost Effective Capital Funding**

The following recommendations could ensure cost effective capital funds are secured to purchase movable non-current assets at Mbhashe Local Municipality:

- The municipality should adhere to approved expenditure and budgeting guidelines. The municipality's objectives and priorities must be identified and included in the IDP, MTERF and an annual budget.
- Capital investments should be properly assessed and the best option selected.
- Ensure that both expected operational and capital costs are communicated and approved by the municipal council.
- Suitable capital funding option is identified and allocated accordingly.
- Performance priorities, standards and objectives should be set and regularly assessed to determine any deviations to inform future planning.

The assessment of actual performance against set standards would help the municipality to determine whether there are movable non-current assets that need maintenance or replacement. Regular assessment and evaluation of cost effective options could result in the purchase and finance of movable non-current assets at reasonable prices.

The evidence from Chapter 4 suggests that there has been lack of alignment of assets with service delivery programmes, and as such next the benefits of aligning assets with service delivery are summarised.

## **5.9 ALIGNMENT OF ASSETS WITH SERVICE DELIVERY PROGRAMMES**

National Treasury (2003:21) prescribed that, aligning assets with service delivery needs helps the municipality to deliver relevant services required by the community. The Mbhashe Local Municipality community was not given an opportunity to contribute in the drafting and implementation of the IDP and neither the Supply Chain Management policies nor procedures were adhered to. The lack of community consultation implies that the intended municipal plans may not completely provide for the actual needs of the Community. Moreover, the municipality's non-compliance with Supply Chain Management policies and procedures and irregular expenditure was exposed. Furthermore, the lack of regular monitoring or review of asset performance revealed that the municipality was unaware of the condition or capacity of their existing assets.

### **5.9.1 Recommendations: Align Municipal Assets with Service Delivery Programmes**

The recommendations listed below could assist Mbhashe Local Municipality to align its movable non-current assets with service delivery programmes:

- The municipality should ensure that consultation processes are executed during the drafting and implementation of the IDP.
- Performance of movable non-current assets should be reviewed and monitored annually to determine their continued effectiveness.
- The annual performance checks should be supplemented with random physical evaluation of movable non-current assets. This would help to determine the existence, condition, capacity and value of existing movable non-current assets.
- The municipality should ensure that Supply Chain Management policies and procedures are adhered to in order to detect and prevent unauthorised purchase of movable non-current assets that are not useful.

Adherence to Supply Chain Management policies and procedures will ensure that only authorised movable non-current assets required by the municipality are acquired. Community consultation and performance evaluation would also help the municipality to retain movable non-current assets that are relevant for service delivery and reduce unnecessary expenditure of servicing idle and less productive assets.

In addition to public consultations and performance appraisal to ensure the alignment of assets to service delivery needs, the budgeting principles and adherence to those values are summarised and recommendations are made.

## **5.10 PRINCIPLES OF BUDGETING**

Mbhashe Local Municipality's budget should be within realistic expected revenue and within the approved IDP and MTERF that is reviewed annually. Also, the budget policy requires that all expenditure incurred is in terms of the approved annual budget and within the approved amounts allocated. Despite the clear budget policy that outlines the criteria for planning and acquisition of movable non-current assets the municipality's revenue records could not be trusted as interest was not charged on all the outstanding debtors. Furthermore, the revenue was not reconciled, revenue targets were not specific, the credit policy and internal control system for customers was not maintained and implemented and there was an inadequate system to record, collect, process, monitor and store revenue information.

### **5.10.1 Recommendations: Adherence to Budgeting Principles**

In order to ensure that budgeting principles are adhered at Mbhashe Local Municipality the following recommendations are suggested:

- Expected revenue and revenue targets should be specific and realistic.
- The municipality should ensure that revenue is reconciled.
- All outstanding debtors must be charged interest.
- Ensure that the municipality's credit policy and internal controls for debtors is maintained and implemented accordingly.
- Ensure that the municipality has adequate systems for recording, collecting, processing, monitoring and storing revenue information.
- Ensure that actual cash flows are compared to budgets annually.

