Republic of South Africa

Medium Term Expenditure Framework Treasury Guidelines:

Preparing budget proposals for the 2007 MTEF

National Treasury

July 2006

The document is available on the Internet at: http://www.treasury.gov.za/document/guidelines

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Overview

These guidelines are intended to assist national and provincial departments in preparing their budgets for the 2007 Medium Term Expenditure Framework (MTEF). They build on previous budget reforms and propose further enhancements to promote effective planning and budgeting.

Over the next two months (July and August), departments are expected to review their medium-term plans and budgets (2006/07 to 2009/10), and decide on revisions that will give effect to policy priorities and programme objectives. In doing so, departments should be guided by Government's broad strategic objectives – growing the economy, expanding social development and achieving greater equity in society. Revisions to the MTEF baselines should also be steered by priorities identified in the Accelerated and Shared Growth Initiative (ASGISA), which may require reallocation of resources within baseline budgets. Responding to the ASGISA objectives will not necessarily result in additional funding, particularly given the already strong growth of baseline budgets.

The 2007 MTEF

For the 2007 MTEF the focus will be shifted from bidding for additional funding to examining past spending performance and assessing the achievement of programme objectives and targets. This focus will entail examination of both financial and non-financial information, which departments can present in a format that best describes the policy objectives and plans of spending programmes.

The main change to this year's process allows for greater flexibility in the manner that departments present their budget submissions. In the main, this will take the form of customized tables that assist in describing how budgets are allocated in support of policy and programme objectives.

The process of planning and budgeting is discussed in **Chapter 2**, which describes the assessment of strategic priorities, the approval of programme structure changes, and the reallocation of funds in line with revised strategic priorities. **Chapter 3** discusses the content of the budget submission and related budget formats. It also provides a brief overview of the link between departmental aims, measurable objectives and how to translate these into indicators and appropriate targets. These requirements will be included in the Appropriation Act from 2007 onwards; hence departments and provinces are encouraged to carefully review measurable objectives and indicators when preparing their budgets.

As in previous budget discussions, the Minister of Finance will consult with provincial counterparts on the 2007 Budget process. This process will be followed by a technical intergovernmental forum in July. These deliberations will assist in formulating an affordable funding level for the Provincial and Local Government's equitable share. The Medium Term Expenditure Committee (MTEC) programme will be finalised after the July meeting of the Minister's Committee on the Budget (MinComBud) and further details will be provided in due course.

Budget submissions from national departments should be submitted to the National Treasury by **Wednesday 16 August**, together with the annexure tables A to C that detail the revised programme objectives and baseline estimates.

Chapter 4 provides additional information on the budget submissions.

Budgeting for infrastructure is discussed in **Chapter 5**. The chapter describes the various categories of infrastructure spending, and the criteria that will be applied when evaluating existing and new projects and programmes. Annexure 5.1 also provides a description of the new infrastructure table that must be completed for all new projects and programmes, according to the definitions outlined in this chapter.

Recognising the uniqueness of certain provincial engagements, **Chapter 6** outlines key dates and interactions within the budget process. Provinces should note this information in addition to the reforms applicable to national departments.

The National Treasury will schedule information sessions on budget submissions and formats, assessment of programme performance and MTEC discussions. Departments will be advised on appropriate dates for these sessions.

The website link containing this guide (*www.treasury.gov.za/documents/guidelines)* will be updated regularly with pertinent information relating to both the MTEF budget and relevant budget reform initiatives. Departments are invited to visit this web link on a regular basis.

Critical dates for the 2007 budget process are provided below.

Critical Budget Process Dates for the 2007 MTEF

Action	Detail	Deadline
Minister's Committee on the Budget (MinComBud) meeting	MinComBud considers MTEF baseline and expenditure reports and budget process	June 2006
MinComBud meeting	MinComBud considers policy and funding issues	July 2006
Intergovernmental (Technical Committee on Finance + meeting)	Joint Forum including officials from Budget Office and Public Finance of the NT, examines intergovernmental implications of MinComBud agreement and draft Division of Revenue (DoR)	Late July
Budget Council Lekgotla	DoR considered by Budget Council	August 2006
MTEF submissions	Departments submit revised MTEF budget proposals	16 August 2006
MTEC hearings	Cross departmental policy discussions and intergovernmental discussions on concurrent functions.	September 2006
MTEC recommendations submitted to MinComBud	MTEC submits 2007 MTEF recommendations to MinComBud for consideration and approval	September 2006
Programme structure changes & measurable objectives finalised	Departments finalise changes to their programme structures & measurable objectives	September 2006
Extended Cabinet Meeting	Extended Cabinet approves DoR	October 2006
Medium Term Budget Policy Statement (MTBPS)	Minister presents the 2006 MTBPS and 2006 Adjustments Appropriation Bill to Parliament	24 October 2006
MTEF approval	Cabinet considers and approves 2007 MTEF	November 2006
Budget Speech	Minister tables 2007 Budget in Parliament	28 February 2007

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Budget Process

Sound budgeting principles require that policy priorities are funded on the basis of affordability and trade-offs that are essential when faced with competing priorities. These principles are fundamental to the South African budget process broadly described below.

This chapter of the *Treasury Guidelines* provides an outline of the budget process. Further guidance is also provided on the content of the budget submission for the 2007 MTEF. Although this chapter broadly relates to the process for both national departments and provinces, **Chapter 6** elaborates further on the provincial process.

The budget consists of a number of legislative bills that are adopted by Parliament: the Division of Revenue Act, Appropriation Act and the Revenue Laws Amendment Act. Once Parliament has appropriated budget amounts to each of the main divisions within a vote, the Executive is tasked with implementation of the budget. The Executive relies on its administration (departments) to implement the programmes funded through the budget. Parliament in turn, exercises its oversight role, by ensuring that the administration implements the programmes approved through the budget. It can do so by assessing the performance of departments through monthly or quarterly in year reports and annual reports.

The MTEF details 3-year rolling expenditure and revenue plans for national and provincial departments. The MTEF budget process is designed to match the overall resource envelope, with the estimation of the current and medium-term cost of existing departmental plans and expenditure programmes.

The MTEF tabled annually in Parliament is guided by the following principles:

- Within limited resources, affordable changes should be used to make trade-offs between and within spending programmes
- Resources should be reprioritised from low priority programmes and activities towards higher priorities and activities
- The allocation of new resources should be driven by the existence of credible implementation plans. This provides greater certainty that services will be delivered as planned.
- An evaluation of past spending performance against measurable objectives and targets should be central to the discussion of future funding.

In summary, the purpose of the budget process is to strengthen the link between policy objectives, implementation plans and available resources. More specifically, the process allows for:

- The revision of the macroeconomic framework, fiscal and budget policy
- Departmental revisions to three year MTEF baselines, and the preparation of detailed, costed plans for possible new funding
- The allocation of available resources between the three spheres of government in line with policy priorities
- Various role-players to provide political and technical advice when faced with trade-offs between competing spending priorities
- The required authority to be obtained from Parliament and provincial legislatures to allocate revenue and to spend.

There are several interlinked key stages in the budget process, which include priority setting, the revision of departmental strategic plans and targets, evaluation of performance through in-year and annual reports, and where necessary, deciding on corrective action. Each of these steps is discussed in turn.

Reviewing policy priorities

Government's broad objectives are to grow the economy, advance social development and achieve greater equity in society. The medium-term plans of departments are informed by these broad objectives, with specific output and targets set out in programmes and sub-programmes.

Revision of strategic plans by national departments

Strategic plans normally cover a period of 3 to 5 years. Once tabled in Parliament, medium-term plans should only be updated with annual revisions after a departmental performance assessment has been completed and corrective measures have been identified. There should be no need to table a strategic plan in Parliament every year, unless there have been significant changes to priorities or significant revisions to targets.

The revision of strategic priorities should be closely linked with the annual performance assessment through the annual report.

Following the annual performance assessment it may be necessary to identify interventions to address slow delivery of services. Any changes to departmental structures should also be considered at this stage. This will ensure that the MTEF budget is linked to revised priorities and new programme structures.

Performance indicators assist in monitoring and evaluating the efficacy of spending programmes and should form an important part of priority setting. Departmental measurable objectives must be informed by the strategic plan and should include appropriate performance indicators.

Achieving the objectives that are set out in the strategic plan requires solid linkages between planning and budgeting and a more rigorous evaluation of budget proposals.

Revision of 5 year strategic plans and annual performance plans by provinces

Only one *Five-year Strategic and Performance Plan (SPP)* per provincial department is produced per election cycle and lays the foundation for the development of the *Annual Performance Plans.*

The purpose of the *Annual Performance Plans* (APP) is to set out what the provincial department intends to do in the upcoming financial year towards progressively achieving the full implementation of the *Five-year Strategic and Performance Plan*. This means specifying measurable objectives and performance targets that will ensure that the provincial department realises its strategic goals and objectives set out in the *Five-year Strategic and Performance Plan.*

A secondary focus area of the APP is to provide annual updates on any changes made to the strategic planning framework set out in the *Five-year Strategic and Performance Plan* – for instance changes resulting from new policy developments or changes in environmental circumstances.

