



2007/08 MTREF Budget Update

This circular is aimed at providing municipalities with information for the preparation of their 2007/08 MTREF (Medium Term Revenue and Expenditure Framework) budgets and includes guidance on growth parameters and related budget issues. It is informed by the 2006 Medium Term Budget Policy Statement (MTBPS) and Adjustment Appropriations tabled by the Minister of Finance on 25 October 2006, and other issues arising from engagements with municipalities. The 2006 MTBPS and Adjustment Appropriations can be viewed on the National Treasury website www.treasury.gov.za.

Policy Priorities and Fiscal Framework

In his 2006 MTBPS, the Minister of Finance tabled a proposal for an additional R18,9 billion for local government over the Medium Term Expenditure Framework (MTEF) period 2007/08 – 2009/10. This will result in local government's share of nationally raised revenue growing from a baseline of R27,7 billion in 2006/07 to R46,8 billion in 2009/10 and includes R27,1 billion to replace revenue with the abolition of RSC levies.

Of the proposed additional R18,9 billion, R5 billion is to be added to the equitable share for purposes of enhancing the ability of municipalities to sustain the rollout of free basic services (water, electricity, sanitation and refuse) to disadvantaged communities. The remaining R13,9 billion, to be added to conditional grants, is earmarked as a contribution to the capital cost to implement regional bulk water services infrastructure, rehabilitation and maintenance of bulk municipal infrastructure and the eradication of the bucket sanitation system as well as assisting the nine host cities with preparations for the 2010 FIFA World Cup. These funds are apart from other resources that are likely to be provided by Provincial Government, which will be reflected in their 2007 MTEF budgets, also to be tabled during February 2007.

Growth Parameters

It is anticipated that the outlook for the South African economy will remain positive over the 2007 medium term. Real Gross Domestic Product (GDP) growth for 2007/08, 2008/09 and 2009/10 is expected to be around 4,4 percent, 4,8 percent and 5,3 percent respectively.

The Consumer Price Index (CPIX) remains within the 3 to 6 percent target range and over the next three years is expected to average 4,8 percent, having climbed from a low of 3,7 percent in April 2006. The CPIX forecast for 2007/08, 2008/09 and 2009/10 is 5,1 percent, 4,3 percent and 4,5 percent respectively. These projections will be revised as better economic data is made available. You may refer to National Budget documentation for further information which is planned to be announced on 21 February 2007.

The guideline growth parameters are consistent with the CPIX target range over the medium term and for the 2007/08 municipal financial year, 3 to 6 percent. Municipalities and their entities are again reminded that the growth parameters apply to annual increases in

municipal charges on existing ratepayers, including property rates, water and electricity tariffs, after due consideration for local conditions.

With strong economic development being experienced, such as new property sub-divisions, housing and commercial developments, the overall resource base of many municipalities is expected to increase. The annual growth (parameter) on existing revenues, accompanied by aggregate growth in revenues generated from new development, will result in higher budgets being adopted. Any increase in tariffs and rates levied, however, must be motivated and explained to the local and business communities, particularly where additional local factors have an impact on revenue. Councils are strongly urged to ensure that national economic, tax and fiscal policy objectives are not undermined through excessive municipal charges. The growth parameters should not be mistaken to mean that expansion of municipal services and infrastructure are curtailed in any way, which must be undertaken within available municipal resources.

Transfers to Local Government

Allocations to municipalities from national government occur mainly through equitable share and conditional grants. Conditional grants are allocated for the expansion and upgrading of key infrastructure and strengthening local government's ability to deliver basic municipal services.

Excluding the provision for RSC levies, the equitable share grows at a real rate of 11,1 percent a year, from R11,1 billion in 2006/07 to R18,9 billion in 2009/10. This increase is aimed at boosting the ability of municipalities to fund the provision of free basic services to poor households and to improve municipal governance and administrative systems.