Realistic revenue, compliance with credit policy and adherence to revenue information systems helps to identify the reasonable amount of expected cash flows on which to base the municipal budget for movable non-current assets. The comparison of actual cash flows with budgets helps to identify any variances and to improve future budgeting.

In order to minimise budget variances and improve future budgeting, below the need for adherence to the budgeting process is summarised and recommendations are made.

## **5.11 THE BUDGETING PREPARATION PROCESS**

According to the approved budget policy of Mbhashe Local Municipality, the CFO, the Municipal Manager and the Director of IDP should draft the IDP process and schedule for the municipality. The schedule should clearly reflect the deadlines for IDP reviews and the revision of the annual budget. The municipality's priorities should be discussed at a strategic workshop which would include senior management and the Mayoral Committee. At the workshop, the IDP, MTREF drafts are presented together with related policies.

The Municipal Manager should prepare the technical aspects of the budget which is divided into operational and capital budget. Most importantly, the budget should reflect realistic cash flows expected by the municipality. At Mbhashe Local Municipality, the budget process was not adhered to primarily because of leadership instability (the municipal executive and key management personnel were suspended or appointed in an acting position). Important

policies and procedures were neither approved nor adopted, poor monitoring by management and consequently, non-compliance with laws and regulations.

### **5.11.1 Recommendations: Adherence to Budget Preparation Process**

The following recommendations could improve adherence to budget preparation process at Mbhashe Local Municipality:

- The National Government should establish a structure that is effective even in the midst of political turmoil. The structure should include administrative employees who are capable of managing the affairs of the municipality even if the municipal executive is suspended.
- The municipality should request the mentorship programme from National Treasury so that their key employees can be trained with the necessary skills. For example, budget related skills.
- The workshops arranged by the municipality to discuss its budget should be considered as work meetings. All the managers and municipal council members that attend such workshops should write and submit a report.
- The municipality should encourage regular monitoring by management so that the budgeting processes are adhered to.

Regular monitoring throughout the budgeting process would help to detect, prevent and correct errors in its process before they become audit queries or variances at the end of the financial period. Mentoring by the National Treasury would help develop in-house skills rather than dependency on out-sourced skills.

The municipal budget that ignores the views of the Community is incomplete and below the need for public participation is summarised and recommendations are made.

## **5.12 PUBLIC PARTICIPATION PROCESS**

Mbhashe Local Municipality's budget policy requires that after tabling the draft annual budget, it must convene hearings thereon and the comments be submitted to the municipal council for approval. Despite the clear guidelines to include public participation, the municipality neither consulted the community during the draft nor implementation stage of the IDP. According to AGSA, the municipality also did not implement the processes to monitor compliance with the approved budget and applicable laws and regulations. For

example, there were consistent reports of irregular expenditure throughout the period of the study which is in contravention of the MFMA. The latter Act prohibits unauthorised purchases.

### **5.12.1 Recommendations: How to Improve Budget and Public Participation Process**

Mbhashe Local Municipality could implement the following recommendations to improve public participation:

- The Asset Manager should assist the Director of IDP to ensure that correct information is submitted during the draft and implementation of the budget process.
- The Internal Audit Function should assist the municipal management to ensure that laws and regulations are complied with. Municipal management should ensure that policies and procedures are adhered to while the internal audit evaluates the effectiveness of the budgeting process as well as note how it can be improved.
- The municipality should consult the community during the drafting and implementation of the IDP.
- The National Government should embark on an awareness campaign to emphasise the importance of public participation during the drafting and implementation of the IDP.

In Chapter 2, Matsiliza (2014:451) reviewed acknowledged that South Africa is lagging behind in participatory budgeting. The awareness campaigns would assist to ensure that people attend public participation meetings and hopefully improve the value of the budgeting process while reasonably lessen service delivery protests.

The approval of the budget by the municipal council is important before the start of the budget year. Hereunder, the need for timely approval of the budget is summarised and the recommendations on how to ensure suitable approval of the budget are made.