The APP covers the upcoming financial year and the following two years in line with the MTEF. The *Annual Performance Plans* should inform and be informed by the *Budget* and the MTEF and should show how the provincial department's future service delivery plans link to its MTEF.

The in-year implementation monitoring of the *Annual Performance Plans* is done through the *Quarterly Performance Reports,* while the end-year reporting is done in the departmental performance section of the *Annual Report.*

Assessing performance

The main purpose of monitoring the budget against strategic plan performance is to ensure that departments utilise the resources allocated by the Legislature optimally and in terms of the Appropriation Act. Monitoring provides an opportunity for departments and the provincial treasury to take corrective measures where necessary.

The assessment of a department’s performance against its strategic plan is performed through in-year monitoring reports (monthly and quarterly). This assessment will enable the department to determine whether quarterly performance is adequate to meet the projected targets at the end of the financial year. This may translate to an achievement of at least 25 per cent of the annual target on a quarterly basis. If less than 50 per cent of programme targets have been met by September for instance, this may necessitate increased focus on a particular program. The adjustments budget process is an ideal time to consider measures to accelerate performance to achieve annual targets. The adjustments budget formats will be communicated to departments around September. The annual reports, which include financial statements, as well as non-financial indicators allow for a further evaluation of performance, which may affect the strategic priorities and MTEF targets for the two outer years.

Medium Term Expenditure Committee (MTEC)

The 2006 Budget tabled in February provided for strong growth in key government programmes. Expenditure grows in real terms by 6,4 per cent over the MTEF.

In order to measure the success of spending programmes, this year’s MTEC discussion will focus on expenditure outcomes and performance. In some instances, MTEC will adopt the form of individual discussions with departments whilst others will involve joint cluster hearings on cross cutting policy issues.

The MTEC discussions scheduled for **September** will prepare the 2007 MTEF for MinComBud to consider before final Cabinet approval.

MTEC infrastructure subcommittee

As with last year, the Capital Budgets Committee will be responsible for reviewing progress on existing infrastructure projects and programmes where required, as well as assessing new infrastructure funding proposals. For the coming MTEF, the number of new proposals will be limited according to the priorities supported by MinComBud. This committee will meet prior to the MTEC meetings in order to set the broad parameters of the MTEC decisions. **Chapter 5** of the guide provides a description of the various categories of infrastructure spending, and the criteria that will be applied when evaluating existing and new projects and programmes.

Finalising the 2007 MTEF

MTEC hearings will culminate in the tabling of recommendations for the 2007 MTEF for consideration by the Minister’s Committee on the Budget and final approval by Cabinet. The Ministers’ Committee will consider MTEC’s recommendations on:

- The performance of spending programmes in relation to measurable objectives and past targets
- The viability of spending plans relating to any requests for additional funding
- Any adjustment to the baseline of programmes.

Cabinet’s decision on changes to programme allocations to national votes, and provincial and local government conditional grants, will be communicated through National Treasury allocation letters to departments and provincial treasuries in mid-November. Once final allocations letters have been received, departments are required to revise their plans for the 2007/08 to 2009/10 period, and to pay particular attention to priority policies and strategies and the affordability of planned outputs that are published in the **2007 Estimates of National Expenditure (ENE)**.

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2007 Budget Submissions

The 2007 MTEF revisions will focus sharply on outcomes of past spending and performance indicators to examine progress and identify interventions to accelerate service delivery.

Proposals to revise the 2007 MTEF baseline must include the following information:

1. A review of progress on implementation of strategic plans and major shifts in strategic priorities i.e. revised objectives and expenditure proposals for 2007/08 to 2009/10
2. A revised estimate for 2006/07
3. An examination of the current baseline which should include
   - Details of revisions in line with revised strategic priorities and programmes
   - An indication of significant trends in non-recurrent expenditure
   - Possible savings to be realised
   - An assessment of actual spending against allocations and non-financial performance of spending programmes from 2004/05 to 2005/06 and the first quarter of 2006/07
   - Outputs and expenditure of new allocations from 2004/05 to 2005/06 as well as the first quarter of 2006/07
4. Proposed interventions to improve or accelerate delivery on present programmes.

Implementation of strategic plans and revised priorities

The significance of strategic plans and priorities has already been highlighted in **Chapter 2**. Departments need to provide details of amendments to strategic plans for the 2007 MTEF and demonstrate how these will impact on their 2007 MTEF budget when completing Annexures A, B and C.

Revised Estimate for 2006/07

Under this section departments should describe revisions to amounts published in the Appropriation Bill and Estimates of National Expenditure for the period 2006/07. Information provided should include all changes already made, as well as proposed virements that are planned for the remainder of the 2006/07 financial year.

Examination of current baseline

The budget preparation time is ideal for departments to consider reprioritisation of baseline allocation amounts to identify programme objectives that have not been achieved and revise implementation plans accordingly. Moreover, departments may decide to substitute low priority programmes with higher priorities to assist in meeting critical service delivery targets. The revision of baselines should be considered in the context of departmental aims and how these relate to measurable objectives, and should be shown in Annexure A. Should the baseline revisions necessitate a change in the structure of the department, changes should be described in Annexure C. **Chapter 4** provides further guidance on the processes to be followed and approvals required before structure changes may be implemented. Material increases or decreases to baseline allocations will only result from those proposals that are accepted by MinComBud for further consideration this year.

Non-recurrent expenditure

Many departmental programmes include projects that are once-off in nature and the associated costs will not recur once the project is concluded. In order to prepare credible MTEF budgets, these amounts should be excluded when the baseline is re-examined in order to avoid distortions and possible under-spending of departmental budgets. Budget Analysts will work closely with departments to finalise this part of the exercise.

Identification of savings

Any savings identified that result from the revision that is undertaken can be re-allocated to higher priorities in budget submissions, but the revised estimates for the next three years may not exceed the baseline allocations.

Summary of outputs against expenditure for 2004/05 and 2005/06

Significant allocations have been provided in the past MTEF, which should be adequate to address stated policy objectives of departments. Actual audited expenditure per programme should be examined to determine effectiveness of spending. Moreover, budget submissions for all departments must include an analysis of actual performance against targets as stated in the ENE.

Interventions to improve or accelerate spending on existing programmes

Performance assessment and the information required above will enable departments to identify slow implementation of existing programmes and allow for strategies to address service delivery bottlenecks. It is important to ensure appropriate accountability for service delivery when evaluating performance of programmes and identifying appropriate interventions. Successful implementation of these interventions should enable departments to clearly identify programmes that significantly contribute to government's growth strategy and accelerate service delivery.

The Accelerated and Shared Growth Initiative of South Africa (ASGISA) is intended to assist in achieving government's growth target of 6 per cent by 2014. Departmental programmes contributing to this initiative should be clearly highlighted in budget submissions. The ASGISA strategy centres on addressing binding constraints to better performance both on the economic and social fronts. Some of these constraints will relate to addressing outstanding policy decisions or making policy reforms that will facilitate service delivery. Other constraints such as the skills deficit may require additional funding. However, departments should carefully examine their existing baseline budgets and re-align spending priorities before looking to the fiscus for additional funding. MTEC and MinComBud are likely to reward those departments that can convincingly demonstrate an ability to deliver on past commitments and a willingness to be creative in meeting ASGISA imperatives. Once again, past outputs and indicators should be linked to any new initiatives.

New MTEF proposals

Once all the information required above has been completed and if departments still believe they have a strong case for additional resources, then the following information should be submitted:

- Detailed costing of the policy proposals
- Spending plans over the MTEF
- Legislative plans where applicable
- Administrative plans (includes resources like personnel, accommodation and other administrative costs) and
- Implementation plans.

Given the already strong growth in budget baselines, MTEC will raise the hurdle for recommending new funding requests. There is a growing concern that Government is not reaping value for money in many of its present spending programmes and departments will need to demonstrate that current budgets are indeed being utilised efficiently and effectively before new funding is considered. Moreover, the proposals will need to be closely aligned with priorities that are emphasised by MinComBud and Executive more generally.

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Instructions to Departments

This chapter of the *Treasury Guideline* provides further details on budget submissions of departments and includes definitions of terminology relating to the budget formats. In addition to the budget submission information contained in **Chapter 2**, the following areas should also be noted for the 2007 MTEF:

- Growth assumptions and inflation projections for the 2007 MTEF
- Devolution of accommodation costs
- Budgeting for personnel expenditure
- Performance information and measurable objectives
- Prioritising the 2010 Soccer World Cup TM
- Changes to programme structures
- Changes in provincial boundaries
- Skills levy.

Each of these items is discussed in more detail under the respective headings and references to annexures are provided where necessary.

Growth assumptions and inflation projections

The MTEF allocations provide for growth in expenditure at an average growth rate of just over 9 per cent in 2007/08 and 2008/09, and at an average rate of 7,2 per cent in 2009/10. The programme baseline for the third-year is an indicative allocation and may change, depending on a more rigorous examination of programme baselines.

Devolution of budgets to provinces with respect to state owned properties

Prior to 1994, the Department of Public Works (DPW), was deemed the custodian ("owner") of most state-owned properties and therefore took responsibility for the payment of municipal property rates. This practice has continued notwithstanding the separation of ownership of state land between National and Provincial Governments determined by the interim Constitution. From 1 April 2007, DPW will devolve the payment of property rates in respect of provincial properties, to the relevant Provincial Government.

