



## 2008/09 MTREF Budget

This circular provides further guidance to municipalities and municipal entities on the preparation of their 2008/09 Medium Term Revenue and Expenditure Framework (MTREF). It is informed by the 2007 Medium Term Budget Policy Statement (MTBPS), previous guidance issued to municipalities and other matters arising from engagements with municipalities.

Topics addressed include:

1. National priorities;
2. Indicative macroeconomic forecasts;
3. Proposed 2008/09 Division of Revenue Act transfers to local government;
4. Strict enforcement for non-compliance with the 2008/09 Division of Revenue Act;
5. Requirements for 2008/09 MTREF budget process timelines and submission;
6. Requirements for 2008/09 MTREF budget documentation content and format;
7. Progress on the development of municipal budget regulations;
8. Implementation of 2008/09 MTREF funding compliance assessment; and
9. Reviews of progress on continuous improvement in municipal budgets.

### 1. Government Priorities

In his *2007 Medium Term Budget Policy Statement (MTBPS)*, the Minister of Finance tabled a forward looking budget framework that provides a perspective on how the government views the economic outlook going forward. The 2007 MTBPS added R81.4 billion to the spending baseline over the next three years. The increase in the baseline allows public expenditure to be implemented in line with national spending priorities included in the government's Programme of Action and any revisions to the baseline will be announced in the 2008 Budget to be tabled on 20 February 2008. This will be communicated in the Budget documentation available on our website.

#### Government Spending Priorities

The spending priorities as reflected in the annually updated Medium Term Strategic Framework (MTSF) and reiterated in the MTBPS are as follows:

- Investing in human and physical capital to ensure long-term growth;
- Improving the quality of education, health and other social services and targeted anti-poverty programmes;
- Extending coverage of basic household services such as water, sanitation and electricity, and reducing the number of people living in informal settlements;
- Improving the efficacy of the criminal justice sector;
- Support initiatives aimed at strengthening the capacity of the State, and
- Supporting targeted interventions in the economy that raise productivity and efficiency, and fostering international partnerships for development.

The review of the medium-term plans was informed by the focused programmes associated with the Accelerated and Shared Growth Initiative of South Africa (ASGISA), the Joint Initiative for Priority Skills Acquisition (JIPSA) and the fundamental need for the successful hosting of the 2010 FIFA World Cup. The President's State of the Nation address on 8 February 2008, identified 24 Apex programmes for focused attention and implementation. The above-mentioned priorities and programmes are of relevance to local, provincial and national spheres of government. However, in some instances, local government would be expected by citizens and residents of the country to play the lead role towards achieving success.

The 2007 MTBPS and other referenced documents can be viewed on the National Treasury website [www.treasury.gov.za](http://www.treasury.gov.za).

## 2. Indicative Macroeconomic Forecasts

Municipalities are expected to levy their rates and tariffs taking into account their local economic conditions, affordability levels and remain broadly in line with macro-economic policy. Municipalities must also take account of the policy and recent developments in government sectors relevant to their local communities.

Rates and tariff increases must be thoroughly substantiated in the municipal budget documentation for consultation with the community. Municipalities engaged in water and electricity distribution will need to fully explain the impact of bulk price increases and its implication on municipal budgets.

The medium-term outlook for the SA economy is summarised in the table below: A revised outlook will be made available when the Minister of Finance tables the national budget on 20 February 2008. The latest available forecasts for CPIX for 2008/09, 2009/10 and 2010/11 are 4.9 per cent, 4.5 per cent, 4.5 per cent respectively. The Reserve Bank inflation target range remains at 3 to 6 per cent.

