ANNEXURES

In addition to the material published in the *Budget Review*, the following annexures are available at www.treasury.gov.za:

- Annexure W1: Explanatory memorandum to the division of revenue
- Annexure W2: Structure of the government accounts
- Annexure W3: Further details on Gateway to Africa reforms

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Report of the Minister of Finance to Parliament

Introduction

Section 7(4) of the Money Bills Amendment Procedure and Related Matters Act (2009, the Act) prescribes that the Minister of Finance (the Minister) must submit a report to Parliament at the time of the budget explaining how the Division of Revenue Bill and the national budget give effect to, or the reasons for not taking into account, the recommendations contained in:

- Budgetary review and recommendation (BRR) reports submitted by committees of the National Assembly in terms of section 5 of the Act.
- Reports on the fiscal framework proposed in the Medium Term Budget Policy Statement (MTBPS) submitted by the finance committees in terms of section 6 of the Act.
- Reports on the proposed division of revenue and the conditional grant allocation to provinces and local governments set out in the MTBPS submitted by the appropriations committees in terms of section 6 of the Act.

Budgetary review and recommendation reports

Section 5 of the Act sets out a procedure to be followed prior to the introduction of the national budget by the National Assembly, through its committees, for assessing the performance of each national department. The committees prepare BRR reports, which:

- Must provide an assessment of the department's service-delivery performance given available resources.
- Must provide an assessment of the effectiveness and efficiency of the department's use and forward allocation of available resources.
- May include recommendations on the forward use of resources.

At the time of tabling the annual budget, the Minister is required to explain how the budget gives effect to these recommendations, or why they have not been taken into account.

The BRR reports were tabled by the relevant portfolio committees between October and December 2012. Due to the large number of BRR reports, a separate document will be tabled in Parliament with detailed responses to the portfolio committees' recommendations. In many cases, however, the different committees have made the same recommendations to a number of departments. This report contains a summary of these overarching concerns, drawing on responses to the specific issues raised in each committee's report set out in the detailed document.

General issues

- *Accelerated recruitment:* Departments must speed up the process of filling vacant positions, especially the recruitment of high-level staff.
- *Reducing staff turnover:* Departments need to tackle high rates of staff turnover, for example, through human-resource development strategies.
- *Realistic targets:* Departments need to establish feasible targets in their annual performance plans that are aligned to their core objectives and budgets.
- *Quarterly reporting:* The importance of quarterly reporting of financial performance in many departments was underlined.
- *Auditor-General recommendations:* Departments should work more closely with the Auditor-General and abide by its recommendations.
- *Performance agreements:* All departments should have staff performance agreements in place.
- *Greater coordination across government:* Greater coordination of activities and strategic planning is required across national departments and the three spheres of government.
- *Strengthen information and communications technology:* Departments need to strengthen their information and communications technology to improve the quality of data on spending and performance.
- *Disabled workers:* Departments must remain committed to employing people with disabilities.
- *Monitoring and evaluation:* Departments must establish mechanisms for monitoring and evaluating their programmes, with measurable objectives and clear timeframes.
- *Stronger internal audit and financial controls:* Internal audit capacity and risk-management systems should be strengthened in a number of departments to ensure compliance with relevant legislation. Financial controls are needed to reduce irregular or fraudulent spending.
- *Better supply chain management:* Departments should focus on proper supply chain management to combat corruption.
- *Abide by previous BRR reports:* Departments should abide by the BRR report recommendations.

Reports without recommendations

The following reports did not have any recommendations:

- Standing Committee on Appropriations on the 2012 Division of Revenue Amendment Bill
- Select Committee on Appropriations on the proposed division of revenue and conditional grant allocations in the 2012 MTBPS
- Select Committee on Appropriations on the 2012 Division of Revenue Amendment Bill.

The Minister thanks these committees and all those that made recommendations for their important contribution to the Budget process.

Recommendations of the Standing Committee on Appropriations on the 2012 MTBPS

Savings and underspending

> *The National Treasury reports to Parliament on declared savings and projected underspending by departments and the effect thereof on performance targets of departments.*

The Adjusted Estimates of National Expenditure, which are published in October each year at the time of the MTBPS, report on declared savings and (where possible) projected underspending. The National Treasury agrees that, in future, the Adjusted Estimates of National Expenditure guidelines and template should show where savings and underspending have implications for service delivery.

Implementing agents for infrastructure programmes

> *The National Treasury reports to Parliament on the minimisation of costs associated with the employment of implementing agents for delivery of infrastructural programmes.*

The National Treasury recognises the importance of ensuring that implementing agents employed by the public sector deliver their services cost-effectively. The National Treasury oversees departmental spending through the annual budget process, but the responsibility for overseeing contractors that departments or state-owned companies have engaged remains with those entities. The Public Finance Management Act (1999) and Municipal Finance Management Act (2003) require that accounting officers at public entities are responsible for ensuring value for money and cost-effectiveness in their duties. The National Treasury will further support departments and public entities with the appointment of a Chief Procurement Officer, whose office will build new capacity to assess the cost-effectiveness of large programmes.