A list of properties deemed to fall under provincial responsibility has been circulated to all provinces for verification in order to advise DPW on whether the information is accurate.

At present not all properties are subject to the payment of rates and taxes. However, the implementation of the Property Rates Act (PRA) may require a rating which will have cost implications for provinces. As a transitional arrangement, DPW will devolve the 2007/08 budget allocation for property which consists of the baseline amounts plus normal inflationary increase for properties; however year 3 includes 15 per cent growth for devolution costs. Provinces will be expected to pay the property rates for all the properties on their respective lists from 1 April 2007 direct to relevant Municipalities. This cost should be factored into the MTEF budget submissions. Progress in this regard will be communicated via the Treasury Committee on Finance (TCF) and Provincial Treasuries.

Budgeting for personnel expenditure

Previous guidelines on personnel budgeting for the 2006 MTEF period were based on the 2004 Wage Agreement, negotiated in the Public Service Coordination Bargaining Council (PSCBC). This agreement was valid for 3 years and ends in the 2006/07 financial year.

Departments and Provinces will budget for a 5,3 per cent wage increase this financial year, which is based on the projected[1] CPIX plus 0,4 per cent. The MTEF makes provision for wage and salary adjustments over the MTEF period, as shown in the table below. The next wage agreement will come into effect from the 2007/08 financial year. Negotiations in this regard have not yet begun in the PSCBC, hence the estimates may have to be revised once the agreement is in place.

Projected salary increases for the 2007 MTEF

2007/08	2008/09	2009/10
5%	5%	4.5%

Performance information and measurable objectives

Performance information indicates how well a department is performing against its aims and objectives and assists in determining budget allocations. This system requires moving from an input-based budgeting to an output-based results-oriented system and links the use of resources (inputs) to objectives (outputs and outcomes) and performance. Credible measurable objectives and related targets and outputs will assist in achieving departmental aims and contribute toward government's objectives. In future, this area will inform decisions on allocations of resources. It is important to set realistic targets, linked to resources allocated to a spending programme and to measure performance against targets, monthly, quarterly and on an annual basis.

National Treasury will shortly issue a detailed guide on performance information as we intend to monitor departmental measurable objectives and outputs in future. The 2007 MTEF provides a critical opportunity to examine current objectives and achievement of targets and to take corrective action where necessary.

Budgeting for 2010 Soccer World Cup ™

Various national and provincial departments will have to adjust their spending plans for the 2010 **Soccer World Cup ™** preparations. As with other government priorities, no new funding will be available for this initiative, hence spending needs should be accommodated within reprioritization of baselines.

Guarantees: Eleven departments (Home Affairs, National Treasury, Safety & Security, Communications, Transport, DEAT, Trade and Industry, Justice and Constitutional Development, Foreign Affairs, Sport and Recreation South Africa and Health) have provided guarantees to FIFA for the 2010 Soccer World Cup **™**. These guarantees have been classified into two categories:

Major expenditure (mainly significant capital works): Sport and Recreation South Africa (stadia), Transport (Infrastructure - road upgrades etc), Communications (Appropriate Broadcast Technology), Safety & Security (Additional Human Resources and Surveillance Technology).

Lesser expenditure mainly additional human resources in the department to deal with 2010 matters: Home Affairs, National Treasury, DEAT, Trade & Industry, Justice and Constitutional Development, Health and Foreign Affairs.

[1] This projection was applicable to the 2005 ENE Guidelines.

Relevant departments should submit budget proposals for specific 2010 Soccer World Cup TM projects at the MinComBud forum. The proposal should include:

- The name of the department and the 2010 project
- A description of the project, including a clear indication of the readiness of the department to implement the project within the 2007 MTEF and the procurement schedules
- Planned outputs and links to other 2010 projects (e.g. connecting stadia to roads/rail links etc)
- Estimated budget implications especially "spikes" in the outer years (recurrent and non-recurrent expenditure)

Departmental budgets should clearly illustrate amendments to spending plans to cater for the 2010 Soccer World Cup ™ and consider maintenance of infrastructure beyond 2010. This will form a key component in future budget assessments.

Amendment of programme structures

Proposals to amend programme structures must be included in the MTEF budget submissions. Budget proposals should thus be submitted in the format which approves new structures. Changes to the budget programme structure of a department may not be made without prior National Treasury approval. These requests, including a detailed motivation on how the changes will affect the aims and measurable objectives of the department, should be submitted to the National Treasury by 16 August 2006 prior to MTEC meetings.

Changes to the budget structure of a department will affect the funds allocated per programme/sub-programme; hence departments must amend the historic expenditure numbers for the past three years in the 2007 ENE database to ensure that the expenditure trends are comparable with the outer years. Annexure C provides further guidance on the formats for old and new programme structures.

The following summary of responsibilities of programme managers may assist with management and revisions to programme structures:

- An accounting officer must designate a programme manager for each programme, or for each sub-programme in the case of associated service programmes, to control, co-ordinate and evaluate the executive programmes for the objectives concerned at a policy level and to be accountable to the accounting officer.
- The designated programme manager will act as liaison and representative for his/her programmes(s)/sub-programmes(s) of the organisational units in the programme/branch. In this capacity (s)he promotes the interests of his/her programme in the programme/branch and endeavours, in co-operation with the accounting officer, financial manager and other programme managers, to accomplish financial equilibrium between programmes during the allocation of the restricted available funds. Departments are requested to keep the National Treasury informed of the names of their relevant programme managers and the programmes controlled by them.

Revisions to provincial boundaries

Cabinet resolved on 5 November 2002 to do away with cross-boundary municipalities and to ensure that provincial boundaries be aligned accordingly. After in-depth consultation, the Minister for Provincial and Local Government requested Cabinet to approve the proposed realignment of provincial boundaries to eradicate cross-boundary municipalities. The required legislation has been amended by the Department of Provincial and Local Government, together with the Department of Justice and Constitutional Development to provide for the above changes to provincial boundaries. Further, the Cross-Boundary Municipalities Laws and Repeal and Related Matters Act, 2005, was enacted to facilitate consultation between the releasing and receiving provinces.

Below is a summary of the changes gazetted:

1. The Ekurhuleni Metropolitan Municipality (Gauteng/Mpumalanga): The existing metropolitan boundary to remain unchanged and the Mpumalanga portion which is currently included in the metropolitan, be excluded from Mpumalanga and to be included in Gauteng;
2. The Tshwane Metropolitan Municipality (Gauteng/North West): The North West portions, which are currently included in the Tshwane Metropolitan Municipality, should be excluded from the North West Province and included in the Gauteng Province;
3. The West Rand District Municipality (CBDC8) (Gauteng/North West): The cross-boundary local municipality of Merafong City and the local municipality of Westonaria be incorporated into the North West Province. The local municipalities of Randfontein and Mogale City and the entire area of the District Management Area (DMA) should remain in Gauteng;
4. The Frances Baard District Municipality (DC9) (Northern Cape/North West): The North West Province portion in the cross-boundary Phokwane Local Municipality (CBLC7) be excluded from the North West and included in the Northern Cape Province;
5. The Kgalagadi District Municipality (CBDC1) (North West/Northern Cape): The entire area of the Ga-Segonyana Local Municipality be included in the Northern Cape Province. The Gamagara Local Municipality should remain in the Northern Cape Province;
6. The Metsweding District Municipality (CBDC2) (Gauteng/Mpumalanga): Should be incorporated into the Gauteng Province;
7. The Sekhukhune Cross-Boundary District Municipality (CBDC3) (Mpumalanga/Limpopo): The Mpumalanga portions of the Sekhukhune Cross-Boundary District Municipality (CBDC3) be incorporated into the Limpopo Province. This means the boundary of the Province would be the existing southern boundary of the district;
8. The Bohlabela District Municipality (CBDC4) (Mpumalanga/Limpopo): The Bushbuckridge Local Municipality (CBLC6) be wholly located in Mpumalanga with Maruleng Local Municipality (NP04a1) remaining in the Limpopo Province. The existing Kruger National Park District Management Area should be split along the Olifants River, the southern portion linking to Mpumalanga and the northern portion being the responsibility of a municipality in the Limpopo Province; and
9. The KwaZulu-Natal/Eastern Cape Boundary: Umzimkhulu Local Municipality should go to KwaZulu-Natal as part of the Sisonke District Municipality. Matatiele Municipality should go to the Eastern Cape as part of the Ukhahlamba District Municipality. Umzimvubu Local Municipality should be included in the Ukhahlamba District Municipality and Alfred Nzo District Municipality to be reconstituted.

Considering the magnitude of the implementation of the newly demarcated provincial boundaries, particularly from a financial perspective, the National Treasury included clauses in the Division of Revenue Act, 2006, to defer the implementation of the new boundaries to 1 April 2007.

The 2007 Budget to be tabled by the Minister of Finance in February 2007 will have to reflect the new provincial boundaries. To meet that deadline, all technical work will have to be finalised before the tabling of the 2006 MTBPS in October 2006.