## **5.13 APPROVAL OF THE BUDGET**

According to Mbhashe Local Municipality's budget policy, the municipal council must consider the MTERF budget for approval before the beginning of the budget year. The municipal council resolution should contain budget policies and performance measures that should be adopted. Following satisfaction of the municipality's budget policies, the



municipal council should approve the budget before the beginning of the budget year, failing which the Municipal Executive Council (MEC) must be informed of the unapproved budget.

After adhering to the necessary processes, the draft resolution (including measurable performance objectives for each budgeted item that is aligned to the IDP) approval of the budget must be tabled at the municipal council. The budget should also include the cash flows, the amendments of the IDP and related budget policies. According to AGSA 2012; 2013; 2014, the General Report on the Audit Outcomes of Local Government Eastern Cape indicated that the Mbhashe Local Municipality lacked standard performance measures making the measurability of planned targets and performance indicators difficult to assess. Moreover, the municipality utilised inadequate formal standards, operating procedures and budgeting systems.

### **5.13.1 Recommendations: How to Ensure Timely Approval of Municipal Budget by the Municipal Council**

In order to ensure that capital budgeting is approved on time, the following is recommended:

- The municipality should set clear budget policies and measurable performance standards.
- The Municipal Manager must ensure that the budget items are clearly measured and communicated to the municipal council. This includes the outline and reliable computing of operational costs resulting from capital acquisitions.
- Ensure that the budget policies and procedures are attached to the MTERF before the approval of the budget.
- Ensure that the MEC is made aware if the budget is not approved and take the necessary steps to safeguard approval of the budget.
- The final draft must include measurable performance objectives that are aligned to the IDP, projected cash flows (operational revenues and expenditures), proposed amendments of the IDP and related budget policies.
- Basic financial planning short courses should be conducted to provide the municipal council with financial planning knowledge and skills.

The clear budget policies, the measurable performance standards, and clear communication thereof will improve the approval of the budget by the municipal council.

Following an approval of the budget the municipality is expected to publish the budget. Below, the need to publish the budget on time is summarised and the recommendations are made.

#### **5.14 PUBLICATION OF THE BUDGET**

According to the Mbashe Local Municipality's budget policy, the final annual draft budget must be tabled before the municipal council for approval. The Director of Corporate Services must post the final draft and the other related documents onto the municipality's website for the public to access as well as send a hard copy to the National Treasury and Provincial Treasury. The CFO must submit the approved budget within 14 days in both printed and soft copy to the National and Provincial Treasury as well as post it on the municipality's website. According to AGSA reports during 2012 financial year, the municipality did not assign the responsibility to monitor compliance with the approved budget and applicable laws and regulations. For example, the Community was not involved in all the stages of the budgeting process which is in contravention with MFMA. Also, it was reported that the municipality had failed to submit monthly budget statements timely to the relevant Provincial Treasury.

##### **5.14.1 Recommendations: How to Improve the Budget Publication**

The following recommendations could ensure timely publication of the budget:

- The municipality should assign the Municipal Manager of the municipality or have an alternative municipal official in the absence of the aforementioned official make public the annual budget and relevant documentation.
- The municipality should invite the Community to submit representations to the budget before the final publication.
- The annual budget should be submitted on time to the National Treasury, Provincial Treasury and related parties affected by the budget.

The assignment of an alternative municipal official in the absence of the Municipal Manager would help to ensure that budgeting laws and regulations are always complied to.

The analysis of the budget policy in Chapter 4 revealed that Mbashe Local Municipality prepares a SDBIP annually. Below the need for SDBIP is explained and the recommendations for an effective SDBIP are provided.

## **5.15 SERVICE DELIVERY AND BUDGET IMPLEMENTATION PLAN**

In Chapter 2, Gibson (2012:53) highlighted that the IDP is not a practical document when there is no SDBIP Mbhashe Local Municipality subscribes to this idea. In the municipality's budget process, the Municipal Mayor must approve the SDBIP not later than 28 days after approval by the municipal council. The components of the SDBIP include amongst others expected monthly revenue and expenditure, quarterly projections of service delivery targets, performance indicators for each budgeted item and detailed capital work plans over three years.