A critical aspect in achieving cost-effectiveness is to improve the public sector's capacity and competence in managing both projects and the implementing agents that participate in project delivery. The first step to achieving this is to improve the planning process in departments and entities, where projects are evaluated thoroughly and costed reliably. This provides a sound foundation for procuring contractors, with contracts set at realistic values, and a basis against which capital expenditure can be monitored. Contracts should address cost overruns, either through penalty clauses or by transferring full responsibility for cost overruns to providers.

Proper management of implementing agents is key to ensuring that projects are kept on-track, on-budget and to specification. The National Treasury assists with building capacity and competence in these areas through the infrastructure development management system and the infrastructure development improvement programme. The programme is a capacity-building initiative, which targets key infrastructure-delivery organs of state, such as the national and provincial departments of health, education, public works and treasuries.

Reviewing the medium-term expenditure framework (MTEF) budgeting framework

> *The National Treasury reports to Parliament on the possibility of reviewing the MTEF budgeting framework so as to strengthen the management, planning and spending in government departments to ensure credible budgets.*

The National Treasury constantly reviews South Africa's budgeting process to strengthen it where possible. The current MTEF budgeting framework incorporates the three previous years, the current financial year and the three future years. This rolling budget means that planning for the outer year must take place at least two years in advance. This focuses the management of the budget over the MTEF period. The National Treasury interrogates the budget and departmental spending information throughout the year. This information affects the proposed budget allocations for future years. It is through this methodology that the National Treasury continues to strengthen management, planning and spending in government departments.

Stemming from the view that better planning during budget formulation will lead to better management of resources and spending during budget execution, the National Treasury continues to play an active role in the implementation of the Framework for Strategic Plans and Annual Performance Plans. The National Treasury is collaborating with the Department of Performance Monitoring and Evaluation in this regard.

Accountability of transferring entities

> *The National Treasury puts in place measures to ensure that transferring entities are held accountable for the administration and performance of the conditional grants.*

The roles and responsibilities of transferring national officers are clearly defined in the annual Division of Revenue Act. Additional, grant-specific responsibilities of national departments are contained in the frameworks for each grant. Each department must submit to the National Treasury monthly financial performance reports and quarterly non-financial performance reports on the grants it administers. These reports are also shared with Parliament on a quarterly basis to facilitate parliamentary oversight of national departments.

Based on information from this monitoring system, the National Treasury has quarterly meetings with national departments to discuss the performance of the grants they administer. These meetings provide a forum for the National Treasury to suggest actions that national departments can take to improve the performance of underperforming grants and to hold departments accountable if such measures are not implemented. Where necessary, departments are requested to add reviews of underperforming grants to their list of responsibilities in the grant framework. This is used as another mechanism to hold departments accountable for completing the work necessary to improve the grant’s performance.

Recommendations of the Standing Committee on Appropriations on the Adjustments Appropriation Bill

Infrastructure planning

> *The Minister of Finance ensures that the National Treasury considers incorporating a clause into the Appropriation Bill to enforce planning as a requirement for infrastructure programmes.*

Adequate planning should precede the proposal of an appropriation of funds in an Appropriation Bill. Section 30 of the draft Treasury Regulations published in the Government Gazette No. 35939 (30 November 2012) governs supply chain management for the delivery and maintenance of infrastructure. This includes a requirement that infrastructure must be provided in line with accepted norms and standards.

Joint recommendations of the Standing and Select Committees on Finance on the Revised Fiscal Framework for 2012

Expenditure monitoring

> *The National Treasury should develop mechanisms to increase monitoring to ensure value for money in terms of proper coordination and procurement processes, which will assist the containment of expenditure within the available budget.*

Since the 2011 Budget process, government has adopted a functional approach to budgeting by grouping activities according to broad policy purpose or type of expenditure. Government institutions that contribute to achieving a particular function are grouped together in a workgroup, including national and provincial departments and their respective entities, so that they reach a common understanding of the function's work.

These agreements are reflected in the budget submissions put forward by the different institutions. They also inform the analysis of the submissions and the proposed budget allocations. This approach promotes transparency and better coordination in the budget formulation process, and provides an opportunity for greater collaboration between departments, programme managers and public entities. The ongoing monitoring of institutional expenditure and performance during budget execution takes place within this setting.

