

Induction Dossier: MEC for Finance

Republic of South Africa
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Introduction

This dossier has been developed specifically for Members of the Executive Council (MECs) for Finance. It tries to highlight some of your key responsibilities and the challenges that you will encounter, and seeks to provide you with a background understanding of the most important aspects of the legal and fiscal systems that are relevant to your functions.

National Treasury appreciates that time is valuable and limited. At the same time, we believe that achieving a good understanding of the public financial management system and budget process will save many hours of headache and difficulties in the future. Therefore, we strongly recommend that you invest the time in reading through this manual and digesting its content. We have tried to indicate where further background reading is necessary, where possible. While the subject matter admittedly is complex, we have tried to be as brief as possible, sticking to the key points in each chapter.

In **Chapter 1 (Role and responsibilities of the MEC for Finance)**, we have indicated some of the most important issues and challenges that you need to be mindful of. These include:

- ensuring that the provincial funding priorities are factored into the national budget process
- creating a sound working relationship between treasuries and executive committees
- ensuring that national and provincial financial standards are applied in the provincial domain
- ensuring that provincial public funds are well spent and provide value for money
- ensuring that financial statements for provincial departments, public provincial entities and the provincial legislature are prepared and submitted to the Auditor-General.

The responsibility for oversight over municipalities' financial management is also described in chapter 1.

Chapter 2 (The Constitution and public finances) shows how the Constitution is the background for the allocation of functions of government, and how this is reflected in the budget allocation to the three spheres of government. Some of the key national financial institutions and the necessary processes for passing the budget bills are also discussed.

Chapter 3 (The intergovernmental fiscal system) describes the intergovernmental fiscal system, its key players and forums, the nature

of intergovernmental transfers, and some of the crucial legal requirements in the annual Division of Revenue Act.

Chapter 4 (The division of revenue and budget process) outlines the budget process and the sharing of the national revenue in detail. This includes the processes for updating policy priorities and reviewing the available resources captured in the Medium Term Expenditure Framework (MTEF), the coordination processes, and the role of the relevant committees and Cabinet.

Chapter 5 (Borrowing by provinces) is about how provinces may borrow for infrastructure projects.

Chapter 6 (Taxation by provinces) discusses the options for provinces for creating new taxes.

Chapter 7 (Exercising oversight) covers oversight functions. It introduces the oversight role of legislatures and public accounts committees, and highlights the need for developing annual reports with audit reports and performance information on service delivery to ensure value for money.

Chapter 8 (Annual reports and accountability) outlines the requirements to annual reports and their relationship to accountability.

Chapter 9 (The integrated financial management system) presents Government's plans for an overarching IT system.

Chapter 10 (Supply chain management) introduces the most important aspects of supply chain management and tendering.

Chapter 11 (Monitoring) looks at the monitoring of programmes and introduces some key concepts in the monitoring of service delivery, in line with the need to produce performance information.

Chapter 12 (Infrastructure management) looks at infrastructure and presents lessons learned, including those related to asset management and integrated planning for infrastructure projects.

Chapter 13 (Public private partnerships) introduces public private partnerships (PPPs) as an avenue for service delivery.

Chapter 14 (Budgeting for infrastructure and capital expenditure) looks at capital budgeting for large projects.

A glossary is provided for easy reference to key terms, institutions and abbreviations.

In the annexures, you will find some of the most important legal documents, such as the Public Finance Management Act (1999) (PFMA), the Framework for Managing Programme Performance Information, and the Guideline for Implementation of Provincial Quarterly Performance. There is also more background information on PPPs and budgeting for capital projects.

It is our hope that you will find the dossier relevant and useful, and we look forward to working with you in the future.

PRAVIN GORDHAN
MINISTER OF FINANCE

1

Role and responsibilities of the MEC for Finance

- The Constitution, the Public Finance Management Act (1999) (PFMA), and other key legal documents outline the most important responsibilities of the MEC for Finance. These are introduced in this chapter, which also discusses the role the MEC for Finance can play in serving his/her province and constituency well.
- The underlying principle is that successful financial management is about more than just budgeting and compliance with rules; it is also about ensuring value for money, creating good teamwork in the Executive Council, assuring quality in budget submissions, and promoting the province's priorities in the budget process.

More than financial compliance and budgeting

The Constitution, together with key legal documents such as the Public Finance Management Act (1999) (PFMA), establishes a number of responsibilities for the provincial MEC for Finance. As a principle, the MEC for Finance leads the policy development and leaves the actual implementation to the administration, the technical departments (according to section 17(2) of the PFMA). However, as the head of the provincial treasury, the MEC for Finance is also responsible for the work carried out by the treasury.

The MEC for Finance is in charge of policy development and oversees the work of the provincial treasury

Financial management concerns more than budgeting and compliance issues; achieving value for money and the oversight of performance are equally important. Furthermore, the allocation of budget resources is a politically driven process, which is essentially underpinned by the prevailing macroeconomic priorities. The MEC for Finance plays a key role in making sure that the provincial priorities are funded in the national budget. With this in mind, and to ensure good use of resources resulting in efficient service delivery and value for money for the province, the MEC for Finance can be effective in a number of areas:

- **Making sure the province's budget** priorities are factored into the national Budget is a two-way process: on the one hand ensuring that the budget submissions are of as high a

Key issues for the MEC for Finance

technical quality as possible, thereby strengthening their chances of success, while on the other hand, promoting the proposals in the budget process meetings in the Budget Council and other forums.

- **Establishing strong working relations** with the various technical departments serves to strengthen implementation and development of service delivery programmes, and enables the provincial treasury to guide the technical departments in a number of areas, and to resolve issues at an early stage.
- **Oversight and management information** is an area where the MEC for Finance and provincial treasury have responsibilities to make sure that both financial and non-financial information is made available for oversight. Performance information related to goals and outcomes of investments makes it possible to assess whether a programme is delivering as expected. The MEC for Finance and the provincial treasury play an important role in ensuring that technical departments include this information in their programmes.
- **Oversight of municipal financial management** is a specific issue of concern, as National Treasury has delegated its oversight responsibility for most of the municipalities to the provincial treasuries.
- **Capital expenditure and project submissions** require sufficient documentation to be successful in the budget process. Often the quality of submissions and the background information to needs assessment and feasibility studies have been found wanting, and in this area the MEC for Finance and treasury can strengthen the technical departments' submissions. (Please see chapter 14 (Budgeting for infrastructure and capital expenditure)).
- **Taking out loans can be a way to finance infrastructure** development, which is crucial for many aspects of service delivery. Provinces have a range of options for borrowing money for certain purposes, and the MEC for Finance and the provincial treasury play a key role in provincial borrowing processes. (Please see chapter 5 (Borrowing by provinces)).
- **Public private partnerships** create options for finance service delivery that are currently underutilised. The MEC for Finance and provincial treasuries can play a facilitative role in bringing these options to the attention of technical departments, and provide support in the technical discussions and processes leading to PPPs. (Please see chapter 12 (Public private partnerships)).
- **Maintenance of infrastructure** is an area where technical departments often fail to meet their responsibilities, according to audit reports. The MEC for Finance and provincial treasuries can facilitate policies to ensure that the

The MEC for Finance plays a role in capital projects, loans and PPPs

maintenance of crucial assets is included in budgeting. In a similar way, integrated strategic planning will serve to get rid of “white elephant” assets. (Please see chapter 12 (Infrastructure management)).

The main responsibilities of the MEC for Finance as defined in the Constitution and PFMA are outlined in the following sections.

■ Relevant legislation

The Constitution

The MEC for Finance, as head of the provincial treasury, must ensure that the provincial budgets and budgetary processes promote transparency, accountability and the effective financial management of the economy, as outlined in section 215(1) of the Constitution.

The MEC for Finance has constitutional responsibilities

The MEC for Finance must also ensure that the provincial budgets follow the form and timing prescribed by national legislation, and show the sources of revenue and the way the proposed expenditure will comply with national legislation, according to section 215(2) of the Constitution.

Further, s/he must ensure that provincial budgets contain:

- estimates of revenue and expenditure, differentiating between capital and current expenditure
- proposals for financing any anticipated deficit for the period to which they apply
- an indication of intentions regarding borrowing and other forms of public liability that will increase public debt during the ensuing year (Section 215(3)).

The Public Finance Management Act

The PFMA prescribes a more detailed set of responsibilities:

The PFMA outlines a detailed set of responsibilities

The MEC for Finance must annually table in the National Assembly and in the province’s legislature, a multi-year budget projection of:

- the estimated revenue to be raised during each year of the multi-year period
- the estimated expenditure expected to be incurred per vote during each year of the multi-year period, differentiating between capital and current expenditure.

The MEC for Finance must ensure that at least every quarter, the provincial treasury submits to National Treasury a statement of revenue and expenditure with regard to the Provincial Revenue Fund, according to section 27 of the PFMA.

The MEC for Finance must submit the consolidated financial statement and audit report within one month of receiving the report from the Auditor-General, for tabling in the legislature, as stated in section 19(3).

The MEC for Finance is responsible for the provincial treasury

Furthermore, as head of the provincial treasury, the MEC for Finance is accountable for ensuring that the provincial treasury observes a number of responsibilities, the most important of which are listed below (section 18 of the PFMA):

- **to prepare and table the provincial budget** within two weeks of the tabling of the national budget
- **to exercise control** over the implementation of the provincial budget
- **to promote and enforce transparency** and effective financial management
- **to ensure that a province's fiscal policies** do not prejudice national economic policies
- **to enforce the PFMA** and national and provincial norms and standards, including generally recognised accounting practices and nationally uniform financial classification systems
- **to monitor and assess** implementation of national and provincial norms and standards in provincial public entities
- **to intervene to address serious and persistent breach** of the PMFA by a provincial department or provincial public entity
- **to provide information required by the National Treasury** in terms of the PFMA
- **to ensure the preparation of consolidated financial statements** for provincial departments, public provincial entities and the provincial legislature and submit those statements to the Auditor-General (section 19(1)(a) of the PFMA)
- **to establish appropriate and effective cash management** and banking arrangements for its Provincial Revenue Fund, according to the national framework prescribed by the National Treasury (section 21 of the PFMA).

The provincial budget must include estimated revenue and expenditure

National Treasury must ensure that the provincial budget includes estimates of all revenue expected to be raised, estimates of current expenditure for that financial year per vote and per main division within the vote, estimates of interest and debt servicing charges and repayment on loans, and estimates of capital expenditure per vote.

The MEC for Finance can delegate powers to the head of department

The MEC for Finance may table in the provincial legislature an adjustment budget, according to section 31 of the PFMA. This budget may only provide for funds that have become available to the province or unforeseeable and unavoidable expenditure as described in section

31(2) of the PFMA. The Minister of Finance may determine the time when such a budget must be tabled as well as the format for these amended budgets, according to section 31(3) of the PFMA.

The MEC for Finance can delegate the powers entrusted or delegated by the PMFA to him or her, to the head of department. This delegation of power, however, does not divest the MEC for Finance of the responsibility for decisions taken by the head of department, as stated in section 20 of the PFMA.

The Provincial Revenue Fund

The provincial treasury is in charge of the Provincial Revenue Fund and must ensure compliance with section 226 of the Constitution in relation to this. This states that all money received by the provincial government, including the province's equitable share and grants, must be paid promptly into the fund. There are some exceptions to this rule, which are outlined in section 22 of the PFMA. Most notably these are:

- money received from the provincial legislature or from a provincial public entity in the province
- money received from donor agencies, which must be paid into the Reconstruction and Development Programme Fund.

Money can only be withdrawn from the Provincial Revenue Fund through a provincial appropriation act, or as a direct charge if it is provided for in the Constitution or a provincial act. Only the provincial treasury may withdraw funds from the Provincial Revenue Fund.

Only the provincial treasury may withdraw funds from the Provincial Revenue Fund

In the case of an emergency, the MEC for Finance may authorise the use of funds from the Provincial Revenue Fund to cover expenditure which is not provided for and which cannot be postponed without serious prejudice to the public interest in the province. Towards the end of the financial year, the emergency clause is occasionally used to appropriate funds that are left unused in the budget. These occasions, however, cannot be described as an emergency situation. More details on this can be found in section 25 of the PFMA.

The MEC for Finance may authorise the use of funds from the Provincial Revenue Fund for emergency use

The Municipal Finance Management Act

The Municipal Finance Management Act (2003) (MFMA) focuses on the role of the mayor and local government. However, in some situations, particularly if a municipality is in crisis, the MEC for Finance takes on a more active role in relation to municipalities, or is kept closely informed about developments. These situations include:

- failure to approve the municipal budget
- extension of deadlines
- non-compliance with specific provisions.

Failure to approve the municipal budget

Section 26 of the MFMA details the case when a municipal council has not approved an annual budget or revenue raising measures to give effect to the budget. The provincial executive must then intervene in terms of section 139(4) of the Constitution. S/he may, among other actions, approve a temporary budget or revenue-raising to enable the municipality to continue functioning.

The MEC for Finance may approve the withdrawal of funds from a municipality's bank account

Until this temporary budget has been approved, the MEC for Finance may approve the withdrawal of funds from the municipality's bank account. These funds may only be used to defray current and capital expenditure in connection with votes approved in the budget for the previous year. These funds may not exceed 8 per cent of the total amount approved in the budget for current expenditure, nor exceed the amount available, according to section 26(3), (4) and (5) of the MFMA.

Extension of deadlines

If a mayor of a municipality becomes aware that the municipality is going to be unable to comply with any provisions of the MFMA or any other legislation relating to the tabling or approval of the annual budget or compulsory consultation processes, s/he must inform the MEC for Finance in the province in writing of the situation, according to section 27 (1) of the MFMA.

The MEC for Finance may extend deadlines

If the lack of compliance is due to a time provision, the MEC for Finance may extend any time limit or deadline contained in that provision, provided this does not compromise compliance with section 16(1), which states that a council of a municipality must approve an annual budget for the municipality before the start of that financial year. However, the MEC for Finance must promptly inform the National Treasury of the extension and its background, according to section 27(2) of the MFMA.

If the mayor of the municipality becomes aware of a situation of non-compliance by the municipality, s/he must inform the executive council, the MEC for Finance and National Treasury in writing of this non compliance and of the remedial or corrective action that the municipality intends to implement to avoid a similar situation.

The mayor must report delays in the tabling of the Budget to the MEC for Finance

The requirements of the municipal budget processes state that the mayor must report any delay in the tabling of the budget to the municipal council and the MEC for Finance, as well as any delay in approval of the service delivery, budget implementation plan or signing of annual performance agreements, according to section 53 (2) of the MFMA.

Non-compliance with specific provisions

If the accounting officer of a municipality or municipal entity fails to submit financial statements to the Auditor-General, or if the mayor fails to table the annual report of the municipality or a municipal entity in the council, the Auditor-General must inform the speaker of the council, National Treasury and the MEC for Local Government

and the MEC for Finance in the province of such failure, and issue a special report on the failure to the relevant provincial legislature, according to section 133(1) of the MFMA.

■ Provincial treasuries' oversight role in municipal financial management

National Treasury has the oversight responsibility for the financial management of all spheres of government including local government, according to section 216 of the Constitution. However, for 266 of the 283 municipalities in South Africa, National Treasury has transferred the oversight responsibility to the provincial treasuries. This delegation is subject to a yearly review of the capacity of provincial treasuries to carry out this function.

While processes to carry out this oversight responsibility have been established in the provincial treasuries, the MEC for Finance nevertheless has to be observant of this responsibility, as financial reporting and management in municipalities may still be cause for concern.

The MFMA prescribes that National Treasury (in effect, the provincial treasuries) may:

- monitor the budget of municipalities to see if they are consistent with overall fiscal and macroeconomic policy
- promote good budget and fiscal management by municipalities and for this purpose monitor the implementation of municipal budgets
- monitor and assess compliance by municipalities and municipal entities with the MFMA and generally recognised accounting standards and revenue classification systems
- investigate any system of financial management and internal control in the municipal entity and recommend improvements
- take appropriate steps if a municipality breaches the MFMA, including by stopping funds to the municipality (for further details please see section 5 of the MFMA).

National Treasury has particular obligations in terms of the MFMA

It should be noted that the oversight function concerns not just monitoring of municipal budgets, but also support and capacity building.

The delegation of responsibility is assisted by capacity building and support initiatives such as the provision of policy support, legal advice and the establishment of a helpline, in line with National Treasury's MFMA initiatives. An approach of support and guidance to municipalities in the oversight relationship between the provinces and the municipalities will give provincial treasuries a good understanding of where problems may occur, and give them the opportunity to take action before a financial crisis occurs.

Oversight can take the form of support and capacity building

While financial management in local government is stronger today than it was before, challenges do remain. A municipality that fails the

requirements of financial management and prudent use of resources concerns not just itself, but also the province, and potentially the whole country, as it missed opportunities for investments and job creation.