This is contrary to the AGSA findings that the municipality did not have realistic projections of revenue where debtors were not charged interest on outstanding accounts, credit policies were not adhered to, revenue was not always reconciled, tariff policy was not adopted and implemented, measurability of performance targets could not be assessed due to the lack of standard operating procedures and the municipality did not conduct its activities according to the IDP.

### **5.15.1 Recommendations for Effective Service Delivery Budget and Implementation Plan**

The following recommendations could ensure an effective SDBIP:

- The municipality should ensure that reasonable revenue and expenditure figures are reported and reconciled.
- Ensure that interests on outstanding debtors are charged, credit policies are adhered to and tariff policies are adopted and implemented.
- The municipality should ensure that revenue and debtor's internal controls are in place and adhered to.
- The municipality should ensure that performance targets and standard operating procedures are set and assessed in order to improve movable non-current asset efficiency and budgeting.
- The municipality should ensure that their activities and budget implementation plans are conducted according to the IDP.

The realistic and reliable revenue and expenditure report will assist during the valuation of capital investments. Alignment of the budget implementation plans with the IDP will ensure that only the approved plans indicated in the IDP are implemented. Additionally, monitoring,

measuring and review of performance for each developed priority will detect, prevent and correct any deviations as and when they occur.

In Chapter 2 above, SDBIP is referred to as a plan that brings the budget and capital budgeting into reality not just a wish list. The next section briefly describes the impact of non-compliance with capital budgeting process and recommendations for ensuring an effective capital budget.

## **5.16 CAPITAL BUDGETING**

Mbhashe Local Municipality's budget policy requires that only expenditure which meets the definition of an asset, has a value that exceeds R10 000 and has life that is more than one year, should be included in the capital budget. The municipality may only spend money on capital projects if appropriated in the capital budget and envisaged funding sources (such as revenue, external loans, capital replacement reserve and grant funding) are carefully considered and the municipal council is assured that the funding is not dedicated for other purposes.

The reports by AGSA throughout the period of the study revealed that Mbhashe Local Municipality incorrectly classified PPE. The PPE could not be confirmed and as a result, it was overstated in the statement of financial position. Also, the municipality failed to disclose and prevent irregular, unauthorised and fruitless expenditure. Non-compliance with GRAP 17 and the MFMA implies that the financial information on which capital decisions were based was incorrect, therefore, unreliable. AGSA reports analysed in Chapter 4 indicate that there had been regular qualifying enquiries that the municipality had not addressed, which indicated that the municipality's internal control structures such as an Audit Committee and an Internal Audit were ineffective.

### **5.16.1 Recommendations: Effective Capital Budget**

The following recommendations could ensure that the municipality achieves a realistic and effective capital budget:

- The municipality should ensure that the Community is consulted during the drafting and the presentation of the IDP.

- The Audit Committee and the Internal Audit Function should assist the municipality to ensure that audit recommendations are implemented.
- The Municipality Management must ensure that PPE is correctly classified and recorded and irregular and unauthorised expenditure is disclosed.

Community consultation and participation would ensure that community external output is controlled and future unauthorised purchases of movable non-current assets are prevented. The Internal Audit and Audit Committee assistance would ensure that the municipality complies with the laws and regulations. Moreover, the PPE presented in the financial statement will be fair and reliable to take reliable capital budgeting decisions.

In Chapter 4 there is evidence to suggest that, cash flows on which the budget was based were not reliable or accurate. Also, the theoretical framework in Chapter 3 suggests that the municipal council should approve the total cash flows before the start of the budget year. This is why, the following section will briefly summarise the impact that unreliable cash flows have to capital budgeting and how to prevent such.