Responsibilities of national departments

National departments responsible for concurrent functions like education, health, social development, housing, etc should take a lead role in ensuring the smooth transition to the newly demarcated provincial boundaries. In this regard, national departments should ensure that:

a. The functions are administered fully in terms of their sector legislation and in terms of the Division of Revenue Act. Any deviation from these legislation should be reported to the National Treasury;

b. It supports the provincial processes that seek to ensure that all assets and liabilities of the affected areas are clearly identified prior to their transfer by the releasing province to the receiving province;

c. All national policies implemented at a provincial sphere are aligned to newly demarcated provincial boundaries; and

d. All allocations should be in line with the new provincial boundaries from 1 April 2007. National departments administering conditional grants should realign their conditional grant allocation mechanism (formulae) to the newly demarcated provincial boundaries. In this regard, all data used in the respective formulae should be amended in terms of the new provincial boundaries.

Responsibilities of provincial governments

Provincial governments need to ensure that their budgets (revenue, expenditure, financing) is aligned to the new provincial boundaries.

Provincial own revenue

There will be shifts in provincial own revenue. When preparing their budgets, provinces must ensure that the impact of these shifts are taken into account. Provincial own revenue is affected in two ways:

a. Firstly there are shifts in the revenue bases of provinces. Some provinces release own revenue generated from motor vehicle license fees, gambling and health patient fees while others will receive added income from these; and

b. Secondly, there needs to be realignment in the tariffs rates of the respective provinces. This is mainly with respect to motor vehicle license fees where provinces have different rates for the different vehicle classes.

Contracts entered into with external agencies to collect provincial own revenue need to be revisited, assessed and possibly transferred from the releasing to the receiving provinces.

Provincial expenditure planning

In preparing their budgets for the 2007 MTEF, provinces must ensure that their expenditure responsibilities are fully aligned with the newly demarcated boundaries. This process should be speeded up and is independent of the reconfiguration of the equitable share and conditional grant formulae currently underway. In this regard:

a. A clear assessment of the expenditure responsibility that needs to shift from one province to another needs to be undertaken. This should include an assessment of each and every provincial department;

b. The implications for personnel as far as it relates to service conditions needs to be assessed;

c. The implications for government policy must be must be carefully considered. In education, for example, there is a difference between the school year and the financial year. The impact of this needs to be assessed and carefully managed;

d. Projects currently underway in the affected areas need to be carefully monitored and where some projects will be spilling over into the new financial year, the transfer thereof needs to be dealt with and be provided for in the budgets;

e. A full assessment of the assets and liabilities, as it relates to the affected areas, needs to be conducted.

Financing and general financial management

There may be a case for the affected provinces to enter into agreements for the financing of functions/projects where commitments are made in the 2006/07 financial year and finalisation thereof is in the next financial year (2007/08). Provinces are encouraged to assess progress in the implementation of these projects and speed them up to ensure that they are completed in the current financial year.

If the need arises, the National Treasury will, when it sends out its guidelines for the preparation of annual financial statements, deal with pertinent financial management issues.

Skills development funding in National Budgets

The Skills Development Act, 1998, established 23 Sectoral Education and Training Authorities (SETAs) across various sectors, to co-ordinate training and learnership programmes in terms of the National Skills Development Strategy: 2000-2005.

It is not mandatory for a public service employer in the national and provincial spheres of government to contribute directly to a SETA. However, they must budget for a **minimum of one per cent of payroll** for the training and education of departmental employees. In this case 'payroll' refers to the total wage bill of the department. This is essentially the total package of the employee and not just the basic pensionable salary. Moreover, this definition includes all employees; permanent, contract, temporary and so forth.

Cabinet has subsequently agreed that each department should contribute 10 per cent of the 1 per cent of payroll to the line-function aligned SETA in order to support the relevant SETA's administrative costs, thus giving effect to Section 30(b) of the Act.

5

Budgeting for infrastructure and capital expenditure

This chapter provides guidance on new and existing infrastructure proposals. All funding requests relating to infrastructure and large capital acquisitions are to be motivated separately from other budget proposals, as these will be reviewed and appraised by a separate sub-committee of MTEC, called the Capital Budgets Committee.

The Capital Budgets Committee (CBC), is an interdepartmental task team, set up during the 2005 MTEC process to undertake the review of funding requests for individual infrastructure/capital projects and programmes of departments and entities. The CBC makes recommendations to the Medium Term Expenditure Committee (MTEC) with regards to the funding of infrastructure projects and programmes as well as large capital acquisitions.

It is the intention of the CBC to develop and implement a more rigorous approach to the appraisal of capital expenditure projects, as well as to encourage the progressive advancement of in-house project appraisal capacity within departments and entities. The reason for this approach is to ensure that funding is prioritised and directed towards maximum economic and social benefit, and that all large and ‘mega’ projects and capital acquisitions have been well thought-out from many different perspectives, accurately costed, risk assessed, strategically aligned, and make sense from an operations point of view.

All infrastructure/capital funding requests and associated explanatory and supporting documentation, motivations and feasibility studies, etc are required before the start of the MTEC process by 16 August 2006 in order to allow the CBC to undertake a proper review of such requests across all departments and associated entities. A Project Concept Note is also required for all projects or programmes to be appraised and is to be attached to the front cover of supporting documentation

The type and depth of information required for appraisal will depend on the size and nature of the capital project being considered. Resources spent on compiling particular project bids should be proportionate to the likely cost of a project, keeping in mind its nature and complexity. All infrastructure projects, programmes and major capital acquisitions must be classed according to three broadly pre-defined categories. These categories will require different levels of analysis and information as they have different budgetary implications and will thus be appraised accordingly. These categories are outlined below.

Classification of Capital Projects and Programmes

Funding requests for infrastructure and capital projects and programmes must be classed according to the category into which they fall. There are three broad categories of projects/programmes as follows:

- **“Mega”** projects or programmes: which are estimated to cost more than R250 million (in total), or have a borrowing or PPP component
- **“Large”** projects or programmes: which are estimated to cost less than or equal to R249 million but more than R20 million.
- **“Small”** projects or programmes: which are estimated to cost less than or equal to R20 million.

Within these broad categories projects can either be *existing projects* or *new projects*. These are discussed in more detail in the paragraphs below, and will be further clarified by the respective budget analyst.

Note on Mega projects and programmes (Over R250 million)

Mega projects consist of all new or existing large infrastructure projects, programmes and capital acquisitions that require *R250 million or more*, either from the fiscus, from departmental virements and savings, inter-departmental or inter-sphere funding, or through borrowings (from private or public institutions). All projects that extend beyond the MTEF period, also fall within the "mega" category. Being the largest capital commitments on the fiscus, mega projects and programmes will require the most detailed information and preparation and will follow a more rigorous review by the CBC in order to lower various risks of project failure as well as the chances of under-expenditure. Detailed feasibility studies are thus required for all mega projects and programmes.

Note on the Extension of Existing capital projects or programmes (Small, Large, Mega)

Funding for "Existing" projects or programmes is either based on the need to complete or the need to extend, based on new needs, within an existing project or programme. Where many small projects (under R20 million) exist, these may be grouped together and motivated as an infrastructure programme requiring extension. Within this category, it is important to give an accurate and detailed account of the history of the existing project or programme, an assessment of its output performance, the change in needs if applicable, and sound reasoning motivating the extension in respect of timing and expenditure as applicable. Ongoing infrastructure transfers to public agencies, entities and other spheres, which require further support may also be motivated under this category.

Note on New infrastructure projects and programmes (Small, Large, Mega)

These are infrastructure projects and programmes, which have not been funded before. New small projects (under R20 million), which are not part of an existing programme, may be grouped together and motivated as a new infrastructure programme. All new infrastructure projects or programmes will require some form of appraisal to be submitted which may vary depending on the size of the project or programme.

Appraisal and submissions for capital funding

Departments and entities are responsible for the appraisal of projects and programmes that require funding. The CBC will undertake a review of appraisals submitted and make recommendations on scarce resources within an environment of 'competing' requests. Therefore the onus is on departments to provide as much detail as possible, and ensure that motivations, feasibility studies and other supporting documents are comprehensive and realistic, to support funding requests. If time permits, the CBC may request further clarity on pertinent issues or request a discussion with officials from the department, as it is not always possible to cover all aspects of the wide variations of requests from departments in a guideline.

The section below sets out some questions/requirements that departments could answer within their motivating documents to demonstrate advanced planning and/or implementation readiness in their capital budget requests. As mentioned the level and detail of information required should vary with the category of project or programme being assessed. In general, the submission should be laid out as a discussion, with supporting graphs and tables where statistical information requires to be illustrated. Different programmes and large and mega projects each require their 'own' submission.

Needs Analysis

A needs analysis must demonstrate why a particular project is required and how the project or programme is aligned to the strategic objectives of an institution. In performing a needs analysis, the following aspects need consideration:

- What are the statistical trends and key indicators in the relevant area of service delivery that point to the need or increased demand at this time and location (if applicable)?
- Assess the extent and urgency of the need and the consequences if the need is not met. What is the rate of increase of pressure on the system, (both peak and average) if this is applicable? By what systems are people/users currently coping etc, and what is the impact on them?
- What proportion of the need is the request intended to fulfil, and how far into the future (at the current rate of increase of the need) will it be operational?
- What are the proposed outputs and outcomes, i.e. what will be built/ procured and how many will it serve, how, and for how long?
- Demonstrate that the project/programme fits with your overall departmental strategic plan or infrastructure delivery plan (supply this as well)?