**Table 1: Macroeconomic Projections: 2008 - 2010**

<b>2007 MTBPS Macroeconomic projections</b>							
Calendar year	2004	2005	2006	2007	2008	2009	2010
		Actual		Estimate	Forecast		
<i>Percentage change unless otherwise indicated</i>							
Final household consumption	6.7	6.6	7.3	6.6	4.2	4.5	5.3
Final government consumption	6.3	5.2	5.4	6.5	6.1	5.5	5.6
Gross fixed capital formation	8.9	9.6	12.7	15.4	10.4	10.5	11.1
Gross domestic expenditure	7.9	5.9	8.7	5.5	4.8	5.9	6.4
Exports	2.9	8.0	5.5	8.4	4.8	5.3	6.3
Imports	14.5	10.7	18.4	9.8	5.6	8.5	9.1
<b>Real GDP growth</b>	<b>4.8</b>	<b>5.1</b>	<b>5.0</b>	<b>4.9</b>	<b>4.5</b>	<b>4.8</b>	<b>5.3</b>
GDP deflator	5.8	4.7	6.9	8.5	6.3	5.0	5.1
<b>GDP at current prices (R billion)</b>	<b>1 398.2</b>	<b>1 539.0</b>	<b>1 727.5</b>	<b>1 965.0</b>	<b>2 182.7</b>	<b>2 401.2</b>	<b>2 659.2</b>
CPIX (average for year)	4.3	3.9	4.6	6.2	5.4	4.6	4.5
Current account balance (% of GDP)	-3.2	-4.0	-6.5	-6.7	-6.9	-7.7	-7.8
Fiscal year			2006/07	2007/08	2008/09	2009/10	2010/11
			Actual	Estimate	Forecast		
<b>GDP at current prices (R billion)</b>			<b>1 787.3</b>	<b>2 019.1</b>	<b>2 230.3</b>	<b>2 458.9</b>	<b>2 723.8</b>
<b>Real GDP growth</b>			<b>5.2</b>	<b>4.7</b>	<b>4.5</b>	<b>4.9</b>	<b>5.4</b>
GDP deflator			7.6	7.9	5.7	5.1	5.1
CPIX (average for year)			4.9	6.5	4.9	4.5	4.5

Municipalities would be aware that DPLG has recently issued draft regulations under the Municipal Property Rates Act designed to promote national rating equity and the attainment of macro-economic objectives. Whilst the final form of the regulations is subject to the consultation process municipalities should consider the future implications of the proposed regulations in establishing their property rating structure for the 2008/09 MTREF. In considering rating changes cognisance must be given to macro-economic targets as well as variations local economic conditions, such as unemployment and property construction growth. All property rate revenue increases must be thoroughly substantiated in budget documentation and subject to consultation with all stakeholders. Excessive increases outside of macro-economic targets and rating structures may not promote rating equity consistent with the proposed regulations.

Where a municipality intends to impose new taxes or extend existing tax instruments on residential and business sectors, including agriculture and mining, the municipality must, prior to implementation of such taxes, submit its impact analysis to the National Treasury. Municipalities are urged to ensure that national economic, tax and fiscal policy objectives are not undermined through excessive municipal taxes. The National Treasury will monitor tariff increases over the medium term and will institute appropriate measures, if excessive.

### 3. Transfers to Municipalities

Section 216 of the Constitution provides for national government to transfer resources to municipalities in terms of the annual Division of Revenue Act (DoRA) to assist them in exercising their powers and performing their functions. These allocations are announced annually in the national budget. Transfers to municipalities from national government are supplemented with transfers from provincial government. The two spheres of government must gazette these allocations as part of the budget implementation process (see Section 31 of the 2007 DoRA). The DoRA (and section 37 of the MFMA) further requires transfers between district and local municipalities to be made transparent and reflected in the budgets of both transferring and receiving municipalities.

#### DoRA Allocations to Municipalities

Additional allocations of R14.4 billion to the local government baseline are proposed over the 2008/09 MTREF period for the provision of basic services, the rollout of infrastructure for economic development, allocations to host cities for the 2010 FIFA World Cup and capacity building initiatives. Of this amount, R6.5 billion will be added to the local government equitable share to help municipalities meet the costs of providing free basic services to poor households. The balance of R7.9 billion in conditional grants is earmarked for municipal infrastructure and programmes to boost planning, budgeting and management capacity in municipalities. Table 2 shows the proposed additional transfers over the medium term under consideration.

**Table 2: 2008 MTEF Division of Revenue Allocations to Municipalities (Additions)**

R million	2007/08 revised	2008/09	2009/10	2010/11	2008 MTEF
Equitable share	-	1 114	711	4 649	6 474
Conditional grants	3 257	1 634	1 888	4 446	7 968
<b>Total</b>		<b>2 748</b>	<b>2 599</b>	<b>9 095</b>	<b>14 442</b>

## **4. Compliance Requirements of the DoRA**

The 2008 Division of Revenue Act takes precedence over all other legislation on the administration of government grants. Municipalities are expected to comply fully with the reporting requirements and other obligations specified in the Act.

The legal obligations placed on transferring and receiving authorities in terms of the DoRA do not deviate significantly from previous requirements. However, these provisions will be strictly enforced in the coming year and municipalities who fail to comply will have their funds delayed or withheld.