Capital transfers amount to R45,7 billion over the 2007 medium term. The allocation of this amount is as follows:

- R24,7 billion to step up infrastructure to enable municipalities to rollout basic municipal services,
- R7,8 billion for the construction and upgrading of 10 stadiums in the nine 2010 FIFA World Cup host cities,
- R6,7 billion to the nine 2010 World Cup host cities as part of national government's contribution to the upgrading of components of municipal infrastructure in the stadium environs, and for public transport and systems improvement. It is expected that the host cities will fund a portion of these programmes from their own revenue,
- R1,4 billion towards the easing of pressure on bulk systems for water supply and sanitation, and to extend future capacity as more households gain access to basic services, and
- R1,4 billion to rollout electricity infrastructure in municipalities.

In addition to the above, about R3,7 billion is earmarked for the Neighborhood Development Partnership Grant to fund improvements to settlements, with the view that they become vibrant and sustainable communities. Further information on this grant can be obtained from the website www.treasury.gov.za/ndp.

Finally, the capacity-building and restructuring grant component of transfers to local government is R749 million in 2007/08, declining to R400 million in 2008/09 due to the local government Restructuring Grant being phased into the local government equitable share.

The 2007 Division of Revenue Bill will be available on budget day **21 February 2007** and can be viewed on the National Treasury website. Municipalities will then be in a position to ensure that the latest national three year allocations to local government are reflected in their 2007/08 budget.

Continuous Improvement in Municipal Budgets

During 2005/06 there has been noticeable improvement across a number of municipalities in the budget process and compliance with the MFMA. Improvements cover the whole budget cycle from the planning phase through to implementation and reporting. Of particular note has been the adoption of the budget prior to the start of the financial year, with only seven municipalities failing to meet the 30 June deadline for the 2005/06 budget. Unfortunately, this was compromised by the failure of over half of the municipalities to table budgets for consultation by the deadline of 31 March, reducing the time available for effective consultation on the budget.

Municipalities and municipal entities are strongly encouraged to focus on the quality of budgets and to use 2007/08 as the year for demonstrating a quantum shift in budget credibility. Following consultation with municipalities and stakeholders, analysis of budgets, annual reports and other key documents and through the various surveys completed by municipalities, a number of issues have emerged and are considered a high priority for budget quality attention for 2007/08. These are summarised below:

- **Capital budgets:** capital budgets are still marred by slow spending and stop-start spending due to a failure to plan for the medium term. To address these concerns municipalities who are not doing so already, are encouraged to adopt multi-year capital budgets for a minimum of three years, as enabled by the MFMA (section 16(3)). Multi-year budgets must be aligned with the IDP.
- **Supply Chain Management:** Proper planning of supply chain management processes is essential to the timely completion of capital projects and the delivery of services. Attributing delays in budget implementation to supply chain management processes is more often due to a failure to plan. Municipalities are encouraged to review existing SCM systems and build capacity where necessary. Further guidance is provided in the publication "Supply Chain Management – A Guide to Accounting Officers" available on www.treasury.gov.za/mfma

Between March through to the adoption of the final budget in May, processes should be implemented to ensure budgeted capital projects and services are coordinated with SCM demand management.

- **Long-term contracts:** In support of multi-year budgets, municipalities are reminded of the ability to enter into long term contracts beyond the three years contained in the annual budget. Section 33 of the MFMA outlines the consultation and financial analysis requirements to be followed.
- **Budget format:** Circular No 28 provides a comprehensive guideline on the format of the municipal budget. These formats were developed following extensive consultation and will form the basis of budget regulations, as may be revised, and soon to be prescribed. Municipalities are encouraged to fully comply with the recommended format and supporting information for the 2006/07 adjustment budget and 2007/08 medium term budget as this will ensure a smooth transition across to the regulated formats in the near future.

- **Budget strategic focus:** Council must ensure that the budget reflects the strategic outcomes embodied in the IDP and related strategic policies. Such a focus represents a shift away from detailed line-item budgets that tend to focus on inputs. Thus council should adopt the budget at a high level vote enabling the accounting officer to oversee the implementation and management of the budget in accordance with appropriate policies and internal controls and through regular reports to council on financial and outcome performance. It is imperative to link the IDP-Budget-SDBIP to be able to measure performance as agreed in the performance contracts of senior officials. Please refer to Circulars 12 and 28 (revised definition) when deciding on the appropriate level of a Vote.

When presenting the budget to council greater emphasis needs to be given to the Outputs/Outcomes to be achieved. Senior managers must be able to motivate in detail reasons why the council should collectively vote to approve a certain budget allocation and simultaneously be convinced as to how the budget allocation is to be spent and what results and standards of performance would be achieved.