While the financial management of municipalities is of concern to provincial treasuries, their powers of enforcement are more limited, as the general oversight function for service delivery falls under the MEC for Local Government. Therefore, establishing good working relations and cooperation with the MEC for Local Government can help to achieve many of the objectives for good financial management in the province, and ensure that any potential crisis situations may be brought to the attention of the MEC for Finance at an early stage.

■ The role of the MEC for Local Government in municipalities' financial management

The MEC for Local Government has the oversight responsibility for service delivery. However, in a situation of financial crisis, s/he plays a central role in the municipalities' financial management. This important interface with the MEC for Finance takes the following form:

When a municipality is in financial crisis it needs to inform the MECs for both finance and local government

According to chapter 13 of the MFMA, when a municipality encounters a serious financial problem or anticipates problems in meeting its financial commitments, it must immediately notify the MEC for Local Government and the MEC for Finance.

Chapter 13 of the MFMA describes two forms of financial crisis in municipal finances:

- serious financial problems
- serious or persistent material breach of financial commitments.

Serious financial problems

A number of indicators point to serious financial problems in municipalities

Serious financial problems may be indicated by one or a combination of the following factors:

- failure by the municipality to make payments
- defaulting on financial obligations
- when current expenditure exceeds the sum of its current revenue plus available surpluses for two or more financial years
- an operating deficit of more than 5 per cent of revenue in the most recent financial year
- if the municipality is more than 60 days late in submitting its annual financial statements to the Auditor-General
- if the Auditor-General has withheld an opinion or issued a disclaimer or issued an opinion which indicates a serious financial problem in the municipality

- any other material condition which indicates that the municipality may be unable to meet its obligations for financial reasons.

If the MEC for Local Government in a province becomes aware of serious financial problems in a municipality, s/he must consult with the mayor, assess the seriousness of the situation in a report – to be shared with the Minister for Local Government – and determine if an intervention according to section 139 of the Constitution (dealing with provincial intervention in local government) is required. If so, the provincial executive must decide whether or not to intervene in the municipality.

Different courses of action may be taken

Options for what to do may include issuing a directive to the municipality, taking responsibility for the relevant obligation to main service delivery, or even dissolving the municipal council and appoint an administrator, as outlined in section 139(1)(c) of the Constitution. Another directive could be preparing a financial recovery plan for the municipality, or finding other ways that would resolve the financial problems sustainably, as outlined in section 137 of the MFMA.

Serious or persistent material breach of financial commitments

Serious or persistent material breach of financial commitments may be indicated by one or a combination of the following situations:

There are a number of indicators of serious or persistent material breach of financial commitments

- failure to make payments to a lender or investor
- failure to meet contractual obligations that provides security, as described in section 48 of the MFMA
- failure to make payments, individually or in aggregate, of more than 2 per cent of the operating expenditure budget
- the municipality's failure impacting on the price of credit or availability of credit to other municipalities
- any failure to meet its financial obligations that could substantially impair its ability to procure goods, services or credit on usual commercial terms. (Please see section 140 of the MFMA for further information.)

Avenues of action

If a municipality is in serious or persistent material breach of its obligations to provide basic services or to meet its financial commitments, the provincial executive must request assistance from the Municipal Financial Recovery Services (MFRS).

The Municipal Financial Recovery Service assists municipalities that cannot carry out their mandates

The executive can request the MFRS to determine the reasons for the crisis, to assess the financial state of the municipality, to prepare a recovery plan, or to recommend changes to budget and revenue raising. The provincial executive can also ask the MFRS to submit the assessment or recovery plan to the MEC for Finance. The MEC for Finance must share this with the municipality, the Minister for Local Government and the Minister of Finance.

The MFRS prepares a financial recovery plan if necessary

When preparing a financial recovery plan, the MFRS must consult with the MEC for Finance and the MEC for Local Government, and submit the plan for comments at least 14 days before finalising the plan.

The MEC for Local Government will approve the financial recovery plan with or without comments, while the MEC for Finance will verify that the process for preparation, as outlined in section 141 of the MFMA, has been followed, and that criteria for the financial recovery plan are met, as outlined in section 142 of the MFMA.

In the case where a municipality is unable to meet its financial obligations, it can apply for stay of legal proceedings, according to section 152 of the MFMA, or for extraordinary relief, as outlined in section 153. In these situations, the MEC for Finance is copied in the proceedings.

The MEC for Finance appoints a trustee if a municipality goes bankrupt

In the case of bankruptcy and termination of financial obligations of a municipality and settlement of claims, the MEC for Finance also has a role to play in terms of appointing a trustee, which is further described in section 155(2) of the MFMA.

More details about the obligations of the MEC for Finance in the resolution of financial problems can be found in chapter 13 of the MFMA.

2

The Constitution and public finances

- This chapter explains the link between the Constitution, which states that national policies will apply evenly across the country, and the division of national revenue in South Africa – geographically and between the national, provincial and municipal spheres of government.
- The national and municipal spheres can generate funds through taxes and levies. Provincial governments have fewer options to do so, whereas their mandates for education, health and social welfare account for much of the public spending.
- The legislative process and the role of the National Assembly and National Council of Provinces in passing the budget bills are introduced in detail.

■ Introduction

Section 1 of the Constitution states that “the Republic of South Africa is one, sovereign, democratic state”, and section 40 states that “in the Republic, government is constituted as national, provincial and local spheres of government which are distinctive, interdependent and interrelated.”

These founding statements impact directly on policy and budget processes, as well as on the structure of budgets.

To understand the role of the Budget and public finances one needs to go to chapter 13 of the Constitution, which is devoted to finances. However, the starting point for understanding budget processes is chapter 3 of the Constitution, which deals with the principles of cooperative government and intergovernmental relations.

South Africa is a unitary state with three spheres of government

■ The spheres of government and the allocation of functions

The fact that South Africa is a unitary state has implications for the way government policies are developed, financed and implemented across the country. There is a constitutional expectation that key economic and social policies will apply uniformly across the country,

Services are to be provided at the same level across the country

be funded equitably, and be implemented without bias. This is re-emphasised by section 146(2) of the Constitution, which deals with instances when “national legislation that applies uniformly with regard to the country as a whole prevails over provincial legislations”, as well as by section 195(1)(d) of the Constitution, which states that “services must be provided impartially, fairly, equitably and without bias”.

These provisions provide the background against which the Constitution then divides functions between the three spheres of government: the national sphere, the provincial sphere and the local sphere.

The Constitution outlines the allocation of functions to the different spheres

Schedules 4 and 5 of the Constitution specify the allocation of functions to provincial and local government. Note that functions not listed in these schedules are automatically the responsibility of national government. Some functions are shared (concurrent) and others are exclusive. The provincial sphere performs functions like school education, health and social welfare, which do not lend themselves to substantial cost recovery, but account for a substantial proportion of public spending. Provinces only raise about 4 per cent of their own revenue. Municipalities, by contrast, have significant revenue-raising powers and collect between 60 to 95 per cent of their own revenue, as two-thirds of their activities such as water, electricity and refuse-removal, are self-funded.

Functions are shared between the different spheres of government

The large concurrent functions shared between national and provincial governments include school education, health services, social welfare services, housing and agriculture. For these functions, national government is largely responsible for providing leadership, formulating policy, determining the regulatory framework including setting minimum norms and standards, and monitoring overall implementation by provincial governments. Provinces are mainly responsible for implementation in accordance with the nationally determined framework. Given these different responsibilities, it is provincial departments that have large budgets for implementing services, while the national department has a relatively small share for its functions.

Provinces are mainly responsible for implementation

The exclusive functions are the sole responsibility of the relevant government sphere. In the case of national government, large exclusive functions include the armed forces, the criminal justice system (safety and security, courts), higher education, water and energy (electricity) resources and administrative functions such as home affairs and the collection of national taxes. These exclusive functions absorb a substantial proportion of national government’s budget. For provinces, exclusive functions include provincial roads, ambulance services, and provincial planning.

National exclusive functions include defence, the criminal system and higher education

Municipalities also have responsibilities for both concurrent and exclusive functions, like the provision of water, electricity, refuse-removal, municipal infrastructure and emergency services.

■ The division of revenue and budget process

All money received by the national government through the South African Revenue Services is paid into the National Revenue Fund, in line with chapter 13 of the Constitution. These funds can only be withdrawn from the National Revenue Fund through direct charge legislation (like the annual Division of Revenue Act) or an Appropriation Act.

The Budget

The Budget consists of a number of legislative acts:

- the Division of Revenue Act
- the Appropriation Act
- the Revenue Laws Amendment Act.

In the annual Division of Revenue Act, funds are first allocated to debt-servicing and statutory commitments, as required by section 214 of the Constitution. The Division of Revenue Act then divides the remaining revenue between the three spheres of government (vertical division), giving each its equitable share. Thereafter, the provincial and local equitable share grant is divided between each province and each municipality (horizontal division) through the provincial and local government equitable share formula, which includes criteria such as fiscal capacity, fiscal efficiency, developmental needs, economic disparities, and the need for stable and predictable revenue, as outlined in section 215 of the Constitution. Further allocations to provinces and municipalities are also made from the national equitable share, as conditional or unconditional grants.

There is a vertical and horizontal division of revenue

Once each sphere of government has received its equitable share allocation, it is required to pass an Appropriation Act – or in the case of municipalities, a budget resolution – before funds can be withdrawn for spending purposes.

The Constitution recognises the importance of the Budget and good financial management, 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” (section 215).

The requirement for good financial management is captured in the Constitution

The PFMA and MFMA give effect to this provision, by requiring transparency in the budget process and budget documents.

Intergovernmental fiscal matters and the fiscal and financial powers of provincial and municipal governments are dealt with in sections 226 to 230A of the Constitution. These sections deal with the taxation and borrowing powers of provinces and municipalities. They also establish obligations for withdrawing funds 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.

■ Financial management

Section 216 of the Constitution requires national legislation to “prescribe measures to ensure both transparency and expenditure control in each sphere of government, by introducing:

- (a) generally recognised accounting practice
- (b) uniform expenditure classifications; and
- (c) uniform treasury norms and standards.”

Uniform standards for budgets and accounts are based on the PFMA and the MFMA

The PFMA and MFMA regulate financial management in governments and public entities in all three spheres of government, as required in sections 215 and 216 of the Constitution. More importantly, these acts lay the basis for uniform budget formats and chart of accounts (expenditure classifications) that are binding on all legislatures.

Chapter 13 also contains provisions on procurement, government guarantees and the remuneration of persons holding public office.

■ National Treasury, the Reserve Bank and the Financial and Fiscal Commission

The Constitution also sets up three important financial institutions, namely the National Treasury, the Reserve Bank and the Financial and Fiscal Commission.

National Treasury ensures compliance with national standards in financial management

1. The National Treasury “must ensure compliance with the uniform treasury norms and standards” outlined in the PFMA and MFMA. The Constitution also empowers the National Treasury to even “stop the transfer of funds to an organ of state if that organ of state commits a serious or persistent breach of those measures” (Section 216(2))
2. The South African Reserve Bank is an independent central bank whose primary object is “to protect the value of the currency in the interest of balanced and sustainable economic growth in the Republic” (sections 223 to 225)
3. The Financial and Fiscal Commission (FFC) serves as an independent body accountable directly to Parliament and provincial legislatures. The FFC is required to make annual recommendations on the Division of Revenue Act and other legislation required in section 220 of the Constitution. It is therefore a key institution in relation to the development of the national budget.

The FFC makes recommendations on the Division of Revenue Act

■ The legislative role of Parliament and provincial legislatures

The powers of Parliament as the legislative authority of the national sphere of government are spelled out in chapter 4 of the Constitution. Section 44 outlines the power of the National Assembly and National Council of Provinces (NCOP) in amending the Constitution and passing of legislation. Note that the National Assembly and NCOP have more limited powers for legislating schedule 5 functions (exclusive provincial and local government competence), and that different approval processes apply for schedule 4 functions (concurrent national and provincial competence), particularly where they affect provincial finances.

The legislative powers of the National Assembly and the NCOP are outlined in the Constitution

Unfunded mandates

Unfunded mandates arise when policies are developed by national government and the responsibility for implementation is allocated to provincial or local government, but no funds or insufficient funds are given to fund implementation. Attention to unfunded mandates is therefore required when passing the budget bills.

Section 76, concerning bills that affect provinces, outlines the powers of the National Assembly and NCOP in the passage of schedule 4 and chapter 13 legislation. Both houses have significant powers over section 76 legislation. In the case of section 76 legislation, provincial legislatures need to be consulted, in contrast to section 75 legislation, which does not affect provinces. The NCOP has weaker powers for section 75 legislation, which includes legislation for non-provincial functions like the criminal justice sector, defence, foreign affairs and also all local government legislation.

The Division of Revenue Bill has to be considered by the NCOP

An important point to note is that in section 77, the Constitution also defines money bills, which are largely appropriation, direct charge, tax and levy legislation. Such national money bills have to be passed as section 75 legislation in the National Assembly, where the NCOP has weaker powers, and where matters do not have to be discussed in provincial legislatures. Hence the annual Appropriation Bill is dealt with as a section 75 bill only.

By contrast, the annual Division of Revenue Bill is NOT a money bill, even though it is a budget bill, and therefore it has to be considered by the NCOP and provincial legislatures, according to section 76(4) of the Constitution.

The Appropriation Bill does not have to be considered by the NCOP

The Division of Revenue Bill is probably one of the most important section 76 bills that both the National Assembly and NCOP (and provincial legislatures) are expected to consider, and approve. The Division of Revenue Bill must be tabled and approved in the National Assembly first, before serving in the NCOP, according to section 76(4). Note that because the Division of Revenue Bill is not a money bill, Parliament may amend it.

Money bills and the Division of Revenue Bill can only be introduced in the National Assembly by the Minister of Finance in terms of section 73(2) of the Constitution, and similarly by the MEC for Finance in a provincial legislature in terms of section 119. National and provincial legislatures should not initiate or prepare money bill legislation, as this is the responsibility of the executive, as confirmed by sections 55, 68 and 114. In terms of sections 77(3) and 120(3), Parliament and each provincial legislature must adopt legislation to spell out how they may amend a money bill, and Parliament has recently initiated such legislation. However, it should be noted that while legislation to amend money bills is outstanding, Parliament can still amend the budget through its power to amend the Division of Revenue Bill.

*Provinces can legislate for
Schedule 4 and 5 functions*

The powers of provincial legislatures are spelt out in section 104 in chapter 6 of the Constitution, and the legislative power of municipal councils is set out in section 156 in chapter 7. Note that the legislative power of a province is limited to schedule 4 and 5 functions, while that of municipalities is limited to those powers in part B of these two schedules. Provinces and municipalities can only deal with legislation outside of schedule 4 and 5 functions if such functions have been assigned to them by national legislation. Similarly, a municipality can only deal with the provincial functions if it has been assigned to do so by national or provincial legislation.

3

The intergovernmental fiscal system

- All spheres of government need funds to carry out their functions. However, some parts have limited options to raise their own revenue. In response to this imbalance, the intergovernmental fiscal system transfers money between the three spheres government, using specific formulae to redistribute revenue.
- The equitable share is the entitlement of a province or municipality of the national revenue, while conditional grants are used to meet pressing needs of specific programmes.
- The principles underpinning the intergovernmental system and the system of cooperative government are introduced in this chapter, as well as key forums and documents.

■ Government functions and their funding

South Africa has a unitary system of government but with strong features of decentralisation. Some functions are performed exclusively by one sphere of government but most functions are shared. A shared function is officially called a concurrent function.

There are three spheres of government: national, provincial and local

National government largely provides leadership, formulates policy, sets the regulatory framework including minimum standards and norms, and monitors implementation. National government also has a number of exclusive functions, which include national defence, the criminal justice systems, higher education, water and energy resources, and administrative functions such as home affairs and the collection of national taxes.

The provincial sphere performs functions like school education, health services, social welfare services, housing and agriculture. These functions account for a large part of national spending but do not lend themselves to significant revenue raising. So while provinces are allowed to raise certain taxes, levies and duties, their ability to independently raise revenue is nevertheless severely limited.

Provinces have limited opportunities for raising revenue

The provinces can only raise about 4 per cent of their revenue on their own. Municipalities, on the other hand, are able to raise between 60 to 95 per cent of their own revenue. Municipalities are responsible for concurrent functions such as the provision of water, electricity and

solid waste removal. To a large degree, these are self-funded functions. There are, however, large differences between the different municipalities' revenue generating capacities. The large urban municipalities are able to generate strong revenues, while many rural and smaller municipalities have weaker fiscal powers.

Municipalities have good opportunities for raising revenue

In response to this mismatch between the spheres' capacities to raise revenue and their functions (often referred to as a fiscal imbalance), and the differing ability to raise revenue within the spheres, the Constitution makes provision for the sharing of nationally raised revenue.