### **Municipal Manager Responsible for Ensuring Compliance with the DoRA**

Municipalities are again reminded that compliance with the conditions of the DoRA is the responsibility of the municipal manager as the “receiving officer”. The municipal manager accounts to the Mayor, Executive Committee and Council on how the municipality is complying with the DoRA as it applies to various conditional grants. This includes, among other things, the tabling of quarterly reports in Council on whether or not the municipality is complying with the DoRA and reporting on any delays in the transfer or the withholding of funds. Failure on the part of a municipal manager to comply with the Act will have financial implications for the municipality as it will lead to losses through foregone or delayed revenue. Where the municipality is unable to comply, or requires an extension of time, the municipal manager must apply to the National Treasury and provide comprehensive motivation for the non-compliance.

Municipal councils are requested to ensure that the 2008/09 performance contracts of their municipal managers, as well as those of senior officials, reflect, among other key performance areas, the above responsibilities and accountabilities.

This Circular is to be brought to the attention of the Mayor and Council. Failure by the municipality to comply with the DoRA will be communicated directly to the Mayor while any withholding of transfers as a result of non-compliance will be communicated to the Council.

### **Key legal provisions to be Strictly Enforced**

The following will be more closely monitored and strictly enforced as from this year:

- The inclusion of all grants (national, provincial and local) in the 2008/09 budget of the municipality as reflected under both the revenue and expenditure budget components;
- The preparation of three-year capital and operating budgets for 2008/09 and the MTREF;
- The submission of Council-approved 2008/09 budgets to the National Treasury by 30 June 2008, indicating how national government priorities like free basic services are to be provided for;
- The submission of Annual Financial Statements for 2007/08 for audit purposes by 31 August 2008 and submission of audited Annual Financial Statements for 2007/08 to the National Treasury and relevant provincial treasuries once the audit opinion has been received;
- All funds transferred from national and provincial government must be deposited in the municipal primary bank account; and
- Reporting requirements for conditional grants must be satisfied including the monthly reports to be submitted by the municipal manager to the relevant national or provincial transferring officer.

## 5. 2008/09 MTREF Budget Process and Submission

Previous years have seen significant improvements in municipal budget processes. For the 2007/08 MTREF, 243 municipalities tabled their budgets by 31 March 2007 and 281 municipalities approved their budgets by 30 June 2007. Municipalities are encouraged to build on and improve all aspects of their budget processes based on the guidance provided in MFMA Circulars 10, 19 and 31.

Once more, municipalities are reminded that the budget process and IDP review process should be combined into a single process. Such an approach enhances community input, encourages debate on service delivery and local economic development issues, improves understanding of community needs and provides an opportunity for feedback, accountability and responsiveness to the needs of the local communities. It further enables the municipality to be responsive to the needs of the community and to provide useful inputs to the relevant provincial and national department strategies and budgets for the provision of services such as schools, clinics, hospitals and police stations.

### Submission Requirements

Hard copy submission to National Treasury must be to: National Treasury, Chief Director: Local Government Budget Analysis, 40 Church Square, Pretoria, 0001. Electronic submissions must be submitted via e-mail to [lgdatabase@treasury.gov.za](mailto:lgdatabase@treasury.gov.za). Further copies of the budget and related documents must be posted on municipal websites in terms of section 75 of the MFMA.

- *Budget Tabled for Consultation at least 90 Days before the start of the Budget Year*

Within five working days after the municipal budget is tabled in the municipal council in terms of section (16)(2) of the MFMA and no later than 7 April 2008, the municipal manager must submit to the National Treasury and the relevant provincial treasury:

1. the budget documentation as set out in MFMA Circular 28 in both printed and electronic format;
2. the draft service delivery and budget implementation plan in both printed and electronic format;
3. the IDP, Appendix A return form and all other budget related documents in both printed and electronic format; and
4. the Appendix B return form in electronic format.

- *Budget Approved by Council before the start of the Budget Year*

Within five working days after the municipal council approves the municipal budget (no later than 7 July 2008) and within five working days of the mayor approving the service delivery and budget implementation plans (no later than 4 August 2008), the municipal manager must submit to the National Treasury and relevant provincial treasury:

5. the approved municipal budget documentation set out in MFMA Circular 28 in both printed and electronic formats;
6. the approved service delivery and budget implementation plan in both printed and electronic formats;
7. the IDP, Appendix A return form and all other budget related documents in both printed and electronic format; and
8. the Appendix B return form in electronic format.

## 6. 2008/09 MTREF Documentation Content and Format

It is anticipated that municipalities make every effort to implement budget reforms, thereby complying with the MFMA. They should aim to prepare multi-year budgets, service delivery implementation plans, publishing key performance targets for each vote on the budget, and implement performance contracts for senior managers linked to these performance targets.