- **Consultation:** Municipalities are congratulated in making progress in community consultation forums. There is a need however for municipalities to build on current good work and strengthen consultation processes during the preparation and tabling of the 2007/08 budget.

To date the concept of consultation has largely been an information sharing exercise, whilst we would urge municipalities to consult with their communities in a manner that encourages an active input from community members, which is considered and responded to. This requires the municipality to make budget information more easily and widely accessible and understandable to its citizens.

There is also a need for greater effort to engage and consult with the remaining stakeholders. District municipalities and provincial government have a key role in promoting alignment with the Provincial Growth and Development Strategy (PGDS), coordinating budget and IDP and to contribute to the achievement of national priorities

In summary, consultation is required with the following stakeholders:

- the local community,
- the relevant district and all other local municipalities within the area of the district (section 21(2) and 23),
- the relevant provincial treasury and local government departments,
- National Treasury,
- National and provincial sector departments (intergovernmental coordination), and
- Provider's of bulk resources (refer MFMA Circular No 23).

In aligning the SDBIP to budget processes it is also key to obtaining the views of the ward councillor. The ward councilor is the direct link between the council and the public. It is his or her responsibility to make sure that consultation is effective and information on council decisions, development and budget plans and any council programmes are effectively communicated to the community.

- **Credible budgets:** Significant under/over revenue collection and spending requiring major budget adjustments indicate credibility issues with budget preparation. A credible budget is one that:
 - funds only activities consistent with the revised IDP, which must recognise the financial resources available to the municipality,
 - is achievable in terms of agreed service delivery and performance targets,
 - contains revenue and expenditure projections that are consistent with current and past performance and supported by documented evidence of future assumptions,
 - is not adjusted on a monthly, quarterly or less frequent basis,
 - also considers the changes required in the IDP and the SDBIP,
 - does not jeopardise the financial viability of the municipality, ensuring that the financial position is maintained within generally accepted prudential limits and that obligations can be met, and
 - provides managers with appropriate levels of delegation sufficient to meet their financial management responsibilities.
- **Funding the budget:** Paramount to a credible budget is the careful estimation of realistic revenue to be collected as required by section 18(1) and (2). Some municipalities are continuing poor practices by adopting budgets that are not based on current and past revenue collection performance or realistically achievable improvements. Under collection of revenue that was provided for in the budget requires curtailment of expenditure and a stop start approach to service provision. The solution may require improved debt collection efforts, increased focus on financial planning and/or a reduction in estimated revenue more in line with past performance.
- **Mid-year budget and performance review:** Municipalities are still faced with the challenge of producing accurate and timely data from internal systems. The mid-year budget and performance review, coupled with the monthly budget statements are considered key documents to assist with the preparation of an adjustment budget and the forthcoming budget. A concerted effort is required to ensure these reports are produced in terms of sections 71 and 72 of the MFMA, are accurate, timely and carefully reviewed.
- **The Role of Mayors' and Officials in the preparing of the MTREF Budget:** Poor internal coordination of the budget process is hampering the efforts of many mayors when developing the budget and discharging their obligations in terms of section 53 of the MFMA. To improve coordination it is recommended that the Mayor, or the Councillor delegated with the responsibility, establish and utilise the expertise in the Budget and Treasury Steering Committee to render support and produce a credible and quality budget. It is also important that the relevant information is promptly posted on the municipal website in terms of section 75. This should be an automated process so that updates are regularly announced.

The MTREF Budget process should be managed in a manner where the Integrated Development Plan, the Municipal Budget Policy Statement of the Municipality, the MTREF Budget and the Service Delivery and Budget Implementation Plan are prepared in unison with one another. This would significantly contribute to ensuring that the desired levels of linkages are achieved. The MTREF Budget gives effect to the strategic priorities embodied in the IDP and simultaneously the SDBIP would demonstrate the results and standards of performance to be attained during the financial year.