Each sphere of government is entitled to an equitable share of nationally raised revenue

Revenue is mainly collected at the national level and then transferred to the provincial and municipal levels to address these fiscal imbalances. Each of the three spheres of government is entitled to a share of the nationally raised revenue, its equitable share that enables it to perform its functions and provide the services allocated to it. In addition to the equitable share, conditional or un-conditional grants from the national revenue are also part of the intergovernmental fiscal system.

In the 2007 Budget, the national sphere received the largest allocation of 49.7 per cent of the nationally raised revenue, while provincial government received 42.7 per cent and local government 7.6 per cent. The allocations to the three spheres of government are set out in the Division of Revenue Act, which is described later.

■ Principles underpinning the intergovernmental system¹

The continuing evolution of the intergovernmental system will always be enriched by clarity and debate about some of its underlying principles. On the basis of the Constitution, various policy documents, legislation and analysis, the following principles could be a point of departure for this debate:

- **Accountability and autonomy:** All governments in the three spheres are distinctive and accountable in their own right, with specific constitutionally defined powers and responsibilities. Each is accountable to its legislature or council only, and empowered to set its own priorities within the framework of nationally agreed priorities. The power of national and provincial governments to intervene in other spheres is confined to where a sphere fails an executive obligation.
- **Good governance:** At the heart of good governance is the accountability of political representatives to the electorate and transparent reporting arrangements within and between spheres. This is achieved through: the electoral process; due reporting to national parliament, provincial legislatures and municipal councils; and an effective flow of information. While political executives are responsible for policy and

¹ These principles were first presented in the 2005 Intergovernmental Review

outcomes, accounting officers are responsible for implementation and outputs.

- **Redistribution:** All three spheres have important roles to play in redistribution, but because inequalities are spread across the national spatial economy, the redistribution of resources is primarily a national function. The equitable share formula therefore relies heavily on poverty-related criteria, and the various conditional transfers to provincial and local government focus primarily on the poor.
- **Broadened access to services:** The Constitution and current government policy prioritise service delivery to all South Africans. The responsible spheres are expected to broaden access to services at affordable costs to consumers, designing appropriate levels of service to meet consumer needs, exploring innovative and efficient modes of delivery, and leveraging public and private resources to acquire capital for investment.
- **Revenue-sharing:** The fiscal system takes into account the fiscal capacity and the functions assigned to each sphere, with each empowered to determine its own budgets, collect revenue and spend funds. Provinces and municipalities are funded through own revenue, equitable share allocations and conditional and unconditional grants. The grant system must be simple and comprehensive and not compensate sub-national governments that fail to collect the revenue due to them.
- **Vertical division:** In determining allocations to each sphere, trade-offs are involved between spheres. For this reason, the budget allocation process should be comprehensive, guided by the setting of priorities by political office bearers, and cover all aspects of governance and service delivery. Separate and ad hoc requests for funds fragment budget allocation and undermine the political prioritisation process.
- **Responsibility over budgets:** Each government has the right to determine its own budget while giving expression to nationally agreed priorities, and the responsibility to comply with its budget. To reduce moral hazard and ensure fairness, national government will not bail out provinces or municipalities that mismanage budgets, nor will it provide guarantees for loans.

■ Cooperative governance and role-players

The Constitution enjoins the three spheres of government to cooperate in policy-making and implementation. All spheres of government have to face the challenge of aligning their policy and implementation processes. Such cooperation is critical, particularly for shared functions.

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

Coordination between spheres of government is particularly critical in the South African system of government

There are key coordinating forums in the budget process

- The Extended Cabinet comprises of the national executive and the nine provincial premiers. The Extended Cabinet is the highest cooperative mechanism advising the national Cabinet when finalising the fiscal framework and division of revenue on which MTEF budgets are based.
- The President’s Coordination Council, which comprises of the national executive, the nine provincial premiers and the chairperson of the South African Local Government Association (SALGA), plays an important monitoring role within the intergovernmental fiscal system.
- Budget Council is established by the Intergovernmental Fiscal Relations Act (1997). It is constituted of the Minister of Finance and the nine MECs for Finance in the provinces. This is the body on which the national and provincial governments consult on: any fiscal, budgetary or financial matter affecting provinces; legislation that has financial implications for provinces; and financial management and monitoring of provinces.
- The Budget Forum is also established in terms of the Intergovernmental Fiscal Relations Act (1997). It consists of the Budget Council and representatives of organised local government. It plays a similar role to the Budget Council, but in relation to local government financial matters.
- MinMECs, which are sectoral policy forums of the national ministers and their provincial counterparts.
- Joint MinMECs, which are MinMECs of selected sectors and the Budget Council.

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

■ The Division of Revenue Act

Each of the three spheres of government is entitled to a share of nationally raised revenue. Section 227(1) states that each provincial and local government is entitled to an equitable share to “enable it to provide basic services and perform the functions allocated to it”. Section 214 of the Constitution requires that the Division of Revenue Act must provide for:

The Division of Revenue Act has schedules that set out the allocations and the provisions regulating the conditional grants

- the equitable division of revenue raised nationally among the national, provincial and local spheres of government
- the determination of each province’s equitable share of the provincial share of that revenue
- any other allocations to provinces, local government or municipalities from the national government’s share, and any conditions on which those allocations may be made.

The key components of the Division of Revenue Act are the schedules that set out the allocations and the provisions regulating the conditional grants. The act is complemented by a gazette, which sets out the framework for each grant included in the act, and by the explanatory memorandum, published as Annexure W1 to the Budget Review. These elements are described in more detail further on.

Intergovernmental transfers

The transfers to provincial and local government broadly fall into two categories: equitable shares and conditional grants.

Transfers to provinces are made up of the equitable share and conditional grants

Equitable shares are unconditional transfers to fund the gap that provincial and local government may experience because of their limited fiscal capacity and the significant expenditure responsibilities assigned to them by the Constitution.

Formulae are used to allocate equitable shares to each of the provinces and municipalities. These formulae are redistributive, allocating more funds to poorer provinces and municipalities in recognition of the challenges that they face in terms of raising funds for their public service delivery.

Conditional grants were introduced to meet pressing needs of specific programmes, and aim to expand the oversight role of national departments over the efficient and effective allocation of these funds. Conditional grants have been used to accomplish the following objectives:

Conditional grants are used to meet a range of objectives

- to ensure that national policy objectives in provision of standard levels of government services, and access to these, are met
- to compensate for inter-jurisdictional spillovers resulting from services provided by sub-national governments (grants for central hospitals are an example)
- to facilitate transition by supporting capacity building and structural adjustment in administrations
- to address backlogs and regional disparities in economic and social infrastructure.

Reforms introduced in successive Division of Revenue Acts have shaped the current conditional grant system. These reforms have helped to clarify accountability between the spheres of government. They have also helped to sharpen the description of policy objectives and grant outputs, which has improved the use of grants to speed up delivery and strengthened parliamentary oversight.

Provisions in the Division of Revenue Act

The Division of Revenue Act adds to the PFMA by clarifying the accounting responsibilities between transferring and receiving accounting officers. It clearly outlines the responsibilities of all stakeholders in administration of the act. Key requirements of the act include the following:

The Division of Revenue Act clarifies the responsibilities of accounting officers

- monthly and annual reporting by transferring and receiving officers
- auditing of all grants
- delaying and withholding of grants to improve performance
- payment schedules and procedure for adjustments
- other general requirements.

The act contains seven schedules. Schedule 1 deals with the equitable share for each sphere; schedule 2 deals with the division of the provincial equitable share; schedule 3 allocates the equitable share of local government to municipalities; schedules 4, 5, 6 and 7 deal with all other allocations, including conditional grants, grants-in-kind and indirect transfers to provinces and local government.

The act legislates one-year allocations, but also contains indicative allocations for the outer years of the MTEF. This enhances the predictability and stability of the transfer system, in line with section 214(2)(i) of the Constitution.

Gazette for conditional grant frameworks

The Government Gazette gives further details about the contents of the annual Division of Revenue Act

The Division of Revenue Act is complemented by a gazette which outlines a framework for each grant as part of the Division of Revenue Act for that year. The grant frameworks outline key information that informs Parliament and the public about the objective of the grant and how its performance will be measured.

The grant framework is prepared by the national department responsible for administering the grant in order to guide provinces and municipalities in planning for its implementation. The national departments must ensure that all the planning requirements for the grant are completed before the financial year begins, to avoid delays to the start of the implementation of the programmes. This information also provides a basis for Parliament and legislatures to monitor performance in the delivery of services targeted by these grants.

Explanatory memorandum on the Division of Revenue Act

The explanatory memorandum on the Division of Revenue Act is useful for providing an understanding of how the Budget is established. It explains why the budget is divided as proposed, and the formulae used to arrive at the equitable shares.

The memorandum is based in section 10(5) of the Intergovernmental Fiscal Relation Act (1997), which requires that the Division of Revenue Bill, when introduced to Parliament, be accompanied by an explanatory memorandum detailing how the bill takes account of the matters listed in section 214(2)(a) to (j) of the Constitution. These matters include national interest, provision for debt, provincial and municipal services and fiscal capacity, and economic disparity, among others. The explanatory memorandum also includes the government's response to any recommendations of the independent Financial and Fiscal Commission (FFC), and any assumptions and formulae used in

arriving at the respective divisions among provinces and municipalities.

The formula for the provincial equitable share 2008

The provincial equitable share for the 2008 Budget included a number of weighted elements to establish the redistributive formula. These elements were:

- an *education share*, based on the size of the school-age population and the number of learners enrolled in public ordinary schools
- a *health share* based on the proportion of the population with and without access to medical aid
- a *basic share* derived from each province's share of the national population
- an *institutional component* divided equally between the provinces
- a *poverty component* reinforcing the redistributive bias of the formula
- an *economic output* component based on GDP by region data.

The explanatory memorandum to the 2009 Division of Revenue Bill was published as Annexure W1 to the 2009 Budget Review. It contains five parts. Part 1 describes the division of resources between the three spheres of government. Part 2 sets out how the FFC's recommendations on the 2008 division of revenue have been taken into account. Part 3 explains the formula and criteria for the division of the provincial equitable share and for conditional grants to provinces. Part 4 sets out the formula and criteria for the division of the local government equitable share and conditional grants between municipalities. Part 5 summarises issues that will form part of subsequent reviews of provincial and local government fiscal frameworks.

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4

The division of revenue and budget process

- The purpose of the division of revenue and budget process is to establish:
 - - what the country wants to achieve in terms of public service delivery
 - - the resources available, by reviewing expenditure over the last year and expected income from tax and other income sources
 - - the allocation of resources for the coming 12-month period.
- The process matches political priorities with available resources and prioritises projects and programmes, and determines which programmes and projects will be funded.
- In this chapter, the budget process is presented, with the forums, committees, institutions, and legislative hearings that are part of it.

■ How the budget is established

The division of revenue and budget process ensures that budgeting in South Africa is led by the national and provincial executives, while at the same time adhering to principles for the compilation of technically sound budgets.

All budgets are formulated within the context of the Medium Term Expenditure Framework (MTEF), which details three-year rolling expenditure and revenue plans for national and provincial departments. The MTEF budget process is designed to match the overall resource envelope, estimated through top-down macroeconomic and fiscal policy processes, with the bottom-up estimation of the current and medium-term cost of the existing departmental plans and expenditure programmes.

The division of revenue and budget process allows government to:

- revise its policy priorities, macroeconomic framework and resource envelope
- allocate available resources between the three spheres of government in line with policy priorities

- involve role-players that provide technical advice when faced with trade-offs between competing spending priorities, while the final decision is taken by the executive
- obtain the required authority from Parliament and provincial legislatures to divide revenue and spend in accordance with the relevant budgets.

The budget process involves allocating scarce resources to meeting government's socioeconomic and political goals

The budget process is about deciding and agreeing on the best allocation of scarce resources to fund government's many social, economic and political goals. This is achieved in two parallel and linked processes: a policy prioritisation process that describes what needs to be done, and a budget review process that describes what resources are available.

Once the national executive has agreed on the most efficient allocation of available resources through a matching of the above outputs, the Budget is tabled in Parliament for legislative hearings, debate and appropriation

■ Matching resources with policy priorities

The current financial crisis is expected to impact on public spending

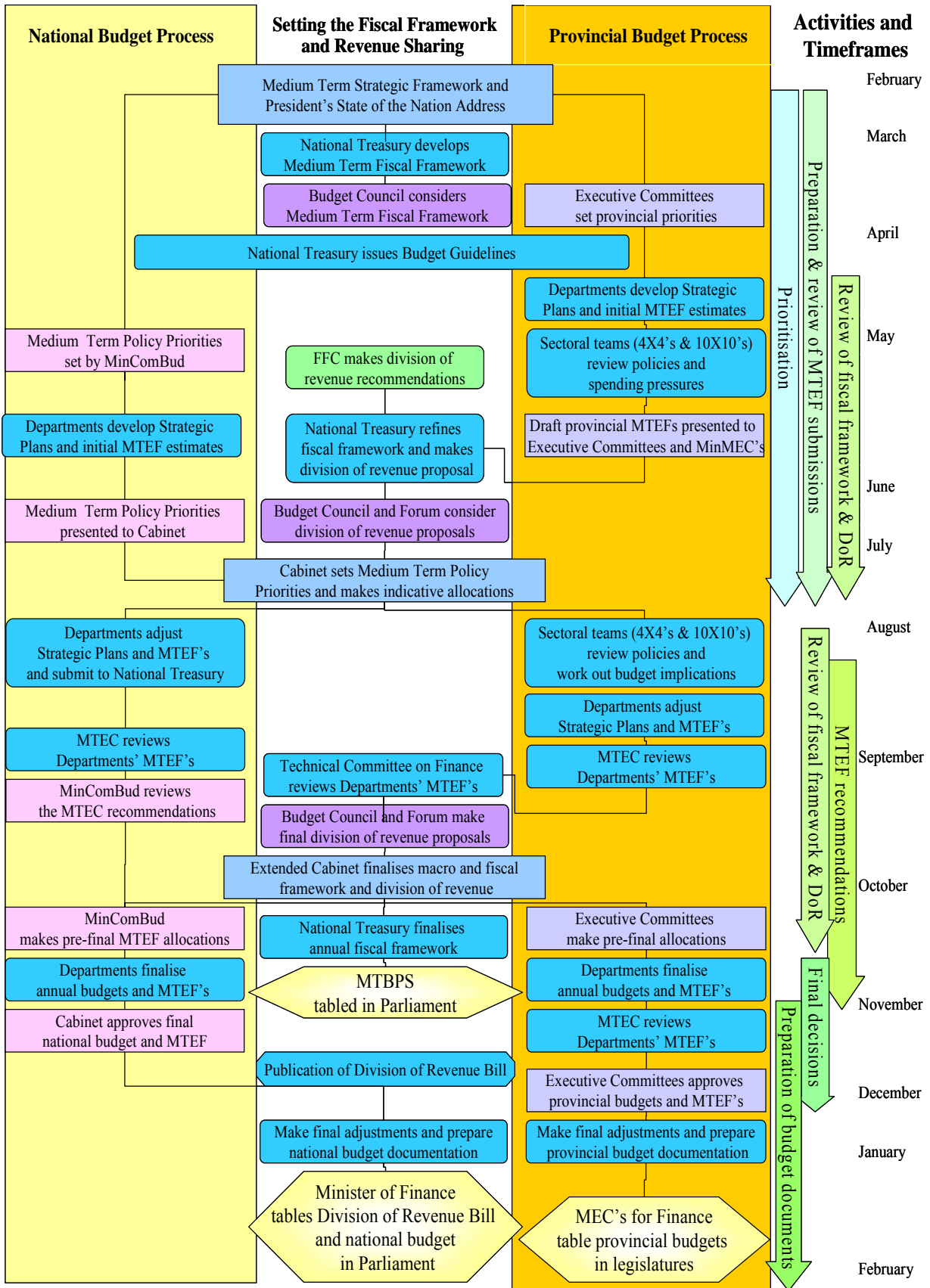
Budgets are developed within the political priorities which are clearly spelt out in the Medium Term Strategic Framework, the Programme of Action, the Accelerated Shared Growth Initiative (AsgiSA) and the Joint Initiative on Priority Skills Acquisition (JIPSA).

Factors influencing the Budget are: the rapid growth in public spending since 2001, with most areas of public spending set to double in real terms from 2001 to 2008; rapid economic growth and faster job creation, partly driven by strong public spending; and a supportive international environment in previous years. However, in the period ahead of 2009, slower economic growth owing to the global financial crisis is expected to reduce tax revenue, and the growth rate of public expenditure is expected to moderate.

Value for money is a key concern in the budget process

There are a number of areas of public spending where the pace of service delivery improvement has not been commensurate with the level of spending growth. It should be noted that value for money is a concern in the budget process, a concern which links to the need to develop performance indicators for service delivery.

The following figure shows the links between the division of revenue process and the national and provincial budgets processes:



The paragraphs that follow describe the activities noted along the right-hand side of the above figure as they relate to the division of revenue and national and provincial budget processes.