### **5.17 MUNICIPAL COUNCIL: APPROVAL OF THE CAPITAL BUDGET**

According to the Mbashe Local Municipality budget policy, the total costs and cash flows for all the financial years until the project is operational should be included. Cash flow simplified refers to the net profit before deducting interest and tax and thereafter add depreciation and deduct taxation. The cash flows are values used to evaluate whether or not to acquire movable non-current assets.

According to AGSA audit reports, VAT was capitalised as the cost of PPE and investments as PPE. Consequently, the amount on which depreciation was calculated was incorrect because its cost of assets was overstated. Moreover, internal controls and information systems were ineffective resulting in differences between the FAR and the physical movable non-current assets making it difficult for the municipality to reasonably estimate what movable non-current assets to include in the municipality's capital budgets and annual budgets.

In order to ensure that the municipal council approves the budget that is based on reasonable and reliable cash flows, it is important for the municipality to comply with GRAP 17. GRAP 17 is the procedure manual that determines how PPE is recognised, recorded and valued.

Compliance with GRAP 17 would also ensure that PPE presented in the statement of financial position is not understated or overstated, while at the same time providing reliable financial information on which to base capital decisions.

In conclusion, the study was focused on the asset management and capital budgeting in Local Government but these challenges may not be limited to the local government sphere. For that reason, it presents an opportunity for other possible research areas to be considered; hence the following section suggests possible research areas.

### **5.18 POSSIBLE RESEARCH AREAS**

Firstly, the municipalities differ because of their capacity; there are local municipalities, district municipalities and metropolitan municipalities. This study focused specifically on a local municipality. This creates an opportunity for future research which could include district municipalities, metropolitan municipalities or government departments.

Secondly, there is also an opportunity to compare whether local municipalities face similar challenges to district municipalities, or the latter to metropolitan municipalities regarding capital budgeting for procurement of movable non-current assets should a sound asset management not exist.

Lastly, an empirical study can also be conducted to analyse unique capital budgeting challenges specific to local as opposed to metropolitan or district municipalities as well as the impact these could have on the procurement of future assets and service delivery.

In the following section, a conclusion regarding whether there is evidence to support that poor asset management negatively affects capital budgeting at Mbashe Local Municipality is made.

### **5.19 CONCLUSION**

In this chapter, a brief discussion of the findings from Chapter 4 was provided. Mbashe Local Municipality's poor compliance with asset management policies and procedures negatively affected budgeting for the acquisition of movable non-current assets. Asset management policies and procedures do not only safeguard movable non-current assets from

misuse but also helps to generate reliable information for evaluating future acquisition of movable non-current assets. As a result, there is evidence to suggest that even though the municipality had an approved budget policy, it had failed to develop and approve an effective movable non-current asset management policy throughout the period of the study.

Consequently, non-compliance with asset management procedures negatively affected their acquisition plans for movable non-current assets. For example, strategic assets were sold without the authorisation of the municipal council as well as inconsistent underspending compared to the capital budget. There were also reports of unauthorised acquisition of movable non-current assets and differences between reported and physical assets. The differences affected financial reporting which also negatively affected capital budgeting decisions made from the financial reports.

## REFERENCE LIST:

Abdelhamid, M.S., Beshara, I. and Ghoneim, M., 2015. Strategic asset management: assessment tool for educational building in Egypt. *HBRC Journal*, 11 (1), 98-106.

Accounting Simplified, 2013. [Online]. Available: <http://www.accounting-simplified.com/assetrecognition.html> (Accessed 01 October 2015).

AGSA, 2009. *Mbhashe Audit Report*. [Online]. Available: <http://www.agsa.co.za>. (Accessed 24 July 2012).

AGSA, 2012. *General Report on the Audit Outcomes of Local Government Eastern Cape*. [Online]. Available: <http://www.agsa.co.za>. (Accessed 28 September 2015).

AGSA, 2013. *General Report on the Audit Outcomes of Local Government Eastern Cape*. [Online]. Available: <http://www.agsa.co.za>. (Accessed 28 September 2015).

AGSA, 2014. *General Report on the Audit Outcomes of Local Government Eastern Cape*. [Online]. Available: <http://www.agsa.co.za>. (Accessed 28 September 2015).