Municipalities are required by the MFMA to table and approve three-year budgets in accordance with uniform formats. Until further notice, the basis for the municipal budget content and format remains the MFMA Circular No. 28 dated 12 December 2005 which is available on the National Treasury's website. This circular explains, among other things, what is meant by a vote, what is a realistic budget, how the entire budget document should be prepared and provides the formats for the budgets of municipalities. The proposed regulations, soon to be released for public comment, will be largely based on this circular. Compliance with this circular will greatly assist municipalities to perform self-tests on funding compliance in terms of Section 18 of the MFMA which is discussed below. In addition, municipalities are encouraged to make every effort possible to comply with the format of Circular No. 28 which will allow for a smooth transition to the new budget formats which are to be regulated to be applicable for the 2009/10 Budget.

Specific areas of the budget are discussed below.

- **Clear Linkage between Budget, IDP and LED**

Municipalities must ensure that their proposed budgets have clear and unambiguous linkages to their IDP and LED strategies. They must also assess the extent to which those budgets, IDPs and LED strategies are aligned and give effect to or complement national and provincial priorities listed above.

- **Budgeting for Free Basic Services**

National and provincial allocations supplement municipalities' own revenue with the aim of enabling them to expand their capacity to deliver free basic services to poor households. Various conditional grants are aimed at assisting municipalities to promote economic activity through increased capital investment and spending on maintenance of water, sanitation, electricity and municipal roads.

Municipalities are advised to include in their budgets documents the levels and projected costs of the various free basic services they will be providing during the 2008/09 budget year and outer years. Alongside these must be the number of indigent households expected to benefit from those services.

- **Budgeting by Vote**

The budget must be broken down by vote (function); separating revenue, operational and capital expenditure, approving strategic objectives and measurable outputs per vote; providing detailed multi-year capital budgets and plans per sector (water, sanitation, electricity, refuse, health, housing, etc); providing information on the rollout of free basic services (property taxes, water, sanitation, electricity, refuse).

- **Budgeting for Capital**

Municipalities are encouraged to produce a three-year capital plan when tabling their budget. This must be disaggregated by municipal ward and reflect the MIG sector priorities to enable

national and provincial transfers to flow directly to municipalities. Capital budgets must also differentiate between those programmes/projects for which multi-year appropriations are approved in accordance with MFMA Section 16(3), and those for which only budget year appropriations are approved.

Municipalities are reminded that sector priorities in MIG refer to the functions of water, sanitation, refuse, electricity, roads, public amenities, etc. This allows for sector departments like, DWAF, DME and others to monitor progress in addressing backlogs, as reflected in the Division of Revenue framework for MIG.

Funds received for capital projects must be included in the capital budget as “revenue” under sources of finance. External loans are loans that are to be obtained from private lenders and/or financial institutions and include loans taken up to fund capital expenditure.

- **Budgeting for Revenue**

The municipal budget must reflect all revenue anticipated to be received and recognised during the 2008/09 budget year and beyond. All sources of revenue such as own revenue, grants, subsidies, agency receipts, donor funds, trust monies must be included.

- **Specific Revenue and Expenditure Items**

Revenue foregone – municipal inquiries suggest that there are inconsistent views and treatment of this item, which can often be related to items such as free basic services or property rate rebates. While not entirely definitive, as each category should be assessed on a case-by-case basis, it is suggested that municipalities apply the “*generally available to all*” rule to determine whether an item is revenue foregone or expenditure. For example, if a rate rebate is available to all ratepayers of a particular category; e.g. residential land use, then the rebate should be treated as “revenue foregone”. The broadly applied rebate is considered an adjustment to the tariff. However, if a rate rebate is provided to a particular ratepayer for charitable purposes this should be treated as expenditure and should be shown as a grant. The rebate is an efficient way of collecting the property rates and then making an equivalent donation, having met specific criteria for same.

- **Budgeting for Maintenance**

Municipalities need to focus attention over the medium term on implementing asset management systems to ensure that adequate provision is made for upgrading and maintenance of infrastructure. Municipalities need to adequately explain their allocation for repairs and maintenance.

Repairs and maintenance – municipalities frequently request guidance on benchmark levels for repairs and maintenance budgets. This is a very complex issue on which to provide general guidance, as asset ownership and condition levels vary greatly between municipalities. Municipalities should at least support their repairs and maintenance budgets with appropriate engineering advice and have regard for trends and levels of capital investment.