Compensation spending

> *Government departments should monitor overspending on compensation of employees over time including managing of sick leave and efficient use of available staff in order to reduce personnel over time.*

Government is putting mechanisms in place to oversee the filling of funded vacant posts and the reprioritisation of personnel budgets during the financial year. This will allow treasuries and other relevant stakeholders to monitor personnel budgets and prevent the filling of unfunded posts.

Ghost employees

> *The National Treasury should work together with the Public Service Commission in addressing the issue of "ghost" employees by, for example, rolling out the head count project that was piloted in Limpopo Province to the rest of the country.*

The National Treasury agrees with this recommendation. It has already started discussions with provincial treasuries to ensure that Statistics South Africa will be called in if headcount verifications have not been undertaken by a credible service provider.

Departmental savings

> *Government, through the National Treasury, should develop plans/mechanisms to monitor the departmental savings without compromising the delivery of services.*

In the budget guidelines issued by the National Treasury, departments and entities are tasked with identifying expenditure reductions in areas that will not affect service delivery. Reductions are sought from non-performing programmes and programmes that are not closely aligned to departmental/entity core mandates and policy priorities. Where expenditure reductions are effected in areas that have an impact on service delivery, this is generally due to the institution indicating that it will not be able to deliver in accordance with its original plans due to circumstances generally not linked to the availability of funds. In such cases, funds are reprioritised to areas where effective spending can take place within the respective budget cycle.

Under the Public Finance Management Act, departments need to report on their expenditure on a monthly basis. Treasury Regulation 5.3.1 requires accounting officers of institutions to establish procedures for quarterly reporting to an executive authority, including on performance, to facilitate effective monitoring, evaluation and corrective action. Throughout the budget cycle, departments and entities are required to show the impact of proposed expenditure and actual expenditure on key performance indicators.

Recommendations of the Select Committee on Finance on the Proposed Fiscal Framework for 2013

These are substantially the same recommendations as were made by the Standing Committee on Finance on the 2012 MTBPS.

Administered prices

> *The National Treasury should formulate a better planned and coordinated approach to the issues of affordability in decisions around administered prices and their effect on the cost of doing business, and report back to the House within 90 days of the adoption of this report by the House.*

The Minister agrees that a more coordinated response to the formation of administered prices is both desirable and necessary. Administered prices provide a signal for production and consumption decisions, so it is critical that they are set at a level that ensures that demand and supply are balanced in the long term, investment funding is adequate and ratepayers receive value for money.

Managing the burden of administered prices on households and businesses requires balancing the benefits that individual users enjoy when receiving a service with the wider social and economic benefits that are enjoyed when people have access to services. The balance between user charges and taxpayer-funded subsidies for these services needs to be considered accordingly.

The National Treasury has analysed administered prices that affect households, as measured in the consumer price index – including water, electricity, waste management, assessment rates, tuition fees, petrol, licence fees and telecommunication fees. It has also investigated the impact on business of administered prices such as port and rail charges.

The current frameworks governing the setting of administered prices mean that price setters are generally focused on revenue generation and cost-recovery. Less attention is paid to improving spending efficiency or ensuring adequate maintenance to reduce final infrastructure costs. The devolved nature of much administered price-setting results in price applications that plan for infrastructure expenditure that may be highly ambitious and inappropriate considering the other competing pressures facing users. Engagement through the Economic Cluster can serve to enhance our understanding of these prices and improve the administered-price-setting framework.

Cross-border investment

> *The National Treasury should finalise a policy document on guidelines for cross-border investment in order to help contain a decline in foreign direct investment flows to the Republic of South Africa by 44 per cent in the 2011/12 financial year, and report back to the House within 90 days of the adoption of this report by the House.*

The National Treasury is preparing a detailed response to the Select Committee's request. The policy document will outline a number of reforms that will encourage foreign direct investment (FDI) within a context of broader policies to boost investment. These include modernising the tax system to simplify the tax treatment of investment and reducing tax and exchange control barriers to support trade with Africa, and pursuing an outward-oriented international policy, particularly focused on deepening economic relationships with Brazil, Russia, India and China.

The National Treasury strongly supports an investment environment free of uncertainty, with no bias in favour of or against foreign investors, and aligned to the objective of job-creating economic growth. The decline in FDI in 2011/12 is cause for concern, though the fall is somewhat overstated due to large inflows the year before. The focus should be broader than FDI, as portfolio capital flows are also important. In particular, inflows into the bond market allow South Africa to finance the fiscal deficit, while offshore borrowing is an important part of government's funding programme.

A broader discussion is needed between the many departments that have an influence on the investment climate, such as the Department of Trade and Industry, the Department of Mineral Resources and the Department of Environmental Affairs. The National Treasury seeks the support of the Select Committee to engage with other relevant committees on this important area of policy.