■ Policy prioritisation

The Medium Term Strategic Framework is the basis for policy priorities

The process of policy prioritisation begins 18 months before the start of the financial year with the preparation of the Medium Term Strategic Framework (MTSF). The MTSF forms the basis for the president's State of the Nation address in February each year. In this speech the President spells out government's priorities in the short and medium term. The short-term priorities should refer to objectives that government has already allocated funds for in the upcoming budget. The medium term priorities are ones that will inform the budget drafting process for the following year's budget.

2010 Budget Priorities

For the preparation of the 2010 Budget, the spending priorities are broadly:

- enhancing the quality of education and skills development
- improving the provision of health, with particular emphasis of reducing infant, child and maternal mortality rates, and broadening prevention and treatment programmes tackling HIV and Aids and tuberculosis
- investing in the criminal justice sector to reduce crime levels and enhance public safety
- expanding investment in the built environment to improve public transport and meet universal access targets in electricity, water, sanitation and housing
- decreasing rural poverty by taking steps to raise rural incomes and improve livelihoods by enhancing access to land and providing support for emerging farmers.

Medium term priorities guide technical departments in drafting their strategic plans

Working within the framework of the MTSF, the Minister's Committee on the Budget (MinComBud) develops a set of medium term policy priorities for national government. National departments will be guided by these priorities when preparing the first draft of their strategic plans for the new budget cycle. Similarly in provinces, the executive committees (or a subcommittee) set provincial priorities to guide provincial departments' strategic planning.

There are consultations between the national and provincial departments

MinComBud and the Budget Council review these medium term priorities in May, June and July - each time they are refined and their feasibility is assessed. In addition, extensive technical consultations are held between the national and provincial treasuries, and between national and provincial departments - particularly in the case of concurrent functions. These latter meetings are referred to as 10X10's or 4X4's, because of the number of national and provincial department participants. These technical meetings are often mirrored by HeadCom and MinMECs for the different functions where policy decisions on different priorities are taken.

Consultations are also held with organised local government, represented by the South African Local Government Association (SALGA), through the Budget Forum.

As part of the prioritisation process, the Financial and Fiscal Commission is required to submit its recommendations on the division of revenue among the three spheres of government for the coming year to the Minister of Finance, Parliament and the provincial legislatures. These recommendations are reviewed and considered by the various consultation forums and the National Treasury.

The independent Financial and Fiscal Commission makes recommendations on the division of revenue

During the policy prioritisation process, Cabinet and the provincial executive committees make policy choices: evaluating competing social and economic priorities in the light of resource constraints. The aim is to develop a focused set of medium-term policies to inform spending priorities that will guide the resource allocation decisions for the new medium-term expenditure period.

Towards the end of July, Cabinet approves a set of Medium Term Policy Priorities and associated indicative division of revenue totals and indicative budget allocations for national departments. Provincial executive committees set similar indicative allocations for provincial departments. Spending agencies have to adjust their initial strategic plans and MTEFs in the light of these indicative allocations.

Cabinet approves a set of Medium Term Policy Priorities in July of each year

Cabinet's decisions on policy and spending priorities are integral to firming up the macroeconomic and fiscal framework and the division of revenue early in September.

■ Preparation and review of MTEF budget submissions

The process of preparing and reviewing the MTEF budget submissions from national and provincial departments runs parallel to the policy prioritisation process. Indeed, these two processes are directly related: the one sets out what needs to be done; the other sets out what resources are available.

The process starts early in March with reviews of the Medium Term Fiscal Framework, first by National Treasury and then by the Budget Council. The fiscal framework defines what resources are likely to be available to government from taxes and other income sources during the new budget cycle; effectively, it sets an initial resource envelope for the budget process.

A review of the fiscal framework determines the budget envelope that will be available

Based on this resource envelope, National Treasury issues budget format guidelines that define the principles and formats for the preparation of MTEFs by both national and provincial departments. Departments then prepare MTEFs that include the cost of continuing existing policies, along with proposals for cost saving measures and the cost of new policy proposals. National departments are required to submit these MTEFs to National Treasury by the end of June. Provincial departments follow a similar procedure, except that they also have to take cognisance of the recommendations arising out of the first round of the 10X10 and 4X4 processes referred to above.

The MTEFs reassess the cost of existing and new policies

For the national MTEF, National Treasury evaluates the submissions in consultation with departments and submits comments to them no later than four weeks after receipt of the departmental submissions. Finally, departments may be requested to respond to National

Treasury comments or queries during August in preparation for the Medium-Term Expenditure Committee discussions early in September (see below). The processes in the provinces are much the same, with similar deadlines.

■ Review of the macroeconomic and fiscal framework and the division of revenue

A review of macroeconomic framework and fiscal framework refines the budget envelope

The Medium Term Policy Priorities and draft MTEFs are key inputs into the review of the macroeconomic and fiscal frameworks and the division of revenue process. The MTEF proposals from national departments must include details of existing and possible new conditional grants to provincial and local governments that would need to be taken into consideration in the process of determining the equitable division of revenue among the three spheres.

A second round of technical consultations looks at key provincial spending needs

The process involves a second round of technical consultations between the national and provincial treasuries, and between national and provincial departments, i.e. a second round of 10X10s and 4X4s. The aim of these meetings is to examine key provincial spending pressures and issues arising from the Medium Term Policy Priorities (particularly in relation to the large concurrent functions), as well as matters relating to the administration and implementation of conditional grants. A consultative process between National Treasury and organised local government also takes place for local government grants.

The Budget Council and the Budget Forum prepare for the decision making process

The information from these consultations feeds into the Budget Council and Budget Forum meetings. These forums, as well as the MinComBud, prepare memoranda on the preliminary macroeconomic and fiscal framework and the Division of Revenue (based on June economic data). These memoranda are taken to the Extended Cabinet late in September.

At this stage there is a good picture of the resources available and also of the politically driven priorities for the next 12 months. Now the review process becomes entwined with the recommendation stage of the medium-term allocation process that is described below.

■ Recommendation stage of the medium-term allocation process

Medium Term Expenditure Committees (MTECs) hold hearings during most of September. MTECs are technical committees that formulate recommendations to political decision-makers on changes to the medium-term allocations of departments, given the preliminary division of revenue between the three spheres of government arising out of the division of revenue workshop in October. MTEC hearings are held for both the national and provincial spheres during September, with a second round taking place during November in the case of provincial departments.

The national MTEC is chaired by the director-general or a deputy director-general of National Treasury and includes senior National Treasury officials and other director-generals from a number of key departments - including the Presidency and the Department of Public Service and Administration. The provincial MTECs involve officials from National Treasury together with the relevant provincial treasuries and provincial line departments.

The MTECs recommend changes to allocations to departments

The accounting officer, chief financial officer and other senior departmental officials are invited to the MTEC hearings. The purpose of these hearings is to evaluate the MTEF budget submissions of departments, assessing how they propose to reprioritise within their baseline allocations.

Key issues in departments’ budget proposals

When preparing for the MTEC hearings in September, National Treasury focuses on the following aspects of each department’s MTEF budget proposal:

MTEC hearings are held every September

- the proposed revisions to a department’s medium-term plans and how they link to government’s policy priorities and the key challenges identified for each sector
- the credibility of the costing and the affordability of the new proposals
- the department’s ability to implement new proposals over the MTEF period, based on past performance and expenditure trends
- the outputs to be achieved in support of measurable objectives.

The MTEC will discuss each of the above areas with the relevant department, and finalise a recommendation to MinComBud and Cabinet that details changes to a department’s programme structure, measurable objectives, and changes to programme MTEF allocations.

The MTEC makes recommendations to the MinComBud and Cabinet

Departments are required to defend proposed increases or decreases to their MTEF allocations.

Recommendations arising out of the provincial MTEC hearings are refined by the Technical Committee on Finance and then submitted to the Budget Council for consideration, which in turn makes recommendations on the division of revenue to the Extended Cabinet meeting at the end of September.

Taking account of the preliminary macroeconomic and fiscal framework and the division of revenue proposals coming from this meeting of the Extended Cabinet, the national MTEC submits recommendations to MinComBud on changes to the three-year allocations for national votes. It takes into account government’s broad policy and spending priorities for the next three years, as guided by political discussions at the start of the budget cycle. This takes place early in October.

This leads directly into the drafting of the Medium Term Budget Policy Statement (MTBPS), which the Minister of Finance tables in Parliament at the end of October each year. The MTBPS draws together all the preceding policy prioritisation, the national and provincial MTEF, the macroeconomic and fiscal framework and the division of revenue processes. In essence it gives a summary of the budget decisions made to date, and specifies the framework for the remainder of the budget process.

The MTBPS summarises budget decisions

National Treasury is responsible for drafting the MTBPS during October. A revised macroeconomic and fiscal framework and division of revenue is presented to the Budget Council and the Budget Forum, and subsequently to Cabinet in mid-October (based on September data). The national MTEF allocations are also presented to the MinComBud in mid-October. Then both are compiled into the MTBPS that is presented to Cabinet, before being tabled in Parliament.

The tabling of the MTBPS represents an important milestone in the budgeting process. It marks the 'end' of the division of revenue process, and a transition from the review and recommendation stages to the final decision making stage.

■ Decision stage of the medium-term allocation process

"Pre-final allocations" for the equitable share are made to the provinces after the MTPBS is tabled

Following the tabling of the MTPBS, National Treasury issues "pre-final allocations" to the provinces, detailing their equitable share from the division of revenue, and their share of conditional grants. Based on these allocations, provincial treasuries hold a second round of MTEC hearings before the final allocations to provincial departments are made in mid-December.

Following the presentation of the national MTEF allocations to MinComBud in mid-October, final recommendations are presented to Cabinet for approval in early November. Cabinet's decision on changes to the MTEF allocations of national votes are set out in 'pre-final allocation' letters to departments in mid-November. These detail the rationale and conditions of the allocations to national votes for the new MTEF period.

■ Preparation of the Budget

Final consultation on the division of revenue takes place in January

A draft of the Division of Revenue Bill is usually produced early in October, as the allocations it makes form the basis for finalising the other components of the national and provincial budgets. An early draft of the bill is circulated to the Financial and Fiscal Commission, provincial MECs for Finance and organised local government early in November, in preparation for final consultations on the division of revenue at the end of January. Towards the end of January, Cabinet reviews the bill, taking into account recommendations flowing from the consultations, and approves the bill for tabling.

Once the MTBPS has been tabled, National Treasury sends “pre-final allocation” letters to all national departments and spending agencies. In the provinces, the provincial treasuries send similar ‘pre-final allocation’ letters to the provincial departments and spending agencies. Following the issuing of these letters the process of preparing the budget documentation starts in earnest.

National Treasury is responsible for the production of the Budget Review, and coordinates the production of the Estimates of National Expenditure. Each national department is required to submit a chapter on the department’s vote for the Estimates of National Expenditure. These chapters, in compliance with the formats prescribed by National Treasury regulations, focus on policy developments, expenditure trends and service delivery indicators. Much of the drafting takes place during December and early January. The accounting officers of departments are then required to ‘sign-off’ on their respective chapters in the second week of February, just before the documents are submitted for printing.

The ENE contains policy developments, expenditure trends and service delivery indicators

National Treasury also prescribes the format of the budget documentation that the provincial treasuries have to produce². This takes the form of the Overview of Provincial Expenditure, previously called Budget Statement One, which is similar to the national Budget Review, and the Estimates of Provincial Expenditure, previously called Budget Statement Two, which is similar to the Estimates of National Expenditure. The provincial departments are each required to submit a chapter on the department’s vote, and the accounting officers are required to sign off on the information they submit. The provincial treasuries compile these chapters to make up the Estimates of Provincial Expenditure.

National Treasury prescribes the format for budget documentation for the provinces

The drafting phase ends on Budget Day. In the past, Budget Day was held towards the end of March. However, in recent years it has been held in the second week of February, to allow Parliament more time to debate the budget before the start of the financial year on 1 April. On Budget Day, the Minister of Finance delivers his Budget Speech and tables the Division of Revenue Bill, the national Appropriation Bill, the Estimates of National Expenditure and the Budget Review.

The Budget is presented in February

The provincial MECs for Finance table their provincial budgets, comprising of the Overview of Provincial Expenditure and the Estimates of Provincial Expenditure in the respective provincial legislatures in the two weeks following Budget Day.

Provincial budgets are tabled two weeks after the national Budget

Legislative hearings, debate and appropriation

On Budget Day the Minister of Finance presents to the legislature the outcome of the Executive’s budget process in the form of a three-year

² In terms of section 6(2)(a) of the PFMA, and section 215(2)(a) of the Constitution.

expenditure framework, and seeks legislative appropriation for the first year.

The national budget is presented as two pieces of legislation, introduced simultaneously:

- The Division of Revenue Bill prescribes how revenue will be divided between the three spheres of government and between the nine provinces.
- The Appropriation Bill, once enacted, gives national departments the legal authority to spend money allocated to them. A brief summary of the Appropriation Act is given in the box below.

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. The Appropriation Act is therefore the legal framework for departments to 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 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. 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 Minister of Finance also tables the Budget Review, the Estimates of National Expenditure and the Estimates of National Revenue. These documents 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
- the 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
- government's medium-term expenditure framework and the division of resources between the three spheres.

The Portfolio Committee on Finance and the Joint Budget Committee have distinct functions

Immediately after tabling in Parliament, the budget documentation is referred by the National Assembly to the Portfolio Committee on Finance (PCOF) and the Joint Budget Committee (JBC). The JBC and the PCOF have responsibility for different parts of the budget. Public hearings and debate on expenditure estimates and service delivery objectives are referred to the JBC, whereas the PCOF deals with macroeconomic policy and tax policy.

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

The PCOF in the National Assembly passes the Division of Revenue Bill within a week of Budget Day, and leaves it to the NCOP to examine the bill in detail. The Division of Revenue Bill is normally amended by the NCOP in the process, and is brought back to the National Assembly thereafter, as it is a section 76 Bill.

The Division of Revenue Bill is usually amended by the NCOP

The PCOF and JBC consider the Budget and hold public hearings on its various parts before reporting back to the National Assembly. The committees may also refer specific aspects of the Budget to another portfolio committee in Parliament. The PCOF leads the first reading debate (broad macroeconomic issues) on the Appropriation Bill, which is concluded in mid-March.

The JBC leads the second reading debate on government spending, after the relevant portfolio committees have considered and debated their departmental budget votes in committee and in the National Assembly. The National Assembly then proceeds to process the Appropriation Bill, which focuses only on the allocation of the national equitable share among national votes.

In the provinces, the MECs for Finance table the provincial budgets within two weeks of the tabling of the national Budget. The provincial budgets consist of a provincial appropriation bill, supported by a Budget Statement. The Budget Statements are divided into two parts:

- Overview of Provincial Expenditure (previously called Budget Statement One) is the equivalent of the national Budget Review
- Estimates of Provincial Expenditure (previously Budget Statement Two) is the equivalent of the national Estimates of National Expenditure.

In addition, each provincial department is required to table an Annual Performance Plan (APP) soon after the tabling of the budget. The APP sets out the service delivery performance indicators and targets that the provincial departments aim to deliver on, on the basis of the funding made available to them through the provincial budgets.

Provincial departments table their Annual Performance Plans after their budgets

Provincial legislatures have Portfolio Committees on Finance, which follow a similar procedure to the JBC for approving the provincial budgets. This involves a first and second reading and then a debate in the house, followed by a vote.

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5

Borrowing by provinces

- Taking out a loan can create options for a province to speed up delivery of its public service obligations, for example, by improving existing buildings or building new schools. This chapter introduces the conditions, purposes and processes involved when a province wants to take out a loan.

Loans for bridging purposes and capital projects

Provinces are granted the ability to take out loans, according to section 230 of the Constitution, for either current expenditure or capital projects:

- To cover a shortfall in current expenditure, a province may take out a short-term loan for bridging purposes, to be repaid within 12 months.
- If a province experiences a backlog in development of infrastructure, long-term loans can serve to meet such pressing priorities.

Since the enactment of the Constitution, loan and project appraisal processes have been strengthened, to create a flow of capital to provinces that may help them meet their obligations in service delivery.

National government or private banks can lend money to provinces

Conditions for loans

For capital projects, the Borrowing Powers of Provincial Governments Act (1996) lists the conditions for a province to take out a loan. The most important of these conditions are:

- Only the MEC for Finance may take out a loan on behalf of the province.
- Loans must be approved by the Loan Coordinating Committee (LCC), which is chaired by the Minister of Finance.

- Loans may be taken out as direct borrowing from the national government or from private banks and financial institutions.
- Provinces cannot take out loans in foreign currency except unless specifically authorised to do so by the MEC for Finance.
- The interest of the loan shall be within certain limits and accepted by the MEC for Finance.
- A province's total expected amount of interest to be paid at the end of the year must not exceed a certain percentage in relation to the total budgeted current revenue, determined by the MEC for Finance
- Loans shall be recorded in the books of the province as current and capital transactions.
- National government does not guarantee loans taken out by provincial governments and shall not bail out any provincial government unable to repay its loans.