Options Analysis

All possible ways of meeting a need should be identified and examined critically when considering project options. A discussion is required on other options considered. These should comprise a range of viable solution options available for providing the specified outputs (e.g. service to be provided as a result of capital project). The department should explain why the proposal under consideration was selected as the preferred option and why other options have been rejected.

Cost-Benefit Analysis

1. Show the build-up of all costs, present and future, and all assumptions made including escalation, exchange rates, tender estimation etc;
2. Show the estimates of all revenues (if relevant);
3. Identify the proposed or perceived economic and social benefits (to the country and individuals with respect to cost and time saving, positive externalities, etc.) of the project or programme, present and future, and all assumptions made;
4. Quantify the social and economic benefits as far as possible over time;
5. Perform a financial and economic Net Present Value (NPV) analysis on costs and revenues outlining all assumptions made including financial and social discount rates (see social discount rate given below).

Lifecycle Costs and Affordability

1. What are the operational implications of the infrastructure or capital acquisition on the budget of the department/entity in future years (e.g. more staff, maintenance etc) and is this affordable and sustainable?
2. What are the operational impacts and responsibility implications on other spheres of government and demonstrate their agreement in this regard?
3. If funding is required for a public entity, demonstrate why this should be funded by taxpayers and not the users. Demonstrate that the project assists the financial turnaround of the entity, if so.

Implementation Readiness

1. Indicate the project stage (identification, feasibility, design, tender, construction, etc).

2. What is the proposed start target date for construction and what is the estimated construction duration for the project? Outline the implementation schedule of the project or programme. Does it extend beyond the MTEF period?

3. Who are the intended implementation agents; public works, own department, private sector, etc, for the various stages from design, to construction to project management and monitoring?

4. Discuss the level of planning already undertaken/achieved on the project or programme, and what still needs to be done.

5. Are there other stakeholders that are required to make this project or programme succeed? If so, what is the status of formal negotiation and stakeholder buy-in?

6. What are the risks and constraints faced in the delivery of the project/programme?

7. If an extension of an existing project or programme is being motivated, demonstrate the success of the project or programme with respect to expenditure and physical output.

Funding and Approvals

1. Does this type of infrastructure generate ongoing user revenue? Does a trading account exist for this purpose?

2. What are the funding sources that have been considered?

3. Outline the proportional contributions from each funding source.

4. If relevant, why was a PPP option not considered?

5. List all approvals and permissions obtained for the project/programme including environmental (EIA's) etc.

Notes on Project Appraisal

There are a number of resources including books and courses on how to appraise projects and programmes. Departments are urged to capacitate staff in this important field of study as infrastructure delivery becomes an urgent priority for our country. It is the intention of the National Treasury to progressively require more detailed analyses as funding requests are becoming larger compared to available resources. Under these circumstances it is appropriate to prioritise requests which can demonstrate the largest benefits to our country.

The brief sections below, whilst not exhaustive in the field of Project Appraisal, may assist in enhancing the quality of bids.

Cost-Benefit Analysis

Costs and benefits should be extended to cover the useful lifetime of a project under consideration. Based on the net result of economic benefits minus economic costs, decision-makers will determine whether a particular project or programme is a worthwhile investment – keeping in mind that benefits need to be maximised for society.

Departments must take account of the extent to which projects incur costs over a period of years. Costs should reflect the value of resources displaced (i.e. opportunity cost[2] to society) as a result of the project. Departments must identify and calculate all costs associated with the planned investment; these should include but should not be limited to:

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[2] The value of a resource in its next best alternative use – e.g. suppose a department wants to use a piece of land for a park. In calculating the cost of the park, the department should include the value of the land in its next best use.

- Capital or construction costs (e.g. land, buildings, equipment, labour costs, consultancy fees, contractors, any other pre-production expenses)
- Annual operating costs (e.g. purchases of additional equipment, personnel costs, loan repayments and associated interest, any other operational costs)
- Annual maintenance costs
- In addition, all *non-quantifiable* costs should be listed and described as a matter of public reference.

When gathering data on the cost of inputs local contractors should be consulted and only where the inputs do not exist locally should the imported cost be used. Inflationary and exchange rate factors should also be accounted for as costs escalate over time.

Benefits should be a measure of all the direct social and economic benefits as a result of the project. This measures the *direct effects* that result from the project, usually in the form of revenue earned and employment created. All non-quantifiable benefits should also be listed and described as a matter of public reference.

Externalities are costs and benefits to society that arise from a project but that are not experienced directly by either the project owner or the direct project beneficiaries. They can include environmental, economic and social impacts, and can be both positive and negative. Negative externalities should be included as economic costs and positive externalities should be included as economic benefits – only externalities that result in a significant effect should be included.

An example of a negative externality is environmental pollution or degradation as a result of the project. Displacement effects can also be seen as a negative effect (and should be included as a cost). These are the extent to which a project takes market share, labour or land from existing local firms

Positive externalities can be both social and economic. An example of economic positive externality is the additional value-added generated from direct effects (i.e. *multiplier effects*). These initial effects result in additional effects known as indirect effects, and induced effects.

- *Indirect effects* occur when local businesses benefit from increased purchases of production materials and services due to the project. These are second round effects.
- *Induced effects* arise when those households who benefit from an increase in direct or indirect expenditures spend a portion of their income locally.

Indirect and induced effects thus expand direct spending by a multiple. The *multiplier* (expenditure multiplier) thus measures the extent to which initial expenditure on a project or programme in a locality leads to additional expenditures in the local economy. The multiplier is calculated by dividing the total change in economic activity by the change in initial direct spending.

Discounting

The economic desirability of a project is determined by the net present value (NPV) of its incremental net economic benefits. Costs and benefits occurring at different times must thus be discounted. A discount factor allows us to compute the present value (PV) of a Rand received or paid in the future. The NPV of a future stream of net benefits, $(B_0 - C_0)$, $(B_1 - C_1)$, $(B_2 - C_2)$,… $(B_n - C_n)$ can be expressed as follows:

$$NPV^0 = \frac{B_0 - C_0}{(1+r)^0} + \frac{B_1 - C_1}{(1+r)^1} + \ldots \frac{B_n - C_n}{(1+r)^n}$$

$$= \sum_{t=0}^{n} \frac{(B_t - C_t)}{(1+r)^t}$$

where B represents benefits, C represents costs and r is the discount rate which we set at 9 per cent and may be changed by Treasury from time to time.

Risks and Contingencies

Departments must identify and assess the main areas of risk that might prevent a project from delivering anticipated results/outputs. Examples can include:

- Cost overruns
- Difficulties in securing statutory consent
- Delays in project implementation

Recognising risks will better equip stakeholders with the information needed to manage them. These can also relate to the operational phase of a project, e.g. training needs, etc.

Sensitivity Analysis

For large projects, costs should be readjusted to reflect different scenarios based upon variations in key assumptions – e.g. what is the effect of a 10 per cent increase in costs, or what is the effect on the cost of imported inputs if there is a 5 per cent devaluation in the exchange rate?

Example of a scenario analysis for variations in inflation

Risk Variable	**Cost Variations**		
	Pessimistic scenario (6%)	**Baseline Case (4,7%)**	**Optimistic scenario (4%)**
Inflation	R102 000	R100 000	R98 000

Cost-Effectiveness Analysis

Cost-effectiveness analysis (CEA)[3] is a tool that can help to ensure efficient use of investment resources in sectors where it is difficult to value benefits in monetary terms. It is used for the selection of alternative projects with the *same objective* (quantified in physical terms), and has been most commonly used in the evaluation of social projects – e.g. health or education sector.

CEA is employed to find the least cost way of determining a capital project objective. When conducting a CEA the following steps need to be undertaken:

- Identify and quantify the expected result/benefit of the project in physical terms (e.g. number of road accidents avoided, number of patients lives saved, etc.). Consider, what are the programme outputs and which one of these may be considered predominant?
- Determine the total cost of the project or programme (only direct resources that have a well-defined monetary value are included)
- Determine the Cost-Effectiveness ratio (CER)
- $CER = \dfrac{Costs}{Effective\ Benefit}$

[3] CEA can identify the alternative that, for a given output level, minimises the actual value of costs, or, alternatively, for a given cost, maximises the output level.