Contingency plan to deal with downside risk in macroeconomic projections

> *The National Treasury should develop and provide the House with a contingency plan in the event that macroeconomic projections do not result as expected in the Proposed Fiscal Framework, and report back to the Standing Committee on Finance.*

At the time of the 2012 MTBPS, the National Treasury wrote: "If … the substantial risks to the outlook materialise and the economic environment deteriorates, realising [the] fiscal objectives [of counter-cyclicality and debt sustainability] will require a reconsideration of current spending and revenue plans. [T]he necessary adjustments will avoid an unwarranted early withdrawal of fiscal support for the recovery."

Since then, some of the risks to the economy outlined in the MTBPS have been realised. A weak recovery in the global economy, combined with domestic labour disruptions, has produced lower-than-expected economic and tax revenue growth. As a result, the 2012/13 budget deficit is now estimated at 5.2 per cent of GDP. This widening deficit is necessary to support the economy, but continued counter-cyclicality in the short term necessitates a stronger path of consolidation over the medium term.

To ensure fiscal sustainability, the National Treasury has taken steps to moderate growth in expenditure. First, programmes with particularly rapid forecast spending growth were identified, and where these had experienced difficulties in realising spending, additions to spending were reduced. In total, spending projections of national departments were reduced by R10 billion over the MTEF. Second, government has reduced the contingency reserve to a minimum level consistent with the historic needs of unforeseen and unavoidable expenditure.

Government will conduct two expenditure reviews over the coming year. The first will consider general public services (which includes executive and legislative services, financial and fiscal affairs, and foreign affairs). The second will consider personnel expenditure, with a particular emphasis on administrative and managerial hiring. The results will be incorporated into revised spending plans for the 2014 Budget. Expenditure measures will be complemented by a review of tax policy, which will consider whether revenue levels are sufficient to ensure fiscal sustainability over the longer term, and the potential impact of tax changes on growth, employment and equity.

Procurement processes

> *The National Treasury should develop mechanisms to increase monitoring and to ensure value for money in terms of proper coordination and procurement processes, which will assist the containment of expenditure within the available budget, and report back to the House within 90 days of the adoption of this report by the House.*

The National Treasury is finalising a revised supply chain management regulatory framework. Compliance monitoring is being strengthened to maximise value-for-money and eliminate waste and abuse of the procurement system.

Other steps to improve procurement capacity and service delivery include reducing fragmentation and strengthening the national procurement architecture; strengthening the tax clearance system to ensure that those who have defrauded the state cannot do business with the state; and introducing measures to improve institutions' ability to set up their bid committee structures for the invitation, evaluation and adjudication of tenders.

To intensify compliance monitoring and expenditure containment, institutions are required to submit tender programmes to relevant treasuries. Demand-management procurement plans are scrutinised against the tender programmes.

Regulations of the Preferential Procurement Policy Framework Act, which came into effect on 7 December 2011, are applicable to all organs of state, including state-owned enterprises, from 7 December 2012. These regulations are aligned with the Broad-Based Black Economic Empowerment Act (2003). They provide for the designation of certain sectors for local content and production to encourage industrial development and bolster job creation.

Managing the wage bill

> *The National Treasury should report on government's approach to managing overall employment and moderate expenditure on compensation of employees, and report back to the House within 90 days of the adoption of this report by the House.*

Government is committed to moderating growth in the wage bill and aligning it with improvements in productivity in the public sector. As a first step, government has negotiated a three-year wage agreement, which improves predictability of growth in the wage bill over the medium term. This allows government to focus on initiatives to improve the quality of personnel spending, including rationalising staff establishments, restraining growth in personnel numbers and better use of excess personnel. Over time, these measures will help shift the composition of public spending away from compensation of employees towards more productive areas.

Infrastructure spending

> *The National Treasury should report to the House on actual spending on infrastructure by government departments and state-owned enterprises, within 90 days of the adoption of this report by the House.*

The National Treasury publishes expenditure on infrastructure by government departments and state-owned enterprises each year in the Budget Review, which is released on the day of the annual Budget Speech in February. Information is provided by sphere of government – national, provincial, local – as well as by public-private partnerships, extra-budgetary institutions and state-owned enterprises, with a breakdown by the largest entities.

Economic impact of infrastructure projects

> *The National Treasury should facilitate development of an Infrastructure Investment Plan that, in turn, should determine how it would generate levels of economic activity, within 90 days of the adoption of this report by the House.*

The National Treasury recognises the importance of South Africa's infrastructure investment plans. Both the National Development Plan, with its direction on the country's infrastructure priorities, and the Presidential Infrastructure Coordinating Commission, with its focus on providing impetus to the planning and implementation of major capital projects, give shape to the country's national infrastructure plan. The National Treasury supports infrastructure initiatives by ensuring that infrastructure projects and programmes receive substantial finance, and through its various capacity-building initiatives, particularly the infrastructure development improvement programme.