This last point was established as a principle following the crisis in 1997, when provincial governments overspent their budgets massively, using short-term bank loans to cover the deficit. To deal with the crisis national government could either bail out the overspending provinces, or insist that provinces repay their own debt. After careful analysis, it was decided not to follow the bail-out route, as this would undermine fiscal discipline and expose the fiscal system to continuing risks.

Provinces can take out loans either from the private capital market or through on-lending from national government.

■ Capital projects: Borrowing for which purposes?

The major purposes for which provincial governments may take out long-term loans for capital projects include:

- deferred maintenance
- other improvement to existing buildings
- new schools and equipments
- new health buildings and equipment
- new roads
- restructuring of existing assets
- other forms of economic development.

Capital projects are classified according to the definitions below:

Mega projects or programme: Estimated to cost more than R300 million per year for a minimum of three years, or a total cost of at least R900 million. All mega projects require comprehensive appraisal by the Capital Budgets Committee (CBC).

Large projects or programmes: Estimated to cost between R50 million and R300 million per year and totalling more than R150 million but less than R900 million over the three-year period of the MTEF. Large projects require detailed information and a feasibility study to be scrutinised by the CBC.

Small projects or programmes: Estimated to cost less than R50 million per year and not more than R150 million for the three year period of the MTEF. Small projects with similar outputs may be grouped in a programme for evaluation. Small projects outside of a programme will not be subject to CBC review.

Borrowing procedure for mega projects

If a province wants to take out a loan for a mega project – projects with a value of more than R300 million per year for more than three year – the process is as follows:

Particular steps need to be followed in the borrowing process

- The MEC for Finance submits to the Executive Council of the province a project concept paper or pre-feasibility study, which explains key aspects of the project, its expected benefits, timeframe and resource requirements.
- The Executive Council will review the concept paper, evaluate it against other provincial priorities, and coordinate with national level stakeholders to ensure alignment with national priorities from an early stage, and explore funding opportunities.
- The concept paper will be passed to the provincial treasury which will determine if further inputs are required, and then submit the concept paper to the national Technical Committee on Finance (TCF).
- At the pre-feasibility stage, the study must have no more than a 25 per cent margin of error on the cost estimates. Furthermore, the pre-feasibility study should note if the project will require national co-funding.
- The TCF will review the list of mega projects from the provinces and recommend selected projects, based on their merit, to the Budget Council.
- These projects will be required to do a full feasibility study, to further test their viability.
- The full feasibility study will be submitted to the Capital Budgets Committee (CBC), which consists of the technical departments involved in infrastructure development for a detailed review in corporation with the provincial treasuries.
- Following the CBC review, the Budget Council will take a decision for final recommendation, and submit it to Cabinet for approval.

The Technical Committee on Finance recommends projects for further scrutiny

The Capital Budgets Committee carries out a detailed review

The Budget Council makes final recommendations

Mega projects require long-term funding beyond the three-year timeframe of the MTEF. Therefore, funding for full project costs, including annual operational costs over the lifetime of the project,

must be reported, and funding committed by the parties to the projects.

■ Project appraisal process

The Budget Council has so far approved relatively few mega projects, primarily because many of the proposed projects have not been sufficiently in line with core purposes, or because the project documentation has been found lacking or insufficient. The project appraisal process that has to take place before a mega project can be approved is based on the following procedure:

- **Pre-feasibility study:** determines, as a first attempt, if it makes sense to continue with the project in view of the demand for the project, budgetary considerations, and technical and engineering aspects of the project. The pre-feasibility study should provide a clear perspective of the strategic intent, potential and estimated cost and benefits, as well as risk factors.
- **Feasibility study:** a full feasibility study is carried out as a thorough analysis of the project's viability, if the national Technical Committee on Finance recommends the project. The feasibility study will typically include a financial analysis, an economic analysis, an environmental impact assessment and a risk analysis, which are described below:
 - **Financial/Budget analysis:** determines if a project is financially sustainable and is the cornerstone of any major capital investment.
 - **Economic analysis:** helps to determine how a project contributes to the welfare of society.
 - **Environmental impact assessments (EIA):** determines what impact a project will have on the environment. An EIA is required by the Department of Environmental Affairs and Tourism for any major project that may have an impact on the environment.
 - **Risk analysis:** identifies all key risk variables of technical, financial operational and economic nature that could affect the viability of the project.

The feasibility study needs to include a range of analyses

More information about the provinces' ability to take out loans can be found in the Borrowing Powers of Provincial Governments Act (1996). See also the following chapters on budgeting for infrastructure and capital projects and PPPs.

6

Taxation by provinces

- Historically, provinces have generated only limited resources on their own, because many of their services are unable to generate significant funds. However, increased taxes can be a low risk option for a province to expand its revenue stream. The process of instituting new provincial taxes is discussed in this chapter.

■ Introduction

Provinces have the right to impose taxes according to the Constitution, section 228. More specifically section 228 states that:

- (1) A provincial legislature may impose
 - a. taxes, levies and duties other than income tax, value-added tax, general sales tax, rates on property or customs duties; and
 - b. flat-rate surcharges on any tax, levy or duty that is imposed by national legislation, other than on corporate income tax, value-added tax, rates on property or custom duties.
- (2) The power of a provincial legislature to impose taxes, levies, duties and surcharges
 - a. may not be exercised in a way that materially and unreasonably prejudices national economic policies, economic activities across provincial boundaries, or the national mobility of goods, services, capital or labour; and
 - b. must be regulated in terms of an Act of Parliament, which may be enacted only after any recommendations of the Financial and Fiscal Commission have been considered.

Legislative framework

In terms of section 228(1) of the Constitution, provinces may impose taxes, levies and duties other than income tax, VAT, sales tax, property rates and custom duties. In addition they may also levy a flat rate surcharge on the tax base of any tax, levy or duty imposed by national legislation, except for corporate income tax, VAT, rates on property, and custom duties. The Constitution further specifies that provincial taxing powers be regulated by an act of Parliament. The Provincial Tax Regulation Process Act (Act 53 of 2001) gives effect to this.

In terms of Section 18 (1)(c) of the PFMA a provincial treasury must promote and enforce transparency and effective management in respect of, amongst other things, revenue of provincial departments and provincial public entities. The core roles of revenue components within provincial treasuries are the monitoring and co-ordination of the revenue portfolio of the province.

Section 38(1)(c) of the Public Finance Management Act (Act 1 of 1999) requires that an accounting officer of a government department must take effective and appropriate steps to collect all money due to the department. Sections 7, 11 and 21 prescribe how the collected revenue should be managed and how the respective revenue funds should be configured and controlled.

Section 22 of the PFMA exempts schedule 3 public entities from depositing any monies collected into the Provincial Revenue Fund. This makes it very important for provinces that use such entities to collect revenue on their behalf to enter into clearly stipulated agreements with such public entities.

The process of establishing new provincial taxes

In 2001, the Provincial Tax Regulation Process Act was enacted. This act expands the provincial taxation powers, and describes requirements and the process of enacting the proposals.

Requirements to a provincial tax proposal

The proposal for a new tax must describe issues such as:

- the tax base
- the desired tax rate
- the person liable for the tax, tax relief or exemptions measures
- the methods and likely costs of enforcing compliance with that tax
- procedures for tax payer assistance
- the estimation methods and assumption used to determine the amount expected to be collected over a three year period
- the economic impact on individuals and business in the province and in other provinces

- the impact on economic development in the province

The Act specifies a two stage process for introduction of a new provincial tax, as follows:

- A province contemplating a new tax would submit a proposal to the Minister for Finance, 10 months ahead of the tabling of the budget that will introduce the proposed new provincial tax.
- After evaluating the proposed tax and considering the recommendation of the Financial and Fiscal Commission, the Minister for Finance would approve the tax, by passing national legislation authorizing the tax. The approved tax would then effectively become part of a list of taxes that are permissible.

The Minister for Finance has to approve new provincial taxes

The province would then be able to pass provincial tax legislation to impose the proposed tax. Such a tax bill can only be proposed by the MEC for Finance in a province.

Unless otherwise designated by the Minister for Finance, the South African Revenue Services (SARS) is the collecting agent for provincial taxes.

However, historically, only few provinces have expanded their taxes.

Experiences

Some lessons have been learned from previous attempts to establish provincial taxes:

- the revenue yield should be significant in order to justify the tax
- surcharges on price sensitive and highly volatile items such as e.g. fuel may have complex implications
- the proposed tax should be easily administered without requiring excessive investment in new administrative systems
- the proposed tax should not endanger national economic policies.

Provincial taxes, however, are an underutilized source of revenue, which can be harnessed to secure funds for service delivery.

It can be instructive to review the recommendations of The Commission of Inquiry into certain Aspects of the Tax Structure of South Africa in its Synthesis of Policy Recommendations with regard to Provincial Taxation (1998). Among the recommendations by the commission were:

Recommendations by the 1998 tax commission

Taxes on services: taxes on services with relatively immobile tax bases such as rates on rural land or tourist taxes appeared to be ideal candidates for tax devolution, especially since many local and provincial governments already appeared to have considerable experience in this field.

Environmental taxes: The imposition of environmental taxes would be justified on the basis of user charges as the “polluter-pays” principle is the very basis of these corrective charges.

However, due to the inter-jurisdictional spillover effects of some polluting agents, not all environmental charges or green taxes are suited for devolution, and compensation for negative externalities should be decided on a case-by-case basis.

User charges: The Commission, after evaluating all the evidence submitted to it, expressed the opinion that the more provinces were able to make use of user charges for their own facilities, the better.

Taxation remains an attractive alternative to borrowing, the benefit being that there few direct adverse affects on provinces’ finances.

All taxes are a section 75 money bill issue, for which provinces have weak legislative powers. For more details on this issue, see chapter 2 on the Constitution and public finances.

Surcharge on income tax: issues in a proposal for provincial taxes

In 1999, the Budget Council considered a provincial income surcharge tax. Among the problems identified were:

- data on personal income tax by province were not readily available
- some companies with branches over several provinces administer their salary payment from one head office in one province
- some tax payers live in one province and are registered in another province
- provinces would be open to shocks caused in case of undercollection of taxes.

■ Current provincial revenue sources and trends

Currently provincial own revenue is mainly derived from Road Traffic Act fees, hospital fees, gambling fees and income on interest. In addition, all provincial departments contribute to provincial own revenue in one way or the other. Although provincial own revenue only constitutes on average 4 per cent of provincial revenue, on the margin it still remain an important source of revenue.

Road traffic act fees

Provinces have exclusive responsibility under the Constitution for provincial road management and traffic control. The Constitution, however, provides for concurrent responsibility for public transport, traffic registration and vehicle licensing.

Motor vehicle registration and licensing, roadworthy testing, the issuing of learners and drivers licenses, and other traffic-related

activities are done in terms of the Road Traffic Act of 1996 and relevant regulations.

In terms of this Act, provinces have the authority to set fees and appoint registering agents to undertake specific functions on their behalf in return for a commission. Provinces should enter into performance agreement with these agents that clearly outlines the revenue targets to be met, the commission structure and a framework for transferring funds to and from agents.

The revision of fees or tariff structures and appointment of either local authorities or other agents are effected through provincial gazettes. Provinces charge fees for services other than those in the Road Traffic Act. For example, some provinces require heavy trucks to obtain abnormal load permits to travel on provincial roads have not enacted province specific Road Traffic Acts.

Hospital patient fees

The highest proportion of revenue generated by the health sector is from user fees. Medical aid schemes, the Workmen's Compensation Fund, the road accident fund, are among others, the main sources of revenue in this category. Other health-related sources of revenue include boarding and lodging, parking fees, fees charged to doctors for using state facilities for private patients, and income from health training activities.

Hospital patient fees are generated in the main from sales of services to external or private patients in a competitive market and can thus not be classified as compulsory fee. The provision of this service for subsidised patients is constitutionally mandated and is provided to patients who may only pay a portion of the tariff or alternatively receive services free of charge.

Gambling and betting

There are mainly two distinct categories of gambling and betting namely horse racing and the casino.

The role of gambling boards

The National Gambling Act of 1996 provided the framework and regulations for the management of gambling and the collection of fees. The national legislation aims to promote norms and standards while empowering legislatures to pass regulations or laws on provincial gambling. The Act provides for the regulation and coordination of matters relating to casinos, gambling and betting. It establishes the National Gambling Board and makes general statements underlying gambling in the country with special reference to:

- the number of casino licenses to be issued and its distribution across provinces
- principles for regulating the industry
- the appointment of inspectors to ensure compliance
- guidelines on key provincial licensing issues

- prevention of provincial laws on prejudicing the interest of other provinces and National Treasury promote uniformity.

Provinces are able to enact gambling legislation

Provinces enact their own gambling legislation to regulate gambling processes within provinces. It is the establishment of these acts that contributes to the significant differences in the regulations as well as procedures in dealing with gambling in provinces.

Provinces have also established gambling boards in terms of these acts. These gambling boards are public entities in terms of the PFMA. The provincial gambling boards mainly regulate the gambling industry in terms of its own legislation and within the national framework and are mainly responsible for:

Roles of provincial gambling boards

- ensuring compliance of gambling establishments to gambling legislation
- regulating the industry in the province
- ensuring that the industry is ran in terms of national norms and standards
- protecting the provincial industry against unfair competition from other provinces and ensuring that the industry does not jeopardise national interest
- setting of rates and collection of tax or any other revenue on behalf of the provincial government and serves as conduit through which gambling and betting revenues are collected for the province.

The funding of Gambling Boards ranges from self-sustainable in Gauteng to fully funded in the Western Cape. The Boards are regulated and submit annual reports and audited annual financial statements to the provincial legislature and the National Gambling Boards for approval.

Systems for processing betting revenue

These gambling boards have, in conjunction with casino operators, betting agencies and totalisator boards, developed systems and procedures to levy, process, and monitor gambling and betting revenue. Systems and procedures for monitoring, recording and collecting of revenue differ across provinces. This function is devolved to gambling boards and in some cases these are not efficient in their operations. In addition, the departments responsible for monitoring them are also not actively involved in monitoring their operations.

Systems in casinos are fully tested by the board and SABS approved. All machines in casinos are also linked to central monitoring systems, each transaction generated at these machines is inputted and registered at the central monitoring system. All machines are sealed and tampering of any kind will result in exception reports by these central monitoring systems and this, according to the Board, eliminates any chances of understating revenues generated by casinos.

Horsereading has established regulation, fee structure and administration systems.

The gambling and betting fees structures, in some cases have no basis and appear to be determined arbitrarily. The process of developing the tariff structure is not clear. The consultation process between the department responsible for this revenue, the gambling board and legislature approval of fees is not clear. In addition, there are no clear parameters used to review fee structures.

Liquor Licenses

In terms of schedule 5 of the Constitution liquor licenses is an exclusive competence of provinces. The collection of these licenses is regulated in terms of the National liquor Act, No 27 of 1989. Provinces are in terms of this act allowed to apply specific fees for liquor licenses.

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7

Exercising oversight

- The provincial legislatures have the oversight function over the service delivery and programmes that the executive implements, according to the Constitution.
- The oversight concerns not only financial aspects but also service delivery, i.e. if programmes are actually delivering and providing value for money. This creates a demand for access to performance information.
- Public accounts committees play a crucial role in the financial oversight. Annual performance plans and annual reports, which include also the audit reports, are key instruments in the oversight of service delivery.

■ Introduction

The Constitution separates the legislative role of Parliament from the executive role of the Cabinet. Cabinet is vested with executive powers and proposes policies and budgets, which take effect when adopted by Parliament, as outlined in section 44 of the Constitution. Once Parliament has adopted the budget, it is up to the Executive to implement the budget. The Executive relies on its administration, the departments, to carry out the programmes for service delivery funded through the Budget.

However, Parliament has an oversight function, to ensure that the administration in fact does deliver the programmes that have been approved through the Budget. Provincial legislatures have similar oversight powers to the National Assembly in relation to the oversight of provincial executive organs of state.

Provincial legislatures have an oversight function over the provincial executive

Historically, oversight functions have focused on the financial aspects of programmes, with the aim to ensure that rules and regulations were

observed. However, the growing need to ensure value for money means that the oversight functions of legislatures increasingly focus on service delivery outputs and outcomes, i.e. whether departments are delivering the services that they are required to, and whether the programmes create the expected benefits for the population.

Annual reports are important tools for oversight

Evaluation of the annual reports prepared by departments is a crucial tool for the legislature to hold departments accountable for their service delivery performance, together with the evaluation of budget documents, and strategic and Annual Performance Plans. Departments' annual reports must include the annual financial statements and the audit report on those statements.