A guide to municipal asset management will be issued shortly.

- **Prior Year Comparative Information**

Section 17 of the MFMA requires the presentation of the amounts of the “preceding year” in the annual budget. The purpose is to provide historical trend information to assist the Council

and the community to assess the proposed budget. These amounts should be derived from audited financial statements. However, it is noticeable that the amounts presented often do not align to the audited amounts. It is probable that initial drafts of budgets are prepared prior to the finalisation of the audit. Regardless, municipalities should ensure that the amounts are updated when the audit is complete and prior to tabling.

## **7. Proposed Regulations on Budget Content and Format**

Municipalities and municipal entities are informed that National Treasury is in the process of developing regulations related to new budget formats and contents largely based on MFMA Circular 28. Circular 28 was subject to extensive consultation prior to release in December 2005. The development of the proposed regulations has benefited from testing of the principles in Circular 28 over 2 budget periods (2006/07 and 2007/08). The proposed regulations are currently undergoing legal refinement before being made public for comment. The new regulations will, among other things, limit the number of times that municipalities are allowed to pass adjustment budgets. The purpose is to ensure that the planning and budgeting processes in municipalities are legitimate, consultative and credible.

## **8. 2008/09 MTREF Funding Compliance Assessment**

Municipalities are expected to prepare three-year budgets that are, among other things, sustainable in terms of being funded from realistically anticipated revenues to be collected. Consequently, municipalities must seriously assess their revenue situation and financial health for purposes of determining whether or not they have sufficient revenue and adequate financial stability to fund and deliver on their proposed budgets. To this end, municipalities must take into account realistic estimates of revenue to be collected in the current year (2007/08) and actual revenue collected in the preceding financial year (2006/07).

In addition, municipalities are urged to objectively and seriously examine the credibility of their proposed budgets in terms of their spending and institutional capacity. For example, it makes no sense for a municipality to adopt an annual capital budget when it only has a spending and/or institutional capacity to spend half of the amount budgeted.

National Treasury will assess funding compliance on selected municipal budgets to ensure compliance with MFMA section 18. This is a follow up to MFMA Circular 42 dated 30 March 2007.

The purpose of funding compliance assessments are to ensure the budgets of municipalities are adequately funded from realistically collectable revenues based on past performance, cash and unencumbered investments, realistic borrowing as well as previous years' surpluses not committed for other purposes.

The funding compliance assessment will firstly be applied by National Treasury on the 17 non delegated municipalities as part of the 2008/09 MTREF tabled and approved budgets. Once refined, the assessment will be developed into a self-assessment tool which all municipalities will use to ensure their budgets are appropriately funded prior to tabling for consultation.

National Treasury and/or the relevant provincial treasury will independently assess funding compliance of each budget and compare the results to the self assessments carried out by municipalities. In terms of the Constitution and Section 5 of the MFMA, the National Treasury and provincial treasuries will exercise their oversight roles by rejecting and referring back to municipalities those budgets that are not funded in accordance with the MFMA.



## 9. Continuous Improvement in Municipal Budgets

Your attention is drawn to the corresponding section in MFMA Circular 41. While there has been significant progress in these areas by some municipalities it is critical for each municipality to review their own progress.

## Conclusion

The municipal budget process is a holistic exercise linking local imperatives with the strategic priorities of all spheres. Municipalities are required to take a lead in the development of solutions to address local needs and service delivery and in doing so must have regard to national and provincial priorities and policies when formulating the budget, including the containment of tariff and property rate increases within macro economic targets.

Municipalities are encouraged to further develop consultative methods with stakeholders when developing and tabling the annual budget. A single process that links the budget, IDP and LED processes is essential to a sustainable budget. Extensive reforms introduced in 2004 are beginning to take effect but a concerted effort for all municipalities is still warranted to ensure compliant, transparent and realistic budgets are adopted.

Municipalities are reminded to publish their budgets, annual reports and other relevant information on the municipality's website. This will aid in sharing information, limiting the ad hoc requests for similar information, promoting public accountability and good governance.

All relevant documents mentioned in this circular are available on the National Treasury website, [www.treasury.gov.za/legislation/mfma](http://www.treasury.gov.za/legislation/mfma). Municipalities are encouraged to visit this site regularly to download new and important information.

The National Treasury looks forward to receiving the full co-operation and support of all municipalities in the MTREF. For further information on budget related matters, kindly contact **Mr JH Hattingh - Chief Director: Local Government Budget Analysis**, telephone 012 315 5009 or fax 012 395 6553.

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