Ajam, T., 2008. Integrating strategic planning and budgeting: A PFMA perspective. *Southern African Journal of Accountability and Auditing Research*, 8(1), 45-46.

Asha, A., 2014. Capacity challenges for local government efficacy for development planning and implementation. *Journal of Public Administration*, 49(3), 803-812.

Ault, G.W., Van Der Meijden, M.A.M.M., Toneguzzo, J.P. and Welch, I., 2004. *Asset Management Investment Decision Processes*. On behalf of CIGRE Work Group C1-1: Asset Management of Transmission and Distribution Systems, (CIGRE Paris 2002). [Online]. Available: <http://www.transform.ru/articles/pdf/sigre/c1-106.pdf>. (Accessed 07 June 2013).

Bester, L. 2006. *An empirical study of capital budgeting evaluation techniques used by firms in the Nelson Mandela Metropole*. Dissertation, (M.Tech.). Nelson Mandela Metropolitan University.



Boshoff, L., 2009. Municipal infrastructure asset care in South Africa: A reality check. *DBSA & SPAID*, 14.

Chartered Institute of Public Finance and Accountancy (CIPFA), (2008). [Online]. Available: <http://www.cipfa.org/services/property/asset-management-planning/amp-members-document-library/key-document-link-themes/government-guidance-on-asset-management>. (Accessed 02 February 2012).

CoGTA., 2009. *Operation clean audit: The COG That Makes Government Work –Analysis of Provincial Departments and Their Entities*. [Online]. Available: <http://www.cogta.gov.za/index.php/tenders/archive/5-operation-clean-audit-2007-2014-strategic-plan.html>, 1-6. (Accessed 24 July 2012).

Correia, C., Flynn, D., Uliana, E. & Wormald, M., 2008. *Financial Management*: Juta: Kenwyn.

Craythorne, D.L., 2006. *Municipal Administration: The Handbook*. (5<sup>th</sup> Edition). Lansdowne: Juta & Co. Ltd.

Du Toit, M.J. and Pienaar, A., 2005. A review of the capital budgeting behaviour of large South African firms. *Meditari: Research Journal of the School of Accounting Sciences*, 13(1), 19-27.

Elmer, V., 2005. *Capital Improvement Plans and Budgets*. University of California at Berkeley. [Online]. Available: <http://citeseerx.ist.psu.edu>. (Accessed 22 April 2015).

Erasmus, L.J., 2008. Financial performance in terms of the PFMA-what does it mean?. *Southern African Journal of Accountability and Auditing Research*, 8(1), 57-66.

Firer, C., Ross, S.A., Westerfield, R.W. & Jordan, B.D., 2012. *Fundamentals of Corporate Finance*. 5<sup>th</sup> Edition. South Africa: McGraw-Hill (UK) Limited.

Fourie, M.L. & Opperman, L., 2007. *Municipal finance and accounting*. 1<sup>st</sup> Edition. Pretoria: Van Schaik Publishers.

Fourie, D.J., 2005. *The Utilisation of the Budget as a Strategic and Management Tool*. [Online]. Available: <http://www.repository.up.ac.za>. (Accessed 12 March 2014).

French, N., 1994. Asset registers and asset rents for local authorities: A viable property management tool. *Property Management*, 12(3), 15-23.

Gibson, S. 2012. Integrated planning for service delivery in municipality. *Civil Engineering=SivieleIngenieurswese*, 20(9), 50-54.

Glass, H., 2010. [Online]. Available: Mbhashe Municipality- (HRSC) [www.hsrc.ac.za/en/research-outputs/mtree-doc/8359](http://www.hsrc.ac.za/en/research-outputs/mtree-doc/8359). (Accessed 25 May 2015).

Hague, C. & Wilcock, C., 2015. *How to Get Information for Next to Nothing*. [Online]. Available: <https://www.b2binternational.com/publication/desk-research/>, pp 01-03. (Accessed 06 November 2015).