For the National Assembly and the provincial legislature, carrying out the constitutional requirement of oversight of their respective executives, is an enormous task. It would be impossible for the National Assembly sitting in plenary to review all performance aspects of the 35 national departments and approximately 200 national public entities. Legislatures therefore establish portfolio committees to facilitate their oversight work. This division of labour enables the committee members to become experts in different fields and hence be able to provide oversight work of high quality.

Public accounts committees are a key player in the oversight function

In most legislatures, the larger part of the oversight work is done by the public accounts committees, which have traditionally been responsible for exercising end-year oversight of the use of finances by government. The annual reports are generally also referred to the relevant portfolio committees, but the oversight work of these committees has traditionally been less systematic and standardised. While some committees are proactive and exercise robust oversight, others do not. This must be seen in relation to the fact that, previously, legislatures focused on narrow financial oversight only, through the public accounts committee process.

However, the pattern seen in the budget process, where the division of labour between the public accounts committees and the portfolio committees generally works well, is emerging also in relation to the oversight function.

To ensure that the National Assembly and the provincial legislatures can perform their oversight functions properly and in a timely manner, ministers/MECs need to table their annual reports no later than 30 September in accordance with section 65 of the PFMA.

On the following pages, various key tools and documents for oversight are presented. (Please see also chapter 11 (Monitoring)).

■ In-year monitoring

In-year monitoring safeguards against overspending

While annual reports allow legislatures to evaluate performance of a department after the end of the financial year, monitoring of the performance during the financial year is facilitated by in-year quarterly reports. National Treasury gazettes the monthly reports on the financial state of the budget from provinces, as required through

section 32 of the PFMA, and issues them as quarterly financial reports.

In Parliament, the Joint Budget Committee considers the quarterly financial reports, and tables formal reports in the National Assembly. Similarly, in provinces, most finance portfolio committees hold hearings to discuss each quarterly financial report, but do not necessarily issue a formal report to the legislature. Sectoral portfolio committees may also use the quarterly performance reports to assess in-year performance of departments.

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

While in-year monitoring is a highly valuable tool to help ensure no overspending takes place, the focus is presently on streamlining performance indicators to focus explicitly on matters directly relevant to the delivery of services, and to separate these from management or process objectives.

Performance indicators need to be streamlined to focus chiefly on service delivery

For concurrent functions that are shared with provinces, National Treasury, together with the provincial treasuries, national departments and sectoral MinMECs is developing sector-specific budget and performance formats. This requires the full support of all national and provincial legislatures, and will allow comparison of information and performance of the same functional department across sectors.

■ Annual reports

Annual reports are the key reporting instruments for departments to report against the performance targets outlined in their Annual Performance Plans (APPs), which are tabled along with the Budget. Annual reports therefore must contain non-financial service delivery information, in addition to financial statements and the audit report.

The challenge facing government is to ensure that departments provide good quality non-financial service delivery information in their APPs with tight performance targets, and to ensure that departments report against those targets in their annual reports.

Annual Performance Plans should have performance targets

Reforms since 2000, based on the PFMA and the Public Service Act (1994), now require accounting officers to table performance targets for each main division of the vote before the start of the financial year. For the provincial sphere, these performance targets are presented in the Estimates of Provincial Expenditure (previously Budget Statement Two) and in departments' strategic plans.

Annual reports are prepared in accordance with the guide for preparation of annual reports by national and provincial departments, issued by National Treasury and supplemented by other guides that focus on non-financial performance and human resource information. This standardised approach ensures that information is comparable between provinces. While legislatures may request further information from their departments, care should be taken not to duplicate reporting provisions.

Financial statements need to be included in annual reports

Annual reports must also include the financial statements. The primary aim of the financial statements is to report on the departments’ use of funds, which the legislature appropriated from the relevant revenue fund. Further aims of the financial statement are to report on the department’s management of income, expenditure, transfers, cash and assets, as well as the state of its financial management systems.

The audit report

The audit report of the financial statement must also be part of the annual report. The audit report is the only independent assessment of the quality of the financial statement, and therefore one of the most important reports to consider in the oversight function.

The table below outlines the range of opinions used by the external auditors in terms of international standards of auditing and gives an explanation of the different opinions.

Classification of audit opinions used by the external auditor	
AUDIT OPINION	Explanation
a. Unqualified audit opinion	Good opinion – the financial statements may be regarded as fairly reflecting the financial status of the department or entity.
b. Unqualified audit opinion with emphasis of matter	Least severe opinion – the financial statements may be regarded as fairly representing the financial status of the department or entity, but there are a number of issues that are cause for concern which are raised in the emphasis of matter.
c. Qualified opinion (look for the words “except for”)	Severe opinion – when the auditor concludes that an unqualified opinion cannot be expressed, but that the effect of any disagreement with management, or limitation on the scope of the audit is not so material or fundamental as to require an adverse opinion or a disclaimer of opinion.
d. Adverse opinion (look for the words “do not fairly present”)	Most severe opinion - expressed when the effect of a disagreement is so material and fundamental to the financial statements that the auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements.
e. Disclaimer (look for the words “I do not express an opinion”)	No opinion expressed (also very severe) – when the auditor concludes that the possible effect of a limitation on the scope of the audit is so material and fundamental that the auditor has not been able to obtain sufficient appropriate audit evidence, and accordingly is unable to express an opinion on the financial statements

Qualified, adverse or disclaimed audit opinions are a cause for great concern as they could point to serious financial mismanagement.

However, it should be noted that the scope of audit opinions is narrow and may not cover transgressions of sections 213(2) and 226(2) of the Constitution, regarding the unauthorised withdrawal of funds. For this

and other reasons the auditor also issues an “emphasis of matter”, which focuses on critical risk areas or weaknesses in financial management systems that the accounting officer of accounting authority should address. Even if an audit opinion is “unqualified” one should pay close attention to “emphasis of matter”.

Information on programmes and service delivery

As noted at the outset of this chapter, legislatures are increasingly concerned with non-financial performance aspects of the annual reports in their oversight function. Historically, this kind of information has been rather weak, but departments are required to pay attention to this aspect of oversight.

Annual reports also need to include non-financial performance information

The information on programme performance basically concerns the degree to which the department has delivered on its strategic plan and budget, specifically:

- achievement of outcomes, i.e. progress in achieving stated goals and objectives
- delivery of planned outputs, i.e. delivery against performance measures and targets in the strategic plan and Estimates for Provincial Expenditure (Budget Statement Two) and the Estimates of National Expenditure for national departments
- reports on all capital projects that are completed, in progress or started, per municipality
- use of inputs, i.e. the expenditure related to each programme with focus on efficiency and economy and relating expenditure to delivery. The analysis should also focus on specific types of expenditure, for example, the use of consultants, revenue gathering activities, asset management and financial management systems
- information on purchases of goods and services and other supply chain management issues
- other relevant data.

While the need for performance information is integral to determine value for money, the economic crisis and expected decrease in tax revenue underlines the need for performance indication.

More information about these aspects of service delivery can be found in chapter 11 (Monitoring). The Framework for Managing Programme Performance Information and the Guideline for Implementation of Provincial Quarterly Performance Reports in the annexures are also relevant.

■ 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.

■ Intergovernmental role of the NCOP

Like the National Assembly and provincial legislatures, the NCOP has an important role to play with regard to approving legislation, but it does not have an oversight role in terms of the Constitution. The NCOP is expected to play a different, but equally important, role in facilitating intergovernmental arrangements and cooperation. This is particularly important for the budget process, where more than 50 per cent of non-interest spending takes the form of transfers to provinces and municipalities.

Though the NCOP does not get involved in oversight, and given the importance of intergovernmental relations, it has requested that the Auditor-General provide a special report after the end of each financial year, on compliance by national government with the Division of Revenue Act. This is to ensure that all grants to provinces and municipalities are made in accordance with this act.

Intergovernmental fiscal review

Because most spending on concurrent functions is with the provincial and local government sphere, it follows that the national Appropriation Bill does not indicate spending on functions like school education, health, social grants, water and electricity. Total spending on these functions can only be assessed after consolidating all provincial or municipal budgets. For this reason, National Treasury compiles the Provincial Budgets and Expenditure Review and the Local Government Budgets and Expenditure Reviews in alternate years.

These documents provide Parliament and the provincial legislatures with consolidated information for key provincial social and economic functions like education, health, social welfare, housing, roads and agriculture, and local government functions like water, electricity, spatial development and infrastructure investment and maintenance. They enable parliamentary portfolio committees and provincial legislatures to benchmark the budget for a department by considering the budget with the same department in other provinces.

In line with sections 215 and 216 of the Constitution, National Treasury, together with provincial treasuries, national departments and sectoral MinMECs, prescribes sector-specific budget and performance formats in order to ensure comparability between provinces and municipalities.

A key function of the NCOP is to consider these reviews and participate in portfolio committees in the National Assembly, to

A range of annual publications provide Parliament and provincial legislatures with consolidated information in crucial areas

consider the budget allocations made in each province or municipality. This information-sharing role allows the NCOP to promote cooperative governance in the budget process, which is essential for coordinating the budget and policy processes.

Process for sector legislation

A key challenge for the NCOP is to avoid unfunded mandates that stem from the lack of legislative coordination. Legislatures in South Africa generally do not facilitate legislative hearings between two portfolio committees. This weakness is more pronounced for section 76 legislation (on ordinary bills that affect provinces), as provincial executives do not initiate such legislation, and hence have not factored in its impact on future budgetary resources. This is because such legislation is generally referred directly from the NCOP to provincial legislatures.

Unfunded mandates need to be prevented

Provincial finance portfolio committees also do not generally get involved in section 76 legislation, even when such legislation may have a significant fiscal or financial impact on their budget. There is a need to consider how the process for section 76 legislation can incorporate provincial executive and/or provincial financial portfolio committees, to minimise the risk of unfunded mandates.

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8

Annual reports and accountability

- An important aspect of the accounting officer's duties concerns the preparation of the annual report of the department. The importance of the annual report must be understood in the context of the legal demand for accountability, which is founded in the Constitution.

■ The cycle of accountability

In short, the cycle of accountability connects the national strategic plans and priorities with the allocation of funds in the budget to the reporting by departments, as to how they have utilized funds, and the results that have been created as a result.

The technical departments produce strategic plans that set out performance targets and measures (indicators), based on the Mid-term Budget Policy Statement (MTPBS). The Executive allocates funds to implement the strategic plans and programmes for service delivery, through the budget. The Legislature approves the budget and appropriates from the revenue fund the money for implementation of departments' plans. In their annual report, the technical departments account to the Executive, how they have used the funds appropriated.

MECs have to table departments' annual reports to the provincial legislature

According to the Constitution, members of the Cabinet must provide parliament with full and regular reports concerning matters under their control (section 92(3)(b)). As part of this framework of oversight, a Minister of a member of the executive responsible for a department must submit the annual report of the department to the legislature, no later than six months after the end of the financial year. This implies that the accounting officers must submit the annual report to the MEC within five months of the end of the financial year.

■ Elements of the annual report

The annual report must include the following elements:

- the accounting officer's report
- the annual financial statement
- report of the audit committee of the institution
- the external audit report on the statements.

The annual report should express a clear link, from the national strategy direction in the MTBPS to the department's strategic plan and the goals expressed in the Estimates of National Expenditure, and down to the programme objectives. Similarly, the measures and indicators developed for the programmes should be similar to those the ENE.

The accounting officer's report

The accounting officer's report is the opportunity of management to explain the state of financial affairs, the activities and the results of the entity. It would normally include issues such as:

- the entity's business strategy going forward
- capacity constraints
- managements response & plans to address any significant audit findings & SCOPA resolutions
- corporate governance arrangements
- entities reporting to the departments incl. their compliance with PFMA
- organizations that are receiving transfer payments
- events after reporting date.

The annual financial statement

The annual financial statement consists of an appropriation statement, which includes the funds appropriated for the various programmes, shifting and virement of funds and the actual expenditure.

A statement of financial performance provides overview of the total performance and the surplus or deficit for the year. The statement of the financial position shows the assets and liabilities at the end of the financial year. The cash flow statement shows the movements of cash during the year, for operations, investments and financing. The notes to the financial statement contain additional detailed information to the main statement and accounting policies, which are crucial to understand the basis for the statement.

Report of the audit committee

Institutions must have an audit committee as required by PFMA section 38(a)(ii). This is a body that sets out the policies for internal audits in the department. A report from the audit committee should cover issues as:

- the effectiveness of the internal control systems
- the effectiveness of the internal audit function
- the risk areas of the entity's operations to be covered in the scope of internal and external audits
- any significant accounting and auditing concerns, and follow up recommendations made by internal and external audits
- the compliance with legal & regulatory provisions.

External audit report

The audit report is the only completely external review of the financial and performance information of the organisation.

The most important part of the audit report is the audit opinion. The audit opinion ranges from a unqualified audit opinion to the adverse opinion. The unqualified opinion says that the auditor agrees that the statement fairly reflects the financial status of the entity. This may contain also an emphasis of matter in which the auditor states that there nevertheless is cause for concern in some areas.

A qualified opinion states that the reader can rely only the unqualified parts of the annual statement, while in a disclaimed opinion, the auditor states that some part of the information in the annual report could not be assessed as verified. In the adverse opinion, the auditor states that the information provided does not provide a fair account of the activities of the entity. These latter audit opinions are critical and could be seen as an indication of serious financial mismanagement.

A more detailed overview of the audit opinions is presented in chapter 7 on Oversight.

■ Review of the annual report

There are two main types of committees that review and consider the annual reports:

Portfolio committees focus on the service delivery aspects. In particular they examine the technical quality of the annual reports, especially the quality of the performance information, they review the service delivery to see if it has been economic, efficient and effective, they assess the implementation of the service delivery plans, and evaluate management's explanations in case service delivery has not been in line with targets.

Public accounts committees. In Parliament, the Standing Committee on Public Accounts (SCOPA) is the watch dog or protector of the

public purse. In its oversight work, public accounts committee will focus on the following elements:

- financial probity
- general report of the Auditor-General
- compliance with the PFMA
- unauthorised expenditure
- fruitless and wasteful expenditure
- internal control and risk management systems
- supply chain management and procurement
- major financial losses suffered by government
- corporate governance.

Public account committees look at issues as...

In more detail, some of the issues that public accounts committees review would normally be:

- root causes of qualifications of the external audit
- if audit qualifications are repeated over the years
- if funds are shifted or vired for the last six months of the year
- differences between actual performance and compliance with adjusted budget and explanations in the notes
- effectiveness of the accounting and control environment
- unauthorized expenditure
- extent of consulting fees versus employee related costs
- extent of spending on training and staff development
- material losses, unauthorised, fruitless and wasteful expenditure
- analysis of aging of receivables, which indicates collectability and commitment to collection of debt
- extent of donor support
- analysis of aging of payables, indicating compliance to Treasury Regulations.

Committees may draw on other institutions for information and assistance

Portfolio and public accounts committees should consider all sources of strategic information and may solicit the assistance of institutions that may have information or expertise available to carry out their oversight responsibilities.

Accountability of public entities and enterprises

Accounting officers for public entities and enterprises face a set of obligations that are fairly similar to those of the provincial

departments. They must submit annual reports, with financial statements and audit reports, to the executive for tabling in the National Assembly before September. Corporate and strategic plans must include key performance indicators, and actual performance against predetermined performance indicators.

Some of the key issues that oversight and portfolio committees are likely to consider in regard to public entities and enterprises are:

- timely submission of annual reports
- legal mandate
- technical quality of the annual reports
- usefulness of the non-financial information
- reliability of the service deliver information
- proper analysis of financials of business enterprises
- assess how the entity may improve its performance.

Enforcement

In case of issues of serious issues of outputs not being achieved, it becomes the duty of the executive, the portfolio committees and in the last instance the relevant minister or MEC, to take action.

In terms of serious financial mismanagement, the legal framework prescribes actions and sanctions to be taken, including up to five years in jail.

The office of the Accountant-General in the National Treasury is in the process of establishing a Special Investigations Unit to look into issues of serious financial mismanagement.

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9

The Integrated Financial Management System

- Government intends to update the existing separate IT system used in the public sector with one integrated system that can remedy the inadequacies of existing IT functions. The Integrated Financial Management System (IFMS) will with time take over the role of existing systems as PERSAL and LOGIS, but the implementation will take place in a phased manner.

■ Integrated Financial Management System

What is the IFMS?

Presently a number of systems are in use across the public sector in South Africa. These different systems, with their inadequacies and inaccuracies for effective financial management, are presently managed as separate stand-alone features, with duplication of efforts as a result. These systems are unable to meet Government's requirement in the long run.

The integrated financial management system (IFMS) is designed to be a key support service to Government in information and knowledge management. The IFMS will consolidate, integrate and upgrade Government's present IT systems.

Government operates in a cycle that includes strategic planning, operational planning, implementation and year-end reporting. The cycle is based on policy development by Parliament, provincial legislatures, and municipal councils. The cycle includes information from previous years, e.g. previous year's performance, and the plan and budgets for the coming years, and expenditure under the present

programmes. The IFMS will allow incorporation of the information and knowledge sharing elements of this cycle into one IT system.