- **2007/08 MTREF budget time table:** Inadequate planning for the budget process has emerged as the major reason amongst municipalities who failed to table the current year budget in council on time. A number of MFMA circulars have been issued to guide the budget process and related matters, and these should be reviewed and implemented by municipalities.
 - MFMA Circular No 10 & 19 - Budget Process 2005/06 & 2006/07. This introduces the six key steps to preparing a budget and provides a model “Schedule of Key Deadlines”
 - MFMA Circular No 12 - Definition of Vote in the MFMA (revised in Circular 28).
 - MFMA Circular No 13 - Service Delivery & Budget Implementation Plan. Comprehensive guidance on linking the SDBIP to the IDP.
 - MFMA Circular No 28 - Budget Content and Format - 2006/07 MTREF. A prelude to the budget format regulations and a revised definition of Vote in the MFMA.
- To assist municipalities meet the 2007/08 MTREF Budget time lines and to provide adequate time for consultation, the following key dates are provided as a guide:

Key dates for 2007/08 MTREF Budget
<p>28 February 2007 – The Council adopt the 2006/07 Adjustments Budget, where necessary, in terms of optimal compliance with section 28 of the MFMA and to inform the forthcoming budget preparation.</p>
<p>31 March 2007 – The Mayor is required to table the 2007/08 MTREF Budget, the revised IDP and the draft SDBIP. The accounting officer must, on the same day, publish the budget on the website of the municipality in terms of section 75 of the MFMA and forward information to stakeholders for comment.</p>
<p>1 April 2007 to 30 April 2007 – The Mayor and Council are required to manage the public participation programme with all communities within its municipality and call for public submissions and convene public hearings.</p>
<p>1 May 2007 to 15 May 2007 – The Council consider any submissions and comments that are submitted by organs of state, e.g. district and local municipalities, provincial government, national government and the local communities on the 2007/08 MTREF Budget and the revised IDP.</p>
<p>16 May 2007 to 31 May 2007 – The Mayor tables the final 2007/08 MTREF Budget, IDP and SDBIP for Council approval by 31 May 2007.</p>
<p>13 June 2007 – The accounting officer submit the approved documentation to the national and provincial treasuries and relevant organs of state with Appendix A, B and C and update the performance contracts of senior staff accordingly.</p>

Tabling the budget – diagramme

MARCH				APRIL				MAY			
Wk1	Wk2	Wk3	Wk4	Wk1	Wk2	Wk3	Wk4	Wk1	Wk2	Wk3	Wk4
Adjust-ment Budget	Table municipal and entity budgets, resolutions, SDBIP, IDP revisions and budget related policies			Call for public submissions, national & provincial consultation , council to have meetings with key stakeholders				Council hearings and Council meeting to consider submissions		Council meeting - mayor to submit final budget for adoption	

Budget questionnaire – due by 16 April 2007

Please complete and return the attached questionnaire by 16 April 2007 to assist us in monitoring compliance with the MFMA. Email the completed form to mfma@treasury.gov.za or fax to 012 315 5230. Municipalities are required to table the annual budget at least 90 days before the start of the budget year (i.e. 31 March) and it is recommended the MTREF Budget be adopted by council by 31 May 2007.

Conclusion

Municipalities are expected to table credible and sustainable budgets. These multi-year budgets should be outputs/outcomes focused and consistent with the form required in terms of the MFMA and supported by the budget and revenue related policies. In this regard, we emphasise the need to ensure that revenue projections are realistic and achievable, allocations from other sources are consistent with the Division of Revenue Act, provincial and district budgets, tariffs and rates are raised taking into account affordability levels of the community, the backlogs in infrastructure are being addressed, whilst maintaining a balance between new and rehabilitation of assets, sufficient provision is made for maintenance of existing assets, provision for working capital, administrative overheads are minimised and overdrafts are managed downwards over the next financial year. We also remind councils to ensure that they consider the Provincial Growth and Development Strategy and take account of national objectives when revising their IDP's and linking these to the resource allocations in the budget.

When preparing the budget, the mayor of a municipality is required to take into account the national budget, the relevant provincial budget, the national governments fiscal and macro economic policy, the annual Division of Revenue Act and any agreements reached in the Budget Forum. This is in addition to consultation with the community and other stakeholders, including district and all local municipalities within the district.

This circular highlights the key national priorities and provides guidance to municipalities and entities in framing the 2007/08 MTREF Budget.

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