Hofert, A., 2006. Buffalo City budgeting: Visibility into your future performance and sight to make it better. *IMFO: Official Journal of the Institute of Municipal Finance Officers*, 7(1), 22-23.

Johnson, B. and Christensen, L., 2008. *Educational Research: Quantitative, Qualitative and Mixed Approaches*. [Online]. Available: <https://te.columbusstate.edu>. Sage publication Inc.

Joubert, F., Du Plessis, D., Von Holdt, C. & Fourie, A., 2014. Life cycle asset portfolio renewal optimisation. Drakenstein municipality leading the way. *IMIESA*, 39(1), 34-38.

Kumar, R., 2014. *Research Methodology: A Step-By-Step for Beginners*. 4<sup>th</sup> Edition. London: SAGE publication Inc.

Laldaparsad, S., Geyer, H. & Du Plessis, D., 2013. The reshaping of urban structure in South Africa through municipal capital investment: Evidence from three municipalities. *Town and Regional Planning*, 63(1), 37-48.

Lampe, M. & Strassner, M. M-lab, 2003. *The Potential for the Use of RFID for Movable Asset Management*. Zurich, October 12 2003, St Gallen University: Swiss federal Institute of technology Zurich, pp. 01-21. (Accessed 04 March 2014).

Leedy, P.D. & Ormrod, J.E., 2005. *Practical Research: Planning and Design*. 8<sup>th</sup> Edition. New Jersey: Pearson Education Ltd.

Local Government Finances and Budgets, (2015). [Online].

Available:<http://www.etu.org.za/toolbox/docs/localgov/webmunfin.html>. (Accessed 14 July 2015).

Mahabir, J. & Mabena, N., 2015. *Identifying the Funding Constraints in Municipal Investments*. [Online]. Available: <http://www.ffc.co.za/.../833-2015-2016-tr-chapter-9-identifying-the-funding-constraints-in-...>Submission for the 2015/16 Division of Revenue, 245-270. (Accessed 28September 2015).

Marx, J., De Swardt, C., Beaumont-Smith, M., Naicker, B. & Erasmus, P., 2004. *Financial Management in Southern Africa*. Cape Town: Maskew Miller Longman.

Mathiba, L.S., 2011. *Evaluation of Financial Management Practices in the Department of Correctional Services*. Dissertation, (MPA.). University of Stellenbosch.

Matsiliza, N.S., 2012. Participatory budgeting for sustainable local governance in South Africa. *Journal of Public Administration*, 47(2), 443-452.

Marimutu, P.D. & Cloete, J.E., 2010. *Basic Accounting for Non- Accountants*. 5<sup>th</sup> Edition, South Africa: Van Schaik Publishers.

Mbhashe Local Municipality (2015). Mbhashe Municipality Budget Policy. [Online]. Available:[http://www.mbhashemun.gov.za/web/download/Budget-Policy\\_2.pdf](http://www.mbhashemun.gov.za/web/download/Budget-Policy_2.pdf). (Accessed 28 May 2015).

Mkhize, N. and Ajam, T., 2006. The new budgeting approach in South Africa: A critical assessment. *Journal of Public Administration*, 41(4), 761-775.

Mouton, J., 2001. *How to Succeed in Your Master's & Doctoral Studies: A South African Guide and Resource Book*. Pretoria: Van Schaik Publishers.

Myburg, J., Dreyer, D. and Van Der Westhuizen, J., 2011. Integrated asset life cycle management as a tool to ensure sustainable service delivery. *Civil Engineering= Siviele Ingenieurswese*, 19 (9), 46-50.

National Treasury, 2003. *PN006 Guideline on Effective Asset Management Framework Final....* [Online]. Available: [www.treasury.gov.za/legislation/PMFA.....](http://www.treasury.gov.za/legislation/PMFA.....) (Accessed 03 June 2015).

National Treasury, 2004. *Asset Management Guideline: Framework for the Recognition of Assets* issued as Version 3.3 in April 2004. [Online]. Available: <http://www.treasury.gov.za>. (Accessed 05 September 2015).