IFMS will take over functions of separate existing systems

The IFMS system is designed to meet the functions that are required by the PFMA, including generally recognized accounting practices (GRAP), budget guidelines and treasury guidelines. The system will in due time take over the functions of present IT systems as BAS, PERSAL, LOGIS, FMS and VULINDLLELA, as well as current IT systems for Human Resource Management, Procurement Management and the bespoke Asset Register.

Challenges in implementing IFMS

The challenges in implementing a project of this kind and magnitude relate to cost, limitations in the existing information technology capacity in South Africa, operational risks in supplanting a number of existing systems as a single project, and integrating the costs into existing budgets for IT.

A phased approach in implementing the IFMS has therefore been selected and the project will be evolutionary in nature, with each phase of the project seeing old and new systems co-exist for a while until the new systems are phased-in. This process serves a masterplan for IT system across the country and thereby puts on hold the procurement of other major IT systems at provincial and sub-provincial level.

The present release plan for the IFMS project includes a road map with a three separate options for phasing of the implementation.

10

Supply chain management

Supply chain management in the public sector includes procurement by departments and public entities, and is one of the most important areas of public expenditure. South Africa is the only country where supply chain management is captured in the Constitution. This chapter gives an overview of the main elements in the procurement process.

■ The Constitution sets the framework for procurement

Section 217 of the Constitution states that:

“When an organ of state in the national, provincial or local sphere of government, or any other institution identified in national legislation, contracts for goods or services, it must do so in accordance with a system which is fair, equitable, transparent, competitive and cost-effective.”

The basis for procurement is ideally the strategic and planning sessions carried out by the procuring departments, public entities, municipalities and municipal entities. In these sessions, the specific and detailed functions that they will carry out inform their need for goods and services, which is then further refined within the framework of the available budget.

Procurement starts in the planning process

As the political head of the treasury, the MEC for Finance has an oversight duty to ensure that the actions of the treasury are in line with the policy and realm of the legislation.

The PFMA compels the accounting officer/authority to accept accountability for the financial administration of the department, as outlined in section 38 and 39. The tendering processes are therefore the responsibility of the accounting officer.

While the accounting officer/authority officer may delegate decisions to subordinates, only the decision-making can be transferred, not the responsibility for the decisions. Further to this principle, while the accounting officer/authority may procure the services of an advisor for

specific procurement issues, the advisor cannot be part of the final decision-making process.

■ Regulation of the procurement system

National Treasury regulates the procurement system according to section 217 of the Constitution. A system consisting of three independent committees is the cornerstone of the present supply chain system for provincial procurement. These committees are appointed by the accounting officer/authority:

- **The bid specification committee:** This committee is responsible for compiling the bid specifications. Sound management practices prescribe that in major procurement the specifications should only be advertised following the approval of the accounting officer. The bid specification committee also establishes the criteria that will be applied for the evaluation of tenders.
- **The bid evaluation committee:** This committee is responsible for the evaluation of the bids received, and should be composed of supply chain practitioners and officials from the user department requiring the goods and services. The bid evaluation committee may only use the criteria specified in the bid documentation in their evaluation.
- **The bid adjudication committee:** This committee should be cross-functional and at least one member should be a supply chain practitioner. The adjudication committee in effect makes a double check of the work of the bid evaluation committee and makes the final award, or makes a recommendation to the accounting officer regarding the award of tender, according to the delegation of authority by the accounting officer.

To strengthen transparency in supply chain management, members from the bid evaluation committees are barred from being members in the bid adjudication committee.

Bid evaluation

As previously mentioned, bids can only be evaluated according to the criteria that are outlined in the tender document. The Preferential Procurement Policy Framework Act (2000) (PPPFA) prescribes that bids must be evaluated in accordance with a preference point system. Any specific development goal for which points may be awarded must be clearly stated in the invitation to bid.

The PPPFA aims to advance development of small, medium and micro enterprises (SMMEs) and historically disadvantaged individuals (HDIs), promote women and physically handicapped people, and promote local enterprise, in a particular region, specific local authority, or in rural areas.

It includes an 80/20 point system for tenders from R 30 000 up to R500 000. The system implies that a maximum of 80 points for price may be awarded for the lowest acceptable offer, and tenders higher in price would score lower points relatively to the difference to the

The Preferential Procurement Policy Framework Act prescribes the bid evaluation process

The act aims to advance the sustainable development of SMMEs

lowest price. A maximum of 20 points may be awarded to historically disadvantaged individuals and for achieving poverty reduction and development goals. The contract is awarded to the tender that scores the highest number of points within the combined 80 and 20 point categories. A similar 90/10 point system applies for tenders above R500 000.

If the bid awarded by either the bid adjudication committee or by the accounting officer differs from what was recommended by the bid evaluation committee, the reasons for such deviations must be forwarded to the relevant treasury and the Auditor-General within 10 working days after the formal award.

While supply chain management is the responsibility of the accounting officer, provincial treasuries have oversight responsibility in relation to the financial management of municipalities. Some of the key aspects of the General Procurement Guidelines (GPG) provide guidance on this.

Provincial treasuries have oversight responsibility over financial management in municipalities

General Procurement Guidelines and oversight of municipal finances

As noted in chapter 2 of the Constitution, National Treasury has an oversight responsibility over the financial management of municipalities. This oversight function is, however, delegated to the provincial treasuries for all but 17 of the 283 municipalities in South Africa.

The GPG elaborates the principles for procurement outlined in section 217 of the Constitution, and provides the background for the oversight function over procurement by municipalities. The GPG prescribes that successful government procurement is based on the following five pillars of procurement: 1) Value for money, 2) Open and effective competition, 3) Ethics and fair dealing, 4) Accountability and reporting, and 5) Equity.

There are five pillars of successful government procurement

In relation to value for money, it should be noted that price alone is not a reliable indicator, and the lowest price does not always equate to the best value for money. Best value for money means the best available outcome when all relevant costs and benefits over the procurement cycle are taken into consideration.

Can a councillor serve on a tender committee?

“No councillor of any municipality may be a member of a municipal bid committee or any other committee evaluating or approving tenders, quotations, contracts or other bids, nor attend any such meeting as an observer.” Municipal Finance Management Act, section 117.

Departments should seek to encourage effective competition. This includes that potential suppliers have reasonable access to know about procurement opportunities, and that options are advertised in a timely manner. Government staff who are involved in procurement, especially those dealing with suppliers, must observe criteria for ethics

Heads of department are accountable to their ministers for procurement activities

and fair dealing. These include, among others, that they do not compromise the standing of the state by accepting gifts or hospitality, and recognise and deal with potential conflicts of interest.

An essential element of openness and transparency is scrutiny through public reporting. Within the procurement framework, heads of department are accountable to their ministers for the overall management of their procurement activities, while heads of procurement are accountable to heads of department, and individual procurement officers are accountable to heads of procurement.

Equity in the context of the GPG refers to observing government policies to advance persons who have been disadvantaged by unfair discrimination. This fifth pillar is vital to public sector procurement in South Africa, and ensures that government is committed to economic growth by supporting especially development of small, medium and micro enterprises (SMME) and historically disadvantaged individuals (HDI).

■ **Good management in supply chain management**

The “March spike” may be a sign of bad procurement planning”

What is occasionally seen towards the end of the financial year is that procurement suddenly bursts into life as departments want to spend unused funds, a phenomenon also known as the “the March spike”. This practice may however result in poor procurement and could jeopardise the concept of value for money. Good management practices would suggest that the MEC for Finance requests a plan of spending from all departments at the start of the financial year, which will allow monitoring of the progress in departments’ procurement expenditure during the year.

■ **SCM monitoring**

The Minister for Finance has decided to establish a unit dealing with irregularities in the tendering process, with the purpose to restore integrity in the supply chain management processes. The unit will seek to strengthen identified areas of weakness, with emphasis on prevention of corruption. Among others, the functions of the unit will be:

- to render assistance in regard to training
- to compile business cases for procurement of strategic commodities
- to participate in bid processes of strategic importance
- to monitor supplier performance
- to carry out trend analysis of allegations
- to respond to allegations
- to monitor SCM maturity of entities.

The unit is being established in 2009. It will actively investigate allegations of corruption, in coordination with the Auditor-General,

the Accountant-General and other agencies. The Supply Chain Management Compliance Monitoring Unit will be established within National Treasury.

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11

Monitoring

- Financial management concerns not only the expenditure side of public funds, but also if government in fact is getting value for money, i.e. are the public funds actually well spent and do they produce the expected results?
- Monitoring is a key tool for treasuries to know if investments in programmes are delivering the expected results. Monitoring also assist treasuries in benchmarking programmes and enables provincial government to meet their responsibility to provide oversight information.
- By ensuring that proper monitoring systems are in place, the MEC for Finance will be in a good position to ensure that the province is getting value for its money.
- Key concepts and elements in monitoring are introduced in this chapter.

■ Monitoring and oversight

Public institutions have a responsibility to publish administrative and performance information to account to Parliament and provincial legislatures, according to sections 92 and 114 of the Constitution. Provincial MECs are accountable to their legislatures and have to provide these with full reports on matters under their control. Therefore they must ensure that appropriate performance information systems are in place so they can fulfil these accountability responsibilities.

Departments and entities are required in their strategic planning documents and budgets to state the objectives of their programmes, and in their Annual Performance Plans to report on the progress made in actually meeting these objectives. This performance information enables treasuries to monitor and benchmark the performance of programmes.

However, the quality of this performance information has not always been optimal. Treasuries should therefore cast a critical eye when ascertaining the quality of the monitoring frameworks that departments and institutions are establishing for their programmes and projects.

Treasuries should evaluate the objectives and monitoring systems of budget submissions

Monitoring is an important management tool

■ Key concepts in monitoring systems

Monitoring is often misunderstood as a form of control. Rather, monitoring should be seen as a tool that will enable technical management to understand what is happening in a programme and take steps, if necessary, to revise plans and correct problems before they get out of hand.

When describing what government institutions do for purposes of measuring performance, the following terms are usually used:

- **inputs:** all the resources that contribute to the production and delivery of outputs. Inputs are "what we use to do the work". They include finances, personnel, equipment and buildings.
- **activities:** the processes or actions that use a range of inputs to produce the desired outputs and ultimately outcomes. In essence, activities describe "what we do".
- **outputs:** the final products, or goods and services produced for delivery. Outputs may be defined as "what we produce or deliver".
- **outcomes:** the medium-term results for specific beneficiaries that are the consequence of achieving specific outputs. Outcomes should relate clearly to an institution's strategic goals and objectives set out in its plans. Outcomes are "what we wish to achieve".
- **impacts:** the results of achieving specific outcomes, such as reducing poverty and child mortality.

A good monitoring system will develop indicators providing performance information for all the five aspects of a programme outlined above. Where possible, departments should use direct indicators to measure inputs, activities, outputs, outcomes and impacts. Typical direct indicators include cost or price, distribution, quantity, quality, dates and time frames, adequacy and accessibility.

■ Baseline and performance

The baseline is the current level of performance that the institution aims to improve. The initial step in setting performance targets is to identify the baseline, which in most instances is the level of performance recorded in the year prior to the planning period. So, in the case of annual plans, the baseline will shift each year and the first year's performance will become the following year's baseline.

Performance standards express the minimum acceptable level of performance, or the level of performance that is generally expected. These should be informed by legislative requirements, departmental policies and service-level agreements. They can also be benchmarked against performance levels in other institutions, or according to accepted best practices.

Performance targets express the specific level of performance that the institution or programme is aiming to achieve within a given

period. Whether to express the desired level of performance in terms of a target or a standard depends on the nature of the performance indicators. Often standards and targets are complementary. For example, the standard for processing pension applications is 21 working days. A complementary target may be to process 90 per cent of applications within this time.

Good monitoring systems use performance targets and indicators that are “SMART”:

SMART indicators are key in good monitoring systems

- specific: the nature and the required level of performance can be clearly identified
- measurable: the required performance can be measured
- achievable: the target is realistic given existing capacity
- relevant: the required performance is linked to the achievement of a goal
- time-bound: the time period or deadline for delivery is specified.

A good monitoring system indicates how the data it provides will feed into planning and reporting by the technical department, and establishes processes and mechanisms to facilitate corrective action. In other words, it indicates who will do what in case of faltering performance.

■ Questions to ask about monitoring systems

Important questions to ask about technical departments’ and other government entities’ monitoring systems include:

- Are data for the indicators readily available?
- Do indicators monitor the central aspects of the service to be delivered?
- Is the number of indicators manageable? – there is no need to monitor more aspects of a programme than necessary
- Are the performance targets realistic?

On the last point: Performance targets are often set at unrealistic levels. This may result in poor staff morale and detract from the image of the institution, when it emerges that it is unable to deliver. Effective performance management requires realistic and achievable targets that can challenge the institution and its staff.

For a more detailed account of monitoring in relation to programme delivery, please see the Framework for Managing Programme Performance Information and the Guide for the Implementation of Provincial Quarterly Performance Reports, in the annexures.

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12

Infrastructure management

Public infrastructure accounts for a large part of public expenditure. This chapter outlines a number of management issues in public management of infrastructure. Effective management of infrastructure will serve to safeguard against unbudgeted expenses and wasteful expenditure.

■ Key issues in management of infrastructure

Infrastructure is among the most important areas of public spending for provinces. For provincial treasuries, the following issues pertaining to infrastructure are of special concern:

- asset management
- integrated planning
- monitoring infrastructure projects
- changing priorities and over-expenditure
- delays in paying contractors.

■ Asset management

In terms of the Government Immovable Asset Management Act (2007) (GIAMA), provincial governments are vested with the responsibility of managing the assets under their custodianship. This includes the physical infrastructure such as roads, hospitals, schools and other buildings. The provincial asset management systems, however, require some attention, evident in the fact that a number of provinces have received qualified audit opinions in relation to their maintenance of assets (see also the part on audit reports in chapter 7 (Exercising oversight)).

The percentage that should be set aside for maintenance of assets is generally about 4-6 per cent of the replacement asset value, on a yearly basis, but it depends on the nature and state of the asset. For example, roads that are near the end of the structural lifetime will require a higher percentage. When the maintenance of a provincial building or another infrastructure asset is neglected, inevitably its

Maintenance costs should be included in budgets

lifecycle will be shortened, and in the long term higher costs will be incurred for early replacement.

Maintenance is critical for the costing of projects, which should take into account the full maintenance costs over a project's life-cycle. While project budgets are developed by technical departments, the provincial treasury has an interest in ensuring that project budgets fairly reflect the maintenance costs, as also required by the legal framework.

Who owns this road?

An underlying problem in asset management is that the ownership may be uncertain. For example, a total of 200 000 km of roads remain unclassified, and therefore it is unclear who is responsible for their maintenance. The Roads Infrastructure Strategic Framework of South Africa (RISFSA) seeks to address this problem and resolve the issues of ownership and responsibility for maintenance in the roads sector.

■ Monitoring of infrastructure projects

Departments' annual reports should reflect the progress of projects, such as the status of finalisation of an infrastructure development. In some cases, however, the technical departments have not checked progress, and in some cases departments have paid the contractor without checking on the quality of the work delivered. This practice is not conducive to sound financial management, and provincial treasuries need to raise the issue of monitoring projects with technical departments.

Tracking progress in infrastructure development is an area where provincial treasuries should play a key role, as also described in chapter 11 (Monitoring). Capacity and systems, in terms of quality of financial data and inclusion of non-financial data are among the challenges for effective monitoring. The Infrastructure Reporting Model (IRM) is a key tool in this regard.

■ Integrated planning

A key issue is that planning should be based on strategic priorities. Currently, one of the biggest challenges facing the provinces is that plans and budgets are not aligned, and this may lead to spending irregularities:

- Planning must be linked to strategic priorities and departmental objectives, which should then feed into broader infrastructure plans that inform infrastructure budgets.
- This process is formalised through the Cabinet-approved Alignment Model, which seeks to align the infrastructure delivery cycle with either the budget cycle or the strategic planning cycle.

- The infrastructure delivery improvement programme (IDIP) toolkit also provides guidelines on the deliverables required as part of the Alignment Model.

The IDIP seeks to contribute towards the ASGISA by improving the efficiency and effectiveness of the delivery of public sector infrastructure

A second issue is that better coordination is required:

- There is a need for strengthened high level coordination in the planning process. At the strategic level this should be captured within the Provincial Growth and Development Strategy (PGDS).
- Although the PGDS provides strategic direction, planning and implementation needs to be coordinated by departments, through cooperative forums.

An example of the need for this coordination is if a school is built in a remote area, integrated planning will ensure there is an access road to provide transport to the school, or that such a road will be built. This will help avoid money being spent on white elephants. In the interest of value for money and effective use of provincial funds, the provincial treasuries can seek to strengthen integrated planning between technical departments.