Examples:

Cost-effectiveness of three independent programes

1. Health sector

Programme	Cost (R thousands)	Health effect (life-years gained)	CER
A	150,000	1850	81.08
B	100,000	1200	83.33
C	120,000	1350	88.89

Programme A is thus the most cost-effective

2. Road maintenance projects

Programme	Cost (Rand per km)	Increase in expected life (years)	CER
A	210,000	8	26,250
B	140,000	6	23,333
C	250,000	10	25,000

Project B is thus the most cost-effective

Annexure 5.1: Project Concept Note for proposed capital project/programme

1.	Project name:
2.	Contact details of Project Officer:
3.	Project goal/objective:
4.	Brief project description (not more than 500 words):
5.	Proposed location/address:
6.	Estimated construction duration (in months):
7.	Estimated project cost before tender (R thousands per annum over MTEF):
8.	Any other sources of funding (R thousands):
9.	Briefly outline the expected Social and Environmental benefits:
10.	NPV of cost-benefit analysis:
11.	Cost-effectiveness ratio:

6

Provincial budgeting process

In addition to the information provided in the previous chapters, provinces have further requirements to meet in terms of their budget process. This chapter is intended to highlight these differences

Constitution and Budget Process

Section 215 of the Constitution recognises the importance of the Budget and the budget process, by stating that "national, provincial and municipal budgets and budget processes must promote transparency, accountability and the effective financial management of the economy, debt and the public sector". Chapter 4 in both the PFMA and MFMA give effect to this provision, by requiring transparency in the budget process and budget documents.

Linked to the budget process are the fiscal powers of the provincial and local spheres of government. Sections 226 to 230A deal with intergovernmental fiscal matters as well as fiscal and financial powers of provincial and municipal governments. These sections deal with the taxation and borrowing powers of provinces and municipalities, and also establish similar obligations on when funds may be withdrawn from the provincial revenue fund, and what entitlements provinces and local government have on their equitable share allocation from the National Revenue Fund, to ensure that they have the financial resources to provide basic services and perform the functions allocated to them.

Co-operative governance

The South African Constitution enjoins the three spheres of Government to co-operate in policy-making and implementation. All spheres of Government have to face the challenge of aligning their policy and implementation processes. In the context of a young democracy, such co-operation is critical, particularly for shared functions.

The following intergovernmental forums all play an important role in shaping policy and resource-allocation decisions:

- Extended Cabinet and President's Co-ordination Council, which comprises of the national executive, nine premiers and the chairperson of the South African Local Government Association (Salga) for Extended Cabinet. The Extended Cabinet is the highest co-operative mechanism advising the national Cabinet when finalising the fiscal framework and division of revenue on which MTEF budgets are based.
- Budget Council, which is constituted by the Minister of Finance and the nine Members of the Executive Council responsible for finance in the provinces.
- The Budget Forum, which is made up of the Budget Council and local government representatives.
- MinMECs, which are sectoral policy forums of the Ministers and their provincial counterparts.
- Joint MinMECs between selected sectors and the Budget Council.

There are also several intergovernmental forums comprising of senior officials which provide technical support to the political forums.

One measure bearing fruit is the peer learning forums established for financial officials in key sectors like education, health, social administration, housing and roads etc. These forums have contributed to developing uniform approaches to common challenges, providing a forum for promoting best practices, and at the same time allowing for comparisons of similar activities between different provinces. The forums need to be expanded, to cover non-financial aspects for non-financial staff, in areas like planning, personnel management, procurement and infrastructure.

The provincial budget process is to a large extent parallel to the national budget process and also dependent on it. The processes at the national level of government inform the provincial budget process and spells out what is deemed as priorities that have to be met and funded by the provincial budget.

The January Cabinet Lekgotla, State of the Nation address by the President and the State of the Province address by the Premier lay the foundation on what has to be considered in the 2007 provincial budgets and they normally shape the MTEF budget priorities. Provincial priorities, finding expression in the national priorities (outlined in **Chapter 2**), have to be firmed up at this stage. They include the following:

- A core priority is to strengthen education and improve performance of the labour market. Investing in people and ensuring that skills development complements employment creation are critical platforms on which to build future prosperity.
- Alongside an expanded income security net, shared growth must also involve targeted welfare services and stronger partnerships with non-governmental welfare organisations. Addressing the impact of HIV and AIDS, care of child-headed households and appropriate management of children in conflict with the law are among the social service priorities.
- Housing delivery needs to be accelerated, together with municipal capacity building, and investment by both the public and the private sectors to improve the quality of life in poor neighbourhoods.
- Economic infrastructure upgrades will include new power generation capacity, rehabilitation and expansion of road and rail transport networks, improved water resource management and modernisation of communications.
- Industrial development, investment in science and technology, and employment creation will receive additional support. Initiatives promoting small business development and more effective economic regulation are aimed in part at bridging the divide between the formal and informal economies.
- Reducing crime, improving the performance of courts and security services, and improving traffic management and enforcement remain key priorities.
- South Africa continues to extend and deepen its diplomatic presence on the African continent and participation in various international forums. Defence modernisation and military skills development are boosted over the period ahead.
- Public administration reform is now strongly focused on building local government capacity, training and organisational reforms are under way across the public service, together with investment in improved government accommodation and information systems.

Provinces should, within their resources; aim at addressing all or some of these priorities of government. There should also be an attempt to link these priorities with the Provincial Growth and Development Strategies (PGDS) and the Integrated Development Plans (IDPs) at municipal level. During the deliberations with provincial departments, provincial treasuries should ensure that this linkage is reflected between various departmental programmes and the PGDS and the IDPs

Preparation of Annual Financial Statements and Annual Reports

The months of May through to July are the most critical in the provincial budget process. After the financial year end in March, Provincial Departments have two months to submit their pre-audited *Annual Financial Statements* (AFS) to the Office of the Auditors-General. During this period, Provincial Departments are expected to finalise their 2006 *Annual Reports*. The 2005/06 Annual Reports have to be tabled in the provincial legislatures at the end of July 2006.

Annual and Quarterly Reports: Exercising Oversight

The Constitution vests the National Assembly and provincial legislatures with the power of oversight over their executives. Section 55(2) outlines the oversight powers of the National Assembly, by requiring that it "must provide for mechanisms to ensure that all executive organs of state in the national sphere of government are accountable to it; and to maintain oversight of the exercise of national executive authority, including the implementation of legislation; and any organ of state." Note that this power of oversight is not given to the NCOP, as it is expected to play a different role in facilitating intergovernmental relations (co-operative government) in addition to its powers of approval of legislation. Provincial legislatures are provided with similar oversight powers as the National Assembly in Section 114(2), but over provincial executive organs of state.

Whilst the legislative powers of Parliament and provincial legislatures are important for the approval of budget legislation, the oversight powers of the National Assembly and provincial legislatures are important with regard to monitoring and evaluation of the performance of departments and public entities. This is particularly important for the process of considering annual reports, which process needs to be formalised in the same way as Parliament and provincial legislatures have formalised their budget approval processes.

The Constitution recognises that legislatures have a critical role to play in overseeing better performance in the delivery of services. The challenge facing incoming members of Parliament and provincial legislatures is to improve the capacity of portfolio committees to hold departments to account for their performance, using their budget documents, strategic plans and annual reports.

The PFMA and MFMA give effect to management reforms that places greater implementation responsibility on managers in the public service, and make them more accountable for their performance. In the first instance, it is left to the Executive Authority (Minister or MEC) or Executive (Cabinet or Exco) to resolve any management failures – however, thereafter, the National Assembly and provincial legislatures are vested with the power to oversee both the administration and the executive.

Annual reports allow Parliament to evaluate performance of a department after the end of the financial year, whilst in-year quarterly reports allow Parliament to monitor performance during the financial year. However, oversight mechanisms in legislatures are relatively weak, as legislatures previously focused on narrow financial oversight only, through the public accounts committee process. Before 2000, there was no oversight over non-financial service delivery performance, and departments only tabled their financial statements and audit report, rather than an annual report.

Recent reforms since 2000, enacted through the PFMA and Public Service Act, now require that performance targets (through the ENE or departmental strategic plans) are tabled with budgets at the start of the financial year, and that annual reports are tabled within 6 months of the end of each financial year.

Annual Reports

Annual reports are the key reporting instruments for departments to report against the performance targets outlined in the *ENE* (or strategic plans) published in the budget, and linked to the measurable objectives in that budget. Annual Reports therefore should contain non-financial service delivery information, in addition to financial statements and the audit report.

Given this new practice of tabling annual reports, the National Assembly has yet to develop a formal process (and rules) to consider such reports, in the same way that it processes the budget. Like the second reading process, all portfolio committees should consider the departmental annual report soon after its tabling, where it assesses the performance of the department at the end of the financial year, using the annual report. If a portfolio committee completes its hearings on annual reports by the end of October or November, it could also feed into the next year's budget allocation process, thus strengthening Parliament's involvement in the budget process (as these hearings will occur at the same time as the MTBPS).

In developing such a system, legislatures will need to differentiate between the roles of the portfolio and public accounts committees with regard to the 'processing' or use of annual reports. Issues to resolve include: which committee considers the annual report first, and when? Does the portfolio committee consider such reports first, making an assessment on both the financial and non-financial reports? Should the public accounts committee only consider financial or audit issues not resolved through hearings of the portfolio committee? Should each portfolio committee also issue a formal oversight report, commenting on the annual report, on the performance of the department or the quality of performance information, and also to make recommendations on corrective steps to be taken?

The challenge facing portfolio committees is that they ensure that departments provide good quality non-financial service delivery information in their ENE (or strategic plans) with tight performance targets, to then ensure that such departments report against those targets in their annual reports.