National Treasury, 2008. *Local Government Capital Asset Management Guidelines: Framework for the Recognition of Assets* issued as Version 3.3 in April 2004. [Online]. Available: <http://www.treasury.gov.za>. (Accessed 05 September 2015).

National Treasury, 2012. *The State of Local Government Finance National Treasury. Analysis Document*. [Online]. Available: <http://www.treasury.gov.za/legislation/PMFA>. (Accessed 05 September 2015).

National Treasury, 2013. *The State of Local Government Finance National Treasury. Analysis Document*. [Online]. Available: <http://www.treasury.gov.za/legislation/PMFA>. (Accessed 05 September 2015).

National Treasury, 2014. *The State of Local Government Finance National Treasury*. Analysis Document. [Online]. Available: <http://www.treasury.gov.za/legislation/PMFA>. (Accessed 05 September 2015).

Neuman, W.L., 2006. *Social Research Methods: Qualitative and Quantitative Approaches*. 6<sup>th</sup> edition. Boston: Pearson Education.

Ouertani, M.Z., Parlikad, A.K. and McFarlane, D.C., 2008. Towards an approach to select an asset information management strategy. *International Journal of computer science and Applications. IJCSA*, 5(3b), 25-44.

Park, A., 1998. *Facilities Management: An Explanation*. 2<sup>nd</sup> Edition. Macmillan: London.

Phandle, G., (2015, March 25). Municipalities in a mess. [Online]. Available: <http://www.dispatchlive.co.za/news/13-municipalities-ina-mess/>.

Rahim, Y., Refsdal, I. and Kenett, R.S., 2010. The 5C model: A new approach to asset integrity management. *International Journal of Pressure Vessels and Piping*, 87(2), 88-93.

Republic of South Africa (RSA), 1996. *The Constitution of the Republic of South Africa*. Pretoria: Government Printer. South Africa (Republic).

Republic of South Africa (RSA), 2000. *Local Government: Municipal Systems Act 32 of 2000*. [Online]. Available: <http://www.treasury.gov.za>. (Accessed 05 September 2015).

Republic of South Africa (RSA), 2003. *Local Government: Municipal Finance Management Act 56 of 2003*. [Online]. Available: <http://www.treasury.gov.za>. (Accessed 05 September 2015).

SABC News, 2015. Second day of total shutdown to service delivery protest in Dutywa. [Online]. Available: <http://www.sabc.co.za/news/>. (Accessed 30 June 2016)

Schuman, C.A. and Brent, A.C., 2005. *Asset life cycle management: Towards improving*

physical asset performance in the process industry. *International Journal of Operations & Production Management*, 25(6), 566-579.

Slogrove, N., 2008. Agonising over assets - Perspective on assets in local government. *IMFO: Official Journal of the Institute of Municipal Finance Officers*, 9(2), 14-16.

Republic of South Africa (RSA), 2016. Local Government. [Online]. Available: [http://www.gov.za/about - government/government - system/local-government](http://www.gov.za/about-government/government-system/local-government). (Accessed 05 February 2016).

Tewary, S., 2011. Is there too much emphasis on budgeting in municipalities?. *IMFO: Official Journal of the Institute of Municipal Finance Officers*, 12(1), 8-9.

Van der Wath, C., 2010. Effective asset management can mitigate the need for capital outlay when there is an understanding that delivery of infrastructure goes beyond construction. *Civil Engineering= SivieleIngenieurswese*, 18(4), 64.

Venter, A., 2007. *Municipal management –Serving the People*. 2<sup>nd</sup> Edition. South Africa: Juta. Kenwyn.

Viljoen, F., 2009. *What is an Asset?* [Online]. Available: <http://liberta.co.za/blog/what-is-an-asset/>. (Accessed 01 October 2015).

Visser, R., 2006. Integrating asset management into the strategic management process of a municipality. *IMFO: Official Journal of the Institute of Municipal Finance Officers*, 6(4), 14-17.