The MEC for Finance can seek to create such integration in MTEC hearings and other cross-functional forums. In some provinces, quarterly infrastructure meetings are held, which can give the provincial treasury an opportunity to monitor progress of projects and raise questions over funding of new projects, if required.

MTEC forums can be used for strengthening integrated planning

■ Changing priorities and over-expenditure

Avoiding over-expenditure is a critical area of concern for the provincial treasuries. A typical example of over-expenditure is that a technical department decides to change its priorities and start a new infrastructure project during the course of the financial year. This may lead to over-expenditure, if the project has not been part of the strategic and financial planning of the financial year.

Good planning helps to guard against over-expenditure

The best way to avoid this situation is to encourage technical departments to carry out good strategic and financial planning as part of the budget process. If new projects are added during the course of the year, then technical departments must take the budget implications into account, and be able to show the funding source for the project.

Changing priorities that leads to incomplete projects also distort monitoring and reporting patterns from quarter to quarter.

■ Delays in paying contractors

Poor planning may lead to changing priorities. This may again lead to budget constraints, which in turn results in either non- or delayed payment to contractors. Unfortunately, a number of cases exist in which delays in the payment to contractors have resulted in the contractors abandoning the project. Invoices have to be processed within 30 days, but provincial departments have not always paid on

time. This creates an issue of the funding for the interest that is incurred in the process, and who will pay for it. Underlying this problem is often poor supply chain management and poor project management.

Provincial departments have to report on outputs in their annual reports, and it should be noted that there are cases of projects that have been sitting on construction since 2001.

Often it is the SMME contractors with limited cash-flow who have abandoned project sites due to late payments by departments. This is particularly regrettable as legislation seeks to empower this segment of the economy.

13

Public Private Partnerships

- In public private partnership (PPP) procurement, the public sector buys a full set of services, including infrastructure and other services, from the private sector. It pays for these over the term of the PPP agreement, based on successful delivery. The private sector typically puts its own capital at risk. Because of the financial risk the private sector takes, it is motivated to provide a high level of service, as good returns on its investment will depend on the quality of services it delivers.

■ PPPs in South Africa

Since 1999, PPPs in South Africa have been regulated under the PFMA, providing a clear and transparent framework for government and its private sector partners to enter into mutually beneficial commercial transactions for the public good. Treasury Regulation 16, enacted in terms of the PFMA, sets forth the step-by-step processes government must undertake to assess the feasibility of a particular project as a PPP and, where found feasible, its procurement and implementation.

Stated in its simplest terms, a PPP is a contract between a government institution and a private party, where the private party performs an institutional function and/or uses state property in terms of output specifications, where substantial financial, technical and operational risk is transferred to the private party and where the private party receives benefits through a unitary payment from government, user fees or a combination of both.

A PPP is a contract between a government institution and a private party

A PPP differs from traditional infrastructure procurement in that in a PPP, the private party finances, designs, constructs, maintains and operates the infrastructure for which it receives a unitary payment from government or fees from users only once the services are actually provided, over the life of the project. In traditional procurement, government must finance the construction of the

infrastructure, retain staff to operate it and pay for its ongoing maintenance.

The holistic, life-cycle benefits of the PPP approach for the assessment and procurement of services infrastructure have been proven in the implementation of PPPs in South Africa and in most developed countries.

A number of PPPs are operational across the country

Some examples of provincial-level PPPs include Inkosi Albert Luthuli Hospital in KwaZulu-Natal, Gautrain Rapid Rail Link in Gauteng and various hospitals in Free State, Eastern Cape and Western Cape, as well as fleet management services in Eastern Cape and Northern Cape.

Different types of PPPs have different life-cycles

PPP concession periods vary according to the type of service or infrastructure being delivered. For example, fleet management and IT services are usually 5 and 10 year concessions respectively, while infrastructure projects can be anywhere between 15 and 30 years. The role, then, of those charged with a province's financial affairs – the MEC for Finance and the Accounting Officer for a provincial treasury – are of critical importance.

■ The role of the MEC for Finance in PPPs

As a member of the provincial executive, the MEC for Finance must implement all pertinent national legislation, including the PFMA, develop and implement provincial policy and coordinate the finance function of the provincial administration. Sub-section 66 (2) (b) of the PFMA provides that only the MEC for Finance in a province may “issue a guarantee, indemnity or security or enter into any other transaction that binds or may bind a Revenue Fund to any future financial commitment”.

A PPP agreement is such a transaction that may bind the Revenue Fund. Sub-section 66(3)(d) of the PFMA provides similar authority in terms of such transactions involving a schedule 3 provincial business enterprise; however, the concurrence of the Minister of Finance is also required in that instance.

National Treasury's PPP Unit provides financial and technical support

When undertaking their policy development and implementation responsibilities, MECs for Finance should be mindful of the benefits of assessing and procuring services infrastructure via a PPP. National Treasury maintains the Project Development Facility (PDF), which may be accessed for funds to defray the costs of transaction advisors to undertake the feasibility study assessment and, where feasibility is shown, assist a province in procuring the PPP.

When undertaking the coordination of the finance functions of provincial administration, MECs should also ensure that the provincial treasury has the capacity and resources available to it for it to effectively undertake its duties in terms of PPPs.

■ The role of the provincial treasury in PPPs

PFMA Regulation 16 has numerous references to “the relevant treasury” in terms of its requirements to register PPPs and obtain the

various required Treasury Approvals. Treasury Regulation 16.1 defines “relevant treasury” as meaning the National Treasury, “unless delegated in terms of section 10(1)(b) of the Act.” There has been no such delegation; hence the regulatory authority in terms of Regulation 16 resides in National Treasury only.

This does not mean that there is no role for provincial treasuries in PFMA PPPs.

Among the many roles of the provincial treasury in PPPs are:

- using the provincial budget process to identify potential PPP projects, where the private sector can provide innovative lower cost solutions, additional finance or efficiencies in service delivery
- working closely with the Accounting Officer of the provincial department sponsoring the PPP to ensure that the department obtains a sufficient budget allocation with which to make the unitary payment in a provincial PPP and that all such budgets are ring-fenced
- ensuring that the sponsoring provincial department accounts for all revenues and expenditures relating to the PPP appropriately
- ensuring that all payments required by the PPP Agreement are made by the sponsoring provincial department according to its terms
- in provinces where more than one PPP is in implementation, ensuring that common accounting and reporting practices are in effect.

The provincial treasury has a number of responsibilities in relation to PPPs

This list, which is not exhaustive, does not only relate to “once off” functions. Provincial treasuries have important, ongoing roles in relation to these issues and must be capacitated and resourced appropriately.

In order to obtain the maximum benefits from the well-established PPP programme, it is essential there is a clear understanding of the roles and responsibilities of the MEC for Finance, the provincial treasury and all other provincial role players in terms of PFMA PPPs.

The PPP Unit of the National Treasury will be available to provide assistance to both the provincial department sponsoring a PPP and the provincial treasury in carrying out its duties.

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Budgeting for infrastructure and capital expenditure

- Many project and programme proposals fail due to insufficient quality of the documentation, and provincial treasuries have an important role in ensuring that the technical departments in the province submit high quality project proposals, to strengthen its chances of receiving funds in the budget process. This will promote efficiency in infrastructure planning and budgeting and support better allocation of resources across government.

■ Requirements for budget proposals

When technical departments make budget submissions for capital projects and programmes, the processes and needs for documentation are described in budgeting guidelines issued by National Treasury.

While small projects with the same output can be grouped together in a programme for evaluation, large and mega projects proposals must be motivated separately. Proposals for large and mega projects will be evaluated by the Capital Budget Committee (CBC).³

Project proposals must include an economic feasibility analysis and detailed supporting documentation. The type and depth of information for the appraisal depends on the size and nature of the projects, but resources spent on compiling proposals should be proportionate to the likely cost of a project. Project proposals must include an economic feasibility analysis and detailed supporting documentation, and should be submitted to National Treasury.

Project proposals require a feasibility analysis

All infrastructure projects, programmes and major capital acquisitions must be classified according to the broad categories described below.

³ The CBC, a subcommittee of the Medium Term Expenditure Committee, evaluates funding requests for capital projects and programmes of departments and public entities.

■ Classification of capital projects

- **Mega projects or programmes** are estimated to cost more than R300 million per year for a minimum of three years, or a total project cost of at least R900 million. All mega projects require a comprehensive CBC appraisal.
- **Large projects or programmes** are estimated to cost between R50 million and R300 million per year for a minimum of three years – totalling at least R150 million but less than R900 million over the MTEF. Large projects require detailed information and a feasibility study for scrutiny by the CBC.
- **Small projects or programmes** are estimated to cost less than R50 million per year and not more than R150 million over the MTEF. Small projects with the same outputs may be grouped together in a programme for evaluation. Small projects outside of a programme will not be subject to CBC review.

Long-term funding requirements need to be considered

All projects extending beyond the MTEF period, regardless of medium-term funding needs, must outline needs for future funding in the submission. The full project costs, including the annual operational costs over the lifetime of the asset, must be reported.

■ Appraisal for capital projects or programmes

It is the departments and entities that are responsible for developing the appraisal of projects and programmes that require funding, while the CBC will undertake the review of appraisals submitted. The appraisal guidelines are designed to promote efficient project planning across government by assessing the underlying assumptions, cash flows and calculations to reach the best decision. Project appraisal is necessary to:

- develop and formulate potential projects precisely and concisely
- promote value-for-money projects
- identify and mitigate risks
- promote transparency.

The sections below set out questions and requirements that departments need to consider in their capital budget submissions. In general, a submission should be laid out as a discussion, with supporting data, graphs and tables where statistical information requires illustration. Separate large and mega projects each require their own submissions.

Needs analysis

It is important to demonstrate a clear need for a particular project and why government should become involved. The needs analysis should be aligned with the entity's strategic objectives, highlighting how a

The need for a project must be clearly demonstrated

proposed project or programme helps to achieve these goals. The analysis should describe clearly:

- the problem that has given rise to the need
- the statistical data, baseline information and service-delivery indicators pointing to the need at this time
- the extent and urgency of the need
- the consequences if the need is not met
- the proportion of the need a given request is intended to meet
- how the project fits into the department's long-term strategic delivery plan.

Cost-benefit analysis

All possible solution options need to be identified, and the costs and benefits to government and society quantified. Costs and benefits must be considered from a socioeconomic viewpoint. All assumptions made while valuing costs and benefits must also be clearly specified and, where benefits cannot be quantified, a detailed description of those benefits is required. 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, the CBC will determine whether a particular investment is worthwhile, keeping in mind that benefits need to be maximised for society.

The cost benefits and the socio-economic benefits need to be convincing

Options analysis

All realistic ways of meeting a need should be identified and examined critically when considering project options. This list must cover the range of viable options for providing the outputs anticipated from the capital project. Alternatives must be described in a way that makes clear the essential differences between the options. Be aware that solutions may arise from other levels of government. Among the options considered, the list must include an option where government takes the minimum amount of action necessary, or does nothing at all.

Other ways of meeting the need must be explored and assessed

When assessing alternatives, the following needs to be taken into account for each option:

- potential commercial viability (can it generate its own revenue stream? has a public-private partnership been considered?)
- potential benefits, costs and risks to government and society
- constraints associated with reaching the desired objective
- possible funding streams for each option.

The options analysis will likely include a cost-effectiveness analysis (CEA), which is used for selection of alternative projects and has been commonly used to evaluate health and education projects. A CEA identifies and quantifies the expected results/benefits in physical terms, identifies and ranks programme outputs, and determines the total costs of the projects, or the cost-effectiveness ratio.

Any changes to key project assumptions need to be factored in

Scenario analysis

For large and mega projects, costs should be adjusted to reflect different scenarios based upon variations in key assumptions. For example, what is the effect of a 10 per cent increase in costs? Or the effect on the cost of imported inputs of a 5 per cent devaluation in the exchange rate? This is an essential part of the capital submissions.

Risks and contingencies

Departments must identify and assess the main areas of risk that might prevent a project from delivering anticipated results/outputs. Plans to reduce risks must also be outlined in detail. Examples of risks can include:

- cost overruns, including those resulting from inflation or forex fluctuations
- difficulties in securing statutory consent
- delays in project implementation.

Recognising risks will better equip planners with the information needed to manage them. These can also relate to the operational phase of a project.

Implementation readiness

Departments and entities are required to outline their readiness and capacity to implement the project/programme. This should include construction start and end dates. Timelines for environmental impact assessments, land acquisition, development and intergovernmental approvals should be outlined in the supporting documentation. Cognisance should be taken of industry interests and the availability of materials in outlining the department/entity's readiness.

Monitoring and evaluation

The progress of projects appraised and evaluated, whether funded within the baseline or above baseline, will be monitored on a quarterly basis in a separate format prescribed by National Treasury.

A detailed introduction to the appraisal procedures involved in the appraisal of capital projects and programmes can be found in the document 2010 MTEF: Budgeting for Infrastructure and Capital Expenditure Guidelines, attached in the annexures.

Annexures

A: Glossary

B: Public Finance Management Act

C: Framework for Managing Programme Performance Information

D: Guideline for Implementation of Provincial Quarterly Performance

E: 2010 MTEF: Budgeting for infrastructure and capital expenditure guidelines

Glossary	
10X10 and 4X4	Consultations between national and provincial departments when defining priorities for the MTEF. Named after the number of participants.
Allocated expenditure	The part of national budget that can be divided between the three spheres of government after debt interest and the contingency reserve have been taken into account.
APP	Annual Performance Plan. Departments have to establish APPs with service delivery indicators.
Baseline	A baseline establishes the current situation.
Budget Council	Key financial forum consisting of the Minister of Finance, the deputy Minister of Finance and nine provincial MECS for Finance. Coordinates the financial relations between national and provincial government.
Budget Forum	Consists of the same member as the Budget Council plus representatives of organised local government.
Capital expenditure	Government expenditure on assets that last for more than one year, e.g. land, buildings, infrastructure and equipment.
CBC	Capital Budgets Committee. Evaluates requests for large and megastructure capital funding, aims to secure that funding is directed to projects and programme with maximum economic and social benefits.
Conditional grants	Allocation of grants from one sphere of government to another with conditions attached in terms of certain services being delivered or compliance with specific requirements.
Current expenditure	Government expenditure on goods and services, such as salaries, rent maintenance and interest payments.
Depreciation	Reduction in the value of fixed capital due to tear and wear.
Division of revenue	The allocation of national revenue to the three spheres of government.
DOR	Division of revenue.
DORA	Division of Revenue Act.
DPLG	Department of Provincial and Local Government.
DPSA	Department of Public Service and Administration.
Equitable share	The share of the national revenue that a province or a municipality is entitled to according to the Division of Revenue Bill.
EXCO	Executive Councils
Extended Cabinet	Extended Cabinet comprises of the national executive and the nine premiers. The highest cooperative mechanism advising the national Cabinet when finalising the fiscal framework and division of revenue for the MTEF budgets.

FCC	Financial and Fiscal Commission: Key independent commission on fiscal issues, established through the Constitution.
GIAMA	Government Immovable Asset Management Act
HDI	Historically disadvantaged persons.
Joint Budget Committee	Considers the budget, holds public hearings on parts of the budget. Focuses on expenditure estimates and service delivery objectives of the budget bills.
LCC	The Loan Coordination Committee consists of the Minister of Finance and the responsible member of finance each province.
MinBudCom	Minister's Committee on the Budget. Political committee that considers key policy and budget issues before they are tabled in Cabinet. Consists of 8 ministers selected by the President.
MinMECs	Political forum where national and provincial departments in the same sector discuss policy issues. Consists of the national minister the nine provincial MECs supported by key officials.
MTBPS	Medium Term Budget Policy Statement. As part of the budget process, this document pulls together all preceding policy priorities, national and provincial MTEFs, macro-economic and fiscal framework and the Division of Revenue processes.
MTEC	Medium Term Expenditure Committee. Technical committee which evaluates the submissions of national departments and makes recommendations to the Minister of Finance regarding allocations
MTEF	Medium Term Expenditure Framework. Three year spending plans of national and provincial governments.
MTSF	Medium Term Strategic Framework. The MTSF priorities inform the budget drafting for the following year.
NCOP	National Council of Provinces.
PAC	Public Accounts Committee.
PCC	Presidential Co-ordinating Committee.
PFCO	Portfolio Committee on Finance. This committee considers the budget and holds public hearings on parts of the budget. Focuses on macro-economic and tax policy.
PGSD	Provincial Growth and Development Strategy
PPP	Public Private Partnership
PPPRA	Preferential Procurement Framework Act.
SALGA	South African Local Government Association.
Schedule 4	Functional areas for which national and provincial legislative share competence

Schedule 5	Functional areas of provincial legislative competence only
SMME	Small, medium and micro enterprises.
SPP	Strategic and performance plans.
Vote	Technical spending area. Defense, e.g., is vote 19.
PPP	Public Private Partnership