In-year monitoring

In addition to post-financial year evaluation, the legislatures can also oversee budget implementation during the financial year, using the monthly National Treasury gazettes in terms of Section 32 of the PFMA.

Whilst the monthly reports are more important as a management tool, the quarterly reports could be used by legislatures as part of an in-year monitoring mechanism. The last Parliament established a Joint Budget Committee to process the quarterly reports, and tabled formal reports in the National Assembly. Similarly, in provinces, most finance portfolio committees have hearings to discuss each quarterly report, but do not necessarily issue a formal report to the legislature.

Sectoral portfolio committees can also use the quarterly reports to assess in-year performance of departments. This will be even more possible if the current monthly financial reporting system is complemented by a system of quarterly non-financial performance information. Such information will come with a similar lag as the financial information, i.e. 30 days.

There is a need to streamline performance measurable objectives to focus on outputs, and separate these from management or process objectives. Further, more information may be required on the use of important inputs (personnel, textbooks, medicines), as the public sector is still inefficient in the use of such inputs.

For concurrent functions that are shared with provinces, the steps taken by the National Treasury in collaboration with Provincial Treasuries and National Departments and sectoral MinMecs to develop sector-specific budget and performance formats requires the strong support of all national and provincial legislatures. This approach allows for comparability of information and performance of the same functional department across sectors, and makes publications like the Intergovernmental Fiscal Review possible.

The main objective for producing this information is to enable Parliament and national and provincial executives to hold government departments accountable for their performance.

Role of Public Accounts Committees

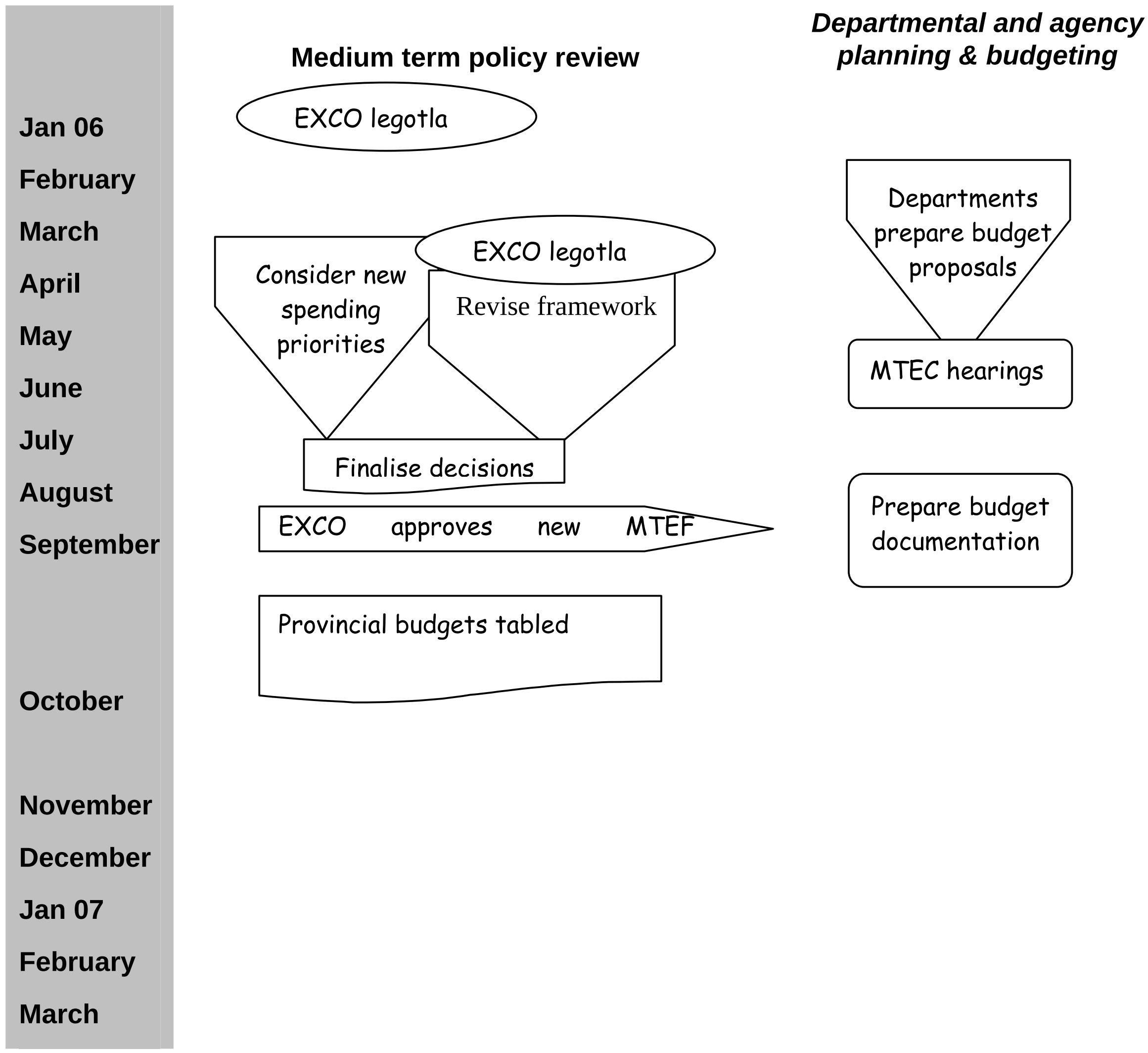
Public accounts committees have an important role to play in each legislature, as they deal with the serious financial management problems not dealt with by the Executive or other portfolio committees. In particular, they ensure that all departments and public entities address the problems raised by the Auditor-General during the financial audit process. The public accounts committee is the ultimate watchdog overseeing sound financial management throughout that sphere of government. The public accounts committee generally does not get involved in policy or legislative matters, unlike other portfolio committees.

It is expected that the 2005/06 Annual Reports should be a mirror image of the 2005/06 Strategic and Performance Plans (SPPs) that were tabled in the provincial legislatures in the previous financial year. Provincial departments, in writing the Annual Reports, are also expected to conform to the guidelines of the preparation of Annual Reports circulated by the Office of the Accountant General (OAG) in the National Treasury.

Once the Provincial Executive Council (EXCO) has agreed on the most efficient allocation of available resources through a matching of the above outputs, the Budget is tabled in the Legislature for legislative hearings, debate and appropriation. (Refer to the budget process description in Chapter 2).

Figure 6.1 below illustrates the various activities that lead to the outputs required in terms of the budget process.

Figure 6.1: Provincial Budget Process



Medium Term Policy Review

The process starts early in the year with Executive consideration of the policy priorities. Additional resources for funding new priorities arise from a review of the overall budget framework, including fiscal policy considerations, overall spending growth, inflation assumptions, and debt interest projections.

Where critical spending pressures and major policy considerations exist, the Provincial Treasury may initiate bilateral discussions with the relevant departments in order to undertake a more rigorous examination of the economic and fiscal implications over the medium-term to long-term period.

The timeline for critical budget decisions in the policy review stage of the process is outlined in Table 6.1.

Table 6.1: Policy review timeline

May – September	Propose spending priorities
May	EXCO considers spending priorities
July – September	Revise macroeconomic framework
June – July	Provincial technical committees consider key spending pressures Policy discussions with line departments
September	EXCO considers in year pressures and new policy priorities for the upcoming MTEF
October/November	Adjusted Estimates tabled in Legislature
December-January	Province prepare budget documentation
February	Provincial budget tabled

The policy review part of the process is designed so that it informs departmental and agency planning and budgeting, and guides the Provincial Treasury in the evaluation of budget proposals.

Departmental and agency planning and budgeting

Planning and budgeting are closely related processes. Planning guides preparation of the MTEF budget proposals that are submitted to the relevant treasury. These proposals are evaluated in line with Government's priorities and recommendations on medium-term allocations made to Cabinet or the relevant provincial executive council.

Before engaging in planning exercises, departments are expected to review performance or service delivery results of the previous period. These results provide feedback when planning for the new medium-term expenditure period. A typical planning process undertaken is outlined in Box 1 below.

Planning process

Assessing service delivery performance against targets and examining departmental strategic objectives against broader Government policy and spending priorities frame the following queries:

- Are departmental strategic objectives and planned outputs aligned with the core functions and mandates of the department?
- Are planned outputs and deliverables still relevant?
- Have service delivery commitments and targets been met?
- **If** there is a high degree of alignment between:
- Government priorities and departmental objectives and outputs
- Service delivery performance against targets

Then the department or institution should revise those aspects of their strategic plan and objectives that will improve service delivery and better achieve the desired results over the next five years.

On the other hand, *if* there is a low degree of alignment *then* the department or institution will have to take a much more extensive review of its delivery plans in relation to Government's medium-term policy and spending priorities. The available budget affects what may be achieved and helps set priorities for resource allocation and service delivery objectives and targets.

The final stage in the process is to assess the costs and resource implications of the revised strategic plan in terms of the departmental medium-term budget allocation. This may lead to significant reprioritisation of the medium-term budget to reflect changing priorities and fiscal realities, which depend on the broader economic environment.

Departments are expected to prepare their new MTEF budget proposals by **August annually** in accordance with a prescribed format that is issued by the National Treasury in May. Where possible, departments are required to indicate five year spending projections. The 4^{th} and 5^{th} years need not be in as much detail as the MTEF budget figures. In addition to their budget proposals, departments also provide the Provincial Treasury with copies of their Annual Financial Statements and Annual Report. These documents are used by the National Treasury budget analysts when preparing for the Medium Term Expenditure Committee (MTEC) hearings in September, which focus on the following aspects of the department's MTEF budget proposals:

- The proposed revisions to the department's medium-term plans and the link to Government's broad policy priorities and key challenges identified for each of the sectors
- The credibility of the costing and affordability of the new proposals
- The department's ability to implement their new proposals over the MTEF period based on past performance and expenditure trends
- The outputs to be achieved in support of measurable objectives.

MTEC discusses each of the above areas with the relevant department, and finalises a recommendation to the Ministers Committee on the Budget and Cabinet that details changes to a department's programme structure, measurable objectives, and changes to programme MTEF allocations.

EXCO's decision on changes to the MTEF programme allocations to provincial departments is set out in the Treasury allocation letters to departments mid November. These detail the rationale and conditions of the final allocations to provincial departments for the new MTEF period. Once final allocation letters have been received, departments are required to revise their plans for the 2005 - 2010 period, and to pay particular attention to priority policies and strategies and to the affordability of their planned outputs.

Table 6.2 summarises the main stages and critical dates for departmental and agency planning and budgeting:

Table 6.2: Departmental and Agency planning and budgeting

May – August	Departments prepare MTEF budget proposals
August - September	MTEC hearing
November	EXCO approves 2005 MTEF
November	Departments submit first draft of budget estimates
February	Budget is tabled

Legislative hearings, debate and appropriation

On Budget Day the MEC for Finance presents to the legislature the outcome of the Executive's budget process in the form of a three-year expenditure framework, and seeks legislative appropriation for the first year.

The provincial budget is presented as follows:

- The *Appropriation Bill*, once enacted, gives departments the legal authority to spend money allocated to them. A brief summary of the Appropriation Act is given in Box 6.2.

Box 6.2 APPROPRIATION ACT

Section 213(2) of the Constitution, 1996 determines *inter alia* that money may only be withdrawn from the National Revenue Fund in terms of an appropriation by an Act of Parliament. It is also a money bill in terms of section 77 of the Constitution. The Appropriation Act is therefore the legal framework by which departments obtain funds from the National Revenue Fund to finance their activities.

The Appropriation Act contains the expenditure information of all national departments at programme level as well as short descriptions of the aims, outputs and targets of the departments and their programmes. In addition to the allocations per department and programme, the expenditure is also divided between current and capital expenditure as well as transfers.

The Appropriation Bill is a money bill in terms of section 77 of the Constitution, 1999, the Bill must be debated and approved by the National Assembly before it is referred to the National Council of Provinces for concurrence and approval. Once Parliament has approved the Bill it is referred to the President for assent and enacted.

Alongside, the budget legislation, the MEC also tables the *Budget Statement.* This document describe the economic and political context that gave rise to the decisions outlined in the allocation of resources. These include:

- Government's outlook for the domestic and global economy
- Implications of tax policy
- The impact of fiscal policy on the budget framework, including changes to expenditure and the deficit
- The management of Government's assets and liabilities; and
- Government's medium-term expenditure framework and the division of resources between the three spheres.

Immediately after tabling in the Legislature, the Budget documentation is referred by the Executive Council to the Portfolio Committee on Finance (PCOF) and the Budget Committee (BC). Responsibility for different parts of the budget is shared between the Budget Committee and the PCOF, public hearings and debate on expenditure estimates and service delivery objectives are referred to the BC, whereas the PCOF deals with the microeconomic policy.

Public hearings and debate in the two committees mainly focus on the allocation of resources in the outer years of the MTEF (years two and three). In this way, the legislature and the public is given the necessary space to influence and contribute to the next budget cycle.

The PCOF and Joint Budget Committee (JBC) consider the overall Budget, and provide a report shortly after the Budget, tabling a report to Parliament (first reading). The PCOF and JBC hold public hearings on the various parts of the Budget before reporting back to the Executive Council. The committees may also decide to refer specific aspects of the Budget to another Portfolio Committee in the Legislature. The PCOF leads the first reading debate (broad macroeconomic issues) on the appropriation bill, which is concluded in mid March prior to the Autumn Legislature Recess.

The BC leads the second reading debate on government spending, after relevant portfolio committees have considered and debated their departmental budget votes in committee and Assembly plenary.

The period between 01 June and 31 August is again critical in the provincial budget process. It is expected that the various intergovernmental fora, in particular, the various sector 4X4s, 10X10s and MinMecs to firm up sector priorities for the following year.

It is acknowledged that the province's specific budget process will differ per province but however, all provinces are expected to submit the first draft of the budget together with their SPPs for 2007 on the 31 August 2006. Provincial treasuries at this stage are expected to have had preliminary discussions with provincial departments at two levels. First level should be discussions around the 2005/06 Annual Reports and AFS and around the first quarter spending of the 2006/07 financial year at the second level.

The Annual Reports and AFS have to be formally tabled in the provincial legislatures and the various oversight committees have to conduct hearings that mainly look at the spending outcomes for the 2005/06 financial year.

The National Treasury also visits provinces in July/August of every year. These two day visits will take place between 22 July and 22 August 2006. The main purpose of these visits will be to discuss quarterly performance reporting and the implementation strategy to roll it out, non-financial information and database and first quarter spending of the 2006/07 financial year with provincial departments.

Date	**Event**
28 June 2006	Education 10 X 10 meeting
30 June 2006	National Treasury issues new guidelines for provincial departments on the Strategic Planning for 2007 Budget. If no new guidelines are going to be issued, provincial treasuries and departments will be notified accordingly.
Mid July 2006	Minister's Committee on the Budget (MinComBud) meeting
22 July and 22 August 2006	National Treasury visits to provinces. Province's specific date will be finalised with the province concerned
28 July 2006	Social development 10 X 10 meeting
31 July 2006	Health 10 X 10 meeting
31 July 2006	National Treasury to issue draft budget format guideline for the 2007 budget to provincial treasuries
31 July 2006	Provincial departments submit **2007 infrastructure plans** to Provincial Treasury in terms of Section 37(1) of the Division of Revenue Act, 2005

The month of August in the provincial budget process is critical. The Extended MinComBud (In other words, MinComBud together with the MECs for Finance from the nine provinces) meet in the first week to agree on the final recommendations that will have to be tabled at the National Cabinet for the 2007 Budget.

During August and the September months, provincial departments are engaged with the provincial treasuries on the draft budgets for 2007. These draft budgets are based on baseline allocations as per the 2006 MTEF. These draft budgets will have to be submitted to the National Treasury on the 31 August 2006. Provinces are also expected to submit the first draft of the 2007 Strategic Plans and Infrastructure Plans to National Treasury for purposes of the Medium Term Budget Policy Statement (MTBPS) which happens in October 2006. The Budget Council Lekgotla takes place towards the end of August.

The provinces conduct their own Budget Makgotla or Izimbizo during the month of September through to December. Provincial MTEC hearings are also expected to take place during this period to consolidate the draft budgets based on provincial and national priorities. Three allocation letters will be issued to provinces. The first allocation letter will be issued on the 01 September 2006. The second will be issued on the 30 October 2006 and this letter will be based on the MTBPS and will be regarded as almost final. The final allocation letter will be issued on the 05 February 2007 after the Budget Council meeting of the 01 February 2007.

On the 05 September 2006 and 29 September 2006, provinces are requested to submit the Annual Reports and the Annual Financial Statements respectively to the National Treasury. An electronic version plus 20 hard copies are required for each of these.

The 2006 MTBPS and the 2006/07 Adjustments Estimate will be tabled on the 25 October 2006. The period mid November to early December is set aside for three day visits by National Treasury officials to provinces. During these visits, infrastructure sites are visited based on the infrastructure reports submitted to the National Treasury. Bilaterals between Treasuries and selected departments also take place at this time. The terms of reference for both the July visits and the November visit are sent to the Provincial Treasuries beforehand. All provinces are expected to table their 2006 Adjustment Estimates by the 28 November 2006.

The key date in December is the 8^{th} whereby provinces are expected to submit their second draft budgets to the National Treasury. The data submitted is mainly used for the 2007 Budget Review and forms the basis for the provincial benchmark exercise discussions to be held in January 2007. The Budgets submitted should be based on the second allocation letter issued to provinces on the 30 October 2006. The results of the benchmark exercises are tabled at the Budget Council meeting to be held on the 01 February 2007 and will also finally inform the final allocation letter that will be issued to provinces on the 05 February 2007.

The National Budget will be tabled on the 28 February 2007 and provinces as per the regulations have to table their budgets two weeks after the Minister of Finance has tabled the National Budget. In the month of February final SPPs are also submitted and checked for quality and alignment with budget allocations before being tabled in the provincial legislatures.

The guidelines should be read together with the Budget Process schedule that forms part of these guidelines **(refer to Chapter